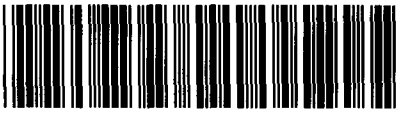

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PUC DOCKET NO. 46245

APPLICATION OF DOUBLE DIAMOND UTILITY COMPANY, INC. FOR WATER AND SEWER RATE/TARIFF CHANGE	**§ § § §**	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

DIRECT TESTIMONY

AND

WORKPAPERS

OF

NELISA HEDDIN

ON BEHALF OF THE

WHITE BLUFF RATEPAYERS GROUP

SEPTEMBER 8, 2017

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DIRECT TESTIMONY AND WORKPAPERS
OF NELISA HEDDIN

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DIRECT TESTIMONY AND WORKPAPERS OF NELISA HEDDIN

I. QUALIFICATIONS AND EXHIBITS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Nelisa Heddin. My business address is P.O. Box 341855 Lakeway, Texas 78734.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am the President of Nelisa Heddin Consulting, LLC. I have served in this role since 2014. Between 2003 and 2013, I was employed by Water Resources Management, L.P. in the position of Vice President. Prior to 2003, I served as a financial, economic and management consultant for Reed, Stowe & Yanke, LLC. My resume detailing all of my relevant work experience is attached as WBRG-1A.

Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES AS PRESIDENT OF NELISA HEDDIN CONSULTING, LLC.

A. My responsibilities include performing cost of service and rate design studies for water, wastewater, solid waste, and electric utilities throughout the country having operating budgets ranging from $150,000 to $100,000,000. Some examples of cities where I have provided consulting services include the Cities of Missouri City, Richmond, Bonham,

Pecos, Pflugerville, and Horseshoe Bay. I held similar responsibilities in my roles while working for my two previous employers.

Q. PLEASE OUTLINE YOUR EDUCATIONAL AND PROFESSIONAL QUALIFICATIONS.

A. I hold a Bachelor of Science degree in Biology from New Mexico State University. I have a Masters of Business Administration from New Mexico State University with a concentration in Finance. I have been a member of American Water Works Association ("AWWA") and the Government Financial Officers Association of Texas ("GFOAT"). Further, I am a past Chair of the Texas Section AWWA Rates and Charges Subcommittee, working to provide educational insight on rate and financial issues facing water utilities in the State of Texas. I have been invited to speak at industry functions ranging from the Government Financial Officers Association of Texas, the Texas and Southwest Sections of AWWA, as well as for Incode, Inc. Because of my background and experience, I have a broad understanding of the water, wastewater and solid waste utilities industries including issues associated with water supply, system capacity, operational issues, rate design and financial implications. I have been performing cost of service and rate design studies since 2000.

Q. ARE YOU INCLUDING ANY EXHIBITS OR ATTACHMENTS?

A. Yes. See the List of Exhibits included in my testimony.

Q. WERE THESE PREPARED BY YOU OR UNDER YOUR SUPERVISION?

A. Exhibit WBRG-1A was prepared by me. The other exhibits are records of public agencies, or were produced by Double Diamond.

II. PURPOSE AND SUMMARY OF TESTIMONY

Q. ON WHOSE BEHALF ARE YOU SUBMITTING THIS TESTIMONY?

A. I am testifying on behalf of the White Bluff Ratepayers Group (WBRG)

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to identify the issues I have found in Double Diamond Utility Company, Inc.'s (DDU) application for a rate/tariff change and recommend adjustments to the revenue requirement and appropriate rates.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. In my testimony, I will address the fact that an indeterminable amount of the assets claimed as part of DDU's rate base were contributed by the developer of the property and the approach the Commission should take to adjust return on investment, income tax, and depreciation expense as a result of the rate base adjustments. I will also address necessary adjustments to operations and maintenance expenses that have been identified. I will determine an adjusted revenue requirement and make recommendations for appropriate rates to be charged to customers within the White Bluff Resort system. Finally, I will address rate case expenses.

III. RATE BASE ADJUSTMENTS

A. INTRODUCTION

Q. PLEASE DESCRIBE WHAT IS MEANT BY THE TERM RATE BASE AND HOW THIS IMPACTS THE PROPOSED RATES.

A. In utility ratemaking, the term rate base is used to refer to the value of property on which a public utility is permitted to earn a return on its investment. Section 13.183(a) of the Texas Water Code directs the Commission to fix rates that "permit the utility a reasonable opportunity to earn a reasonable return on ***its*** invested capital used and useful in rendering service to the public ...." Fundamentally, the rate base is used to arrive at the profit (return on investment) the utility is entitled to earn. This in turn has a direct impact on the rates charged to customers.

Q. PLEASE SUMMARIZE YOUR ADJUSTMENTS TO THE PROPOSED RATE BASE?

A. Applicant's systems in White Bluff, both water and wastewater, were, and continue to be, constructed and paid for by the developer of the White Bluff Resort, and should be treated as developer-contributed assets. Applicant claims that Double Diamond Utilities ("DDU"), the utility branch of the company, separately paid for these assets by directly paying for the assets or by assigning the costs from the developer to Applicant. Yet, Applicant cannot produce the accounting entries reflecting these assignments. Nor can Applicant show that it obtained approval through an STM proceeding authorizing the

transfer of the utility assets from the developer to the utility. Moreover, the developer continues to treat the utility component as part and parcel of its development activities. I have treated 100% of the assets claimed within the rate base as having been contributed by the developer of the White Bluff Resort. Applicant claimed only a portion of the assets were developer contributed. To get to the appropriate revenues requirement, Applicant's rate base, return and income tax expenses should all be adjusted downward to reflect developer contribution of assets.

Furthermore, even if the assets are considered to have been partially funded by the developer as claimed by Applicant, I have identified a number of additional issues within the application related to rate base, including:

1. Flawed trending analysis that resulted in an overstatement of original cost, annual depreciation, return on investment and income tax expenses.
2. An error in the treatment of developer contributions of assets.
3. Inconsistencies between the stated treatment of developer funding for utility system assets, and the actual funding of those assets.
4. Including property that was deeded by Applicant to an unaffiliated entity in 1995.

I will further explain these findings below.

B. AMOUNT OF DEVELOPER CONTRIBUTED ASSETS

Q. PLEASE DESCRIBE WHAT IS MEANT BY "DEVELOPER CONTRIBUTED ASSETS" AND HOW ARE THESE CONTRIBUTIONS SIGNIFICANT WHEN IT COMES TO RATE MAKING?

A. Generally speaking, developer contributed assets are plant and facilities that were paid for in whole or in part by a developer and given to a utility at no cost. As these facilities were paid for (contributed) by the developer, and not the utility, they are excluded from the rate base when calculating the utility's return. Simply put, the utility is not permitted to earn a return on an investment it did not make. This fundamentally keeps the customers from paying the developer for the assets through their purchase of the lot, and then paying the utility a profit on the same assets.

Q. HOW HAS THE COMMISSION ADDRESSED THIS ISSUE IN THE PAST?

A. In 1977, a newly formed water and sewer utility, Sunbelt Utilities, filed an application to change is water and sewer rates in Harris County. *Petition of Sunbelt Utilities for Authority to Change Rates,* PUC Docket No. 804. The unique thing about this case was the fact that the affiliated development company installed the utility system and transferred the assets to the utility without charge. Commission staff argued that because the development company recovered the cost of the utility assets through lot sales, the ultimate purchaser of the lot, the home buyer, paid for his share of the utility assets with the purchase of the home, and that it would be unfair to require the home purchaser to pay for the utility assets a second time through utility rates. The examiner in that docket

reviewed the provisions of PURA and case law from other states and concluded that the utility assets paid for by the development company and recovered through lot sales should be excluded from rate base.[1] The Commission agreed with the examiner, as did the District Court and the Court of Appeals.

In 1979 the case came before the Supreme Court of Texas. I have included a copy of the case as Exhibit WBRG-1C. The Court specifically focused on the exclusion of developer contributions of assets related to a utility that had the same ownership as the developer of the same system. The Commission in the case "excluded the developer's cost of the utility system from the rate base because the rate payers had already paid for the system as a part of the purchase price of their lots." The Supreme Court agreed with the Commission's findings.

The Court evaluated the issue of developer contributions of assets and consideration of these issues by courts and regulatory bodies in other states. The summary I have provided states "the uniform rule followed in these cases is that when a developer has recovered all or part of the cost of the utility system through the sale of lots, the regulatory body has excluded that amount from the utility's rate base." The case found that the "availability of the utility systems made the lots marketable as home sites." .... "Necessarily, this increased the value of the lots. It would be folly for any developer to say that he did not take into consideration the cost of making the subdivision marketable when he determined the price necessary to make a profit."

[1] *Petition of Sunbelt Utilities for Authority to Change Rates,* Docket No. 804, 3 PUC BULL 1167, Examiner's

The Court cited Princess Anne Utilities Company v. Commonwealth ex rel. S.C.C, which stated - "But it would be wholly unrealistic to say that the costs of the sewerage facilities contributed by the land development companies were not passed on to those customers." As the Court pointed out in its opinion, it is common practice in real estate development to finance construction of sewerage facilities by the contribution method employed in this case, with the cost of such construction reflected in the prices paid by the purchasers of homes in the finished development. "Thus, to allow the utility company a return on contributions in aid of construction would have the effect of requiring the customers to pay twice for the same property. This would be unjust. Such contributions were, therefore, properly excluded by the Commission in determining rate base." The Sunbelt Utilities decision also held that depreciation could not be recovered through rates for assets contributed by developers.

Q. HAS THE TEXAS LEGISLATURE ADDRESSED THIS ISSUE?

A. In 1989, through House Bill 1808, the Texas Legislature added Section 13.185(j) to the Texas Water Code to make it clear that developer contributed assets cannot be included in rate base for purposes of determining return, but that depreciation on all currently used and useful developer contributed property is allowed in the cost of service.

Q. HOW ARE DEVELOPER CONTRIBUTED ASSETS ADDRESSED IN THE COMMISSION'S RULES?

A. Commission Substantive Rule 24.31(c)(3) requires that all contributions in aid of construction and other sources of cost-free capital (as determined by the Commission) be

deducted from rate base. Rule 24.31(b)(1)(B) allows the utility to recover depreciation of developer-contributed assets in cost of service.

Also, as stated in the instructions for *Class B Investor Owned Utilities Water and/or Sewer Instructions for Rate/Tariff Change Application 2015* the "utility can include plant and equipment paid for by DEVELOPER contributions in the depreciation schedule, but the utility cannot include plant and equipment paid for by CUSTOMER contributions. Furthermore, when calculating the return on net invested capital, developer and customer contributions must be removed."

Q. PLEASE DESCRIBE YOUR OPINION REGARDING THE LEVEL OF DEVELOPER CONTRIBUTED ASSETS RELATED TO THE WHITE BLUFF SYSTEMS IN THIS DOCKET.

A. It is my opinion that the utility system assets for the White Bluff Resort should be treated as 100% developer contributed. My opinion is based on a number of factors. First, as in the Sunbelt Utilities matter, the developer and the utility are essentially the same entity. When the developer and the utility are the same entity, the burden is on the utility to clearly demonstrate that the utility (and not the developer) paid for the assets because only the utility and the developer have the information to make this showing. Double Diamond has not made such a demonstration in this case. Moreover, the documentation provided by Double Diamond in this matter demonstrates that the developer contributed the assets, or at least the bulk of the assets, to the utility without cost to the utility. The

developer promised the lot purchasers that the developer would fund the utility infrastructure and that the utility would pay the utility operating costs. This promise must be reflected in the rates paid by the ratepayers. Finally, the fact that the developer continues to treat the capital of the utility as if it is the capital of the developer reveals that all investment in assets has been, and continues to be, made by the developer and not the utility.

Q. HAVE YOU HAD AN OPPORTUNITY TO GENERALLY FAMILIARIZE YOURSELF WITH CORPORATE STRUCTURE OF DDU?

A. Yes. I have researched and read about the White Bluff Resort and Double Diamond Resorts on-line, reviewed property tax records, reviewed a copy of the sales contract for lots located in the White Bluff Resort, and reviewed system ownership documents provided by Double Diamond in another rate tariff application[2].

Q. CAN YOU PLEASE DESCRIBE WHAT DOUBLE DIAMOND – DELAWARE, INC. IS?

A. As can be seen on WBRG-1D, Double Diamond – Delaware, Inc. (DDD) is the parent company of DDU, as well as multiple other DDD subsidiaries. These subsidiaries include:

- Double Diamond, Inc. (DDI) (originally incorporated in 1972)
- Double Diamond Properties Construction Co. (DDPC) (Incorporated on December 30, 1996)

[2] *Application of Double Diamond Property Construction Co DBA Rock Creek for a Water Rate/Tariff Change,* PUC Docket No. 46247, SOAH Docket No. 473-17-0067WS.

- Double Diamond Utilities Co. (DDU) (Incorporated on December 30, 1996) (Exhibit WBRG-1E)

While DDD has multiple companies, each of these entities is a wholly owned subsidiary of Double Diamond – Delaware, Inc. (DDD). Each entity has a single shareholder, identified as "DD-Del., Inc." (DDD). The shareholders of DDD have been identified as R. Mike Ward (94.8%) and ESOP (5.2%).

Q. PLEASE DESCRIBE YOUR UNDERSTANDING OF THE DOUBLE DIAMOND PROPERTIES CONSTRUCTION CO. (DDPC).

A. Based upon testimony submitted by Mr. Gracy in SOAH Docket No. 473-17-0067.WS, and in this docket, and on the documents produced in discovery in this docket, it is my understanding that DDPC performs all construction activities of DDD.

Q. DO THESE COMPANIES FILE JOINT TAX RETURNS?

A. Yes. It is my understanding that DDD and all of its subsidiaries file a joint tax return and prepare joint financial statements. Under this approach, the corporation's (DDD's) profit is determined by comparing all revenues and all expenses from the all of the subsidiaries.

Q. PLEASE IDENTIFY YOUR UNDERSTANDING OF WHO IS THE "DEVELOPER" OF THE WHITE BLUFF RESORT.

A. Based upon the company's own website (WBRG-1F), they consider all of the "Double Diamond Companies" to be "the developer." This is how they have presented themselves

to the public and marketed their resort properties, including the White Bluff Resort. They have not distinguished a specific affiliate, or a specific "company" as the developer, but rather have identified the "Double Diamond Companies" (emphasis added) as the developer.

That said, Mr. Gracy has testified that Double Diamond – Delaware, Inc. (DDD) "acquired and began development of the White Bluff project in 1990,"[3] indicating that he considers DDD to be the developer of the White Bluff Resort. However, I would note, as can be seen on Exhibit WBRG-1G, the purchase agreement with lot owners cites DDI as the "seller" of the lots. My review of county tax records indicates that DDI retains ownership of approximately 664 properties in White Bluff. Also indicating that from a real estate contractual and taxing perspective, DDI is the developer of the subdivision. For the purposes of my analysis, I will treat DDD, DDI, and DDPC as the developer of White Bluff.

Q. IN THIS CASE, ARE THE UTILITY AND THE DEVELOPER THE SAME ENTITY?

A. Yes. The utility (DDU) is a wholly owned subsidiary of DDD, and a sibling subsidiary to DDI and DDPC. Based on this corporate structure, and the fact that the owner of the corporations treats the various corporations as a single entity, as reflected by the joint tax returns, and for the other reasons I will discuss later such as the lack of record keeping and

[3] Exhibit DDU-3, Direct Testimony of R. Gracy 5:13.

blending of funds, it is my opinion that the developer and the utility are the same entity and that the utility has the burden of clearly demonstrating that the utility assets were not paid for out of lot sales before the value of the utility assets can be included as invested capital (rate base).

Q. HAS DOUBLE DIAMOND CLEARLY DEMONSTRATED THAT THE UTILITY ASSETS WERE NOT PAID FOR OUT OF LOT SALES?

A. No. Double Diamond's only "demonstration" is contained in the direct testimony of Randy Gracy (Exhibit DDU-3). In his testimony, Mr. Gracy states that Double Diamond "treated" the initial investment in the White Bluff water system, and distribution lines in new sections, as being 80% developer contributions and 20% utility investment. (Exhibit DDU-3 at 8). He claims all other assets were 100% funded by the utility. He makes a similar claim regarding the White Bluff wastewater system. (Exhibit DDU-3 at 10-11).

The problem with Mr. Gracy's claim is that Double Diamond has produced no documentation to support the claim. The only evidence provided by Double Diamond is Mr. Gracy's conclusory statement. Double Diamond provided no accounting records supporting these conclusory statements. In response to WBRG 1-15, Double Diamond states: "The basis for the 80/20 separation is discussed in Randy Gracy's prefiled testimony in [SOAH Docket 582-09-4288]. No documentation exists that corresponding entries were made in the financial records of the developer and the utility." Mr. Gracy's testimony on this issue in the prior docket in 2010 is identical to his testimony in this docket. There is no documentary

support for Double Diamond's claims regarding the division of assets between developer contributions and utility investment.

Q. WHAT HAS DOUBLE DIAMOND DEMONSTRATED IN ITS APPLICATION, TESTIMONY, AND DISCOVERY RESPONSES REGARDING THE DETERMINATION WHETHER THE ASSETS WERE DEVELOPER CONTRIBUTED?

A. The documentation provided by Double Diamond demonstrates that the assets were developer contributed and paid for out of the proceeds of lot sales. This is shown primarily by the agreements made between Double Diamond and the lot purchasers and in Double Diamond's own records.

Q. PLEASE EXPLAIN HOW THE REAL ESTATE CONTRACTS USED IN WHITE BLUFF SHOW THAT THE UTILITY ASSETS WERE DEVELOPER CONTRIBUTED AND FUNDED OUT OF LOT SALES.

A. Exhibit WBRG-1G is a "true and correct copy of a Real Estate Sales Contract used to sell property in the White Bluff subdivision to purchasers."[4] This real estate sales contract outlines the terms and conditions related to the sale of lots within the White Bluff Resort. These contracts are between the purchaser (as identified in the contract) and the seller Double Diamond, Inc.

[4] DDU response to WBRG 3-12

Item number 9 in these contracts clearly outlines that the "Seller" will be responsible for providing the "Central Water System" and the "Central Sewer System." The table further identifies "Double Diamond Utilities Co. ("Utility Co.")" as the party responsible for maintaining the Central Water and Central Sewer Systems.

In my opinion, Double Diamond Inc., through these provisions, represented to the purchasers of lots (who are ultimately going to be ratepayers), that the developer, Double Diamond Inc., would provide utility infrastructure that would be maintained by the utility, Double Diamond Utilities. In other words, these contracts explained to the lot purchasers that the cost of infrastructure would be paid for out of the proceeds of lot sales and that the cost of operating the utility would be paid for out of utility rates.

I have provided an excerpt from the contracts below:

9. ROADS, RECREATIONAL RACILITIES AND CENTRAL SYSTEMS: The following is the Sellers good faith estimate with respect to, and the obligation to provide and complete, certain items within the White Bluff Subdivision:

ITEM	YEAR OF COMPLETION	PARTY RESPONSIBLE FOR PROVIDING	PARTY RESPONSIBLE FOR MAINTAINING
D. Central Water System (1) Water Lines	Complete	Seller	Double Diamond Utilities ("Utility Co.")

(2) Water wells & storage tanks Phase 1 and 2 (483-1400 lots) Phase 3 (if needed – all remaining lots)	 Complete Complete	 Seller Seller	 Utility Co. Utility Co.
A. Central Sewer System (1) Sewer Lines	Complete	Seller	Utility Co.
(2) Storage & Treatment Plants Phases 1 and 2 (183-640 lots)	Complete	Seller	Utility Co.
(3) Phase 3 (if needed – all remaining lots)	Complete	Seller	Utility Co.

Q. HOW DOES THIS CONTRACT SUPPORT YOUR POSITION THAT ALL OF THE ASSETS WERE CONTRIBUTED BY THE DEVELOEPR?

A. This sales contract makes a commitment to property owners that DDI, the developer of the lots, will contribute/provide/make available/supply/furnish the utility infrastructure. The purchase agreement establishes a distinction between the "seller" (DDI) and the "Utility Co." (DDU) and clearly indicates that DDI (the developer) would provide (contribute) the utility infrastructure and DDU (the utility) would maintain the system. Based upon the terms of the purchase agreement alone, I believe that 100% of the assets for the White Bluff Resort should be treated as developer contributions. This is the agreement that the Double Diamond entered into with property owners when they sold the lots; this agreement should be honored when it comes to assessing water and wastewater rates to these customers.

Q. IF THE AGREEMENT WITH THE PURCHASERS WAS THAT DDU WOULD MAINTAIN THE ASSETS, SHOULD DDU BE ALLOWED TO INCLUDE IN RATE

BASE THE INVESTMENT IT HAS MADE IN REPAIRING AND REPLACING ASSETS?

A. I agree that this might be appropriate, if sufficiently documented, but Double Diamond has not provided sufficient information to allow me to decide what investment is a repair or replacement of original infrastructure and what is original investment.

Q. WHAT ELSE DOES THE DOCUMENTATION PROVIDED BY DOUBLE DIAMOND DEMONSTRATE?

A The documentation demonstrates that the bulk of the utility assets at White Bluff were not purchased by the utility, but instead were purchased by the developer, and that no action was taken to transfer the assets from the developer to the utility.

The direct testimony of Victoria Harkins (Exhibit DDU-5) contains exhibits listing the assets claimed by DDU. Exhibits DDU-5B and 5F are the asset lists for White Bluff water and sewer. Exhibits DDU-5D and 5H are the "trending studies" for the White Bluff water and sewer assets. These exhibits are useful in showing who paid for the assets. Although Dr. Harkins does not expressly so state, I assume that she performed a trending study on assets for which no purchase records could be found. This assumption is reinforced by the fact that Double Diamond produced no receipts or payment information regarding these assets. Because no records exist, the Commission should presume that the assets were installed by the developer and not the utility.

Additionally, according to Dr. Harkins, all of the trended assets were installed before December 30, 1996. This is important because the utility, DDU, did not exist until December 30, 1996. Because DDU did not exist at the time of the installation of these assets, they could not have been installed by DDU. All other assets installed before December 30, 1996, also could not have been installed by DDU because DDU did not exist. These assets had to have been installed by DDI. DDU did not provide any documentation that any assets were sold or otherwise transferred by contract or by accounting entry from DDI to DDU. In fact, in response to WBRG 1-15, DDU admits that no documentation exists that accounting entries were made transferring the property installed by DDI was transferred to DDU.

As for assets installed after December 30, 1996, the invoices and check stubs provided by DDU show that the bulk of the assets were paid for directly by DDPC. For example, DDU lists Well No. 4 as being installed on February 22, 2001, at a cost of $163,215.41. (Exhibit DDU-5B, Bates DDU16-011289). The receipts and payment documentation cited in Exhibit DDU-5B (DDU16-010153 – DDU16-010156) reveals that the money used to pay for the asset came from DDPC. Exhibit WBRG-1H. Interestingly, DDU claims that 100% of this asset was paid for by DDU, but DDU has provided no documentation supporting this claim other than tax depreciation schedules that I will address later.

Another example is the White Bluff wastewater asset identified as "purestream wwtp model pt-50-ts(50,000 gpd)," which was installed on April 23, 1997, at a cost of $116,377 (shown on Exhibit DDU-5F, Bates DDU16-011292). DDU did not provide any documentation regarding cost or payment for this asset, nor did DDU perform a trending study to determine

the amount. Without payment documentation, I have to assume that the asset was paid for by either DDI or DDPC. Unlike Well No. 4, this asset does not even appear in the tax depreciation schedules.

One other example is the White Bluff wastewater asset identified as "Ashbrook Sutton Hartley wwtp, " which was installed on August 1, 2008, at a cost of $436,650.00 (shown on Exhibit DDU-5F, Bates DDU16-011292). The supporting documentation for the asset shows that it was paid for DDPC (Bates DDU16-009310). Again, DDU claims that this asset was funded 100% by DDU, but provides no documentation supporting that position other than possibly the tax depreciation schedules.

Q. HOW MANY OF THE ASSETS WERE ACTUALLY FUNDED BY DDU?

A. DDU was requested to "provide proof of payment (e.g. Cancelled checks)" for all assets claimed by DDU as part of the rate base,[5] As illustrated on Table NDH-1 below, DDU provided proof of payment for 69 of the 190 assets claimed as part of the rate base for White Bluff water. Of the 69 assets, only 4 were funded directly by DDU, the remaining assets were mostly funded by DDPC.

Table NDH-1	Number of Transactions	Original Cost	Net Book Value	Percent of NBV
DDPC Funded	64	$428,700.44	$209,076.44	10%
DDU Funded	4	71,367.48	68,355.48	3%
DDI FUNDED	1	1,277.16	800.16	0%
No Documentation	118	1,003,570.75	579,996.75	27%
Trended	3	2,286,954.10	1,329,944.10	61%
	190	$3,791,869.93	$2,188,172.93	

[5] WBRG No. 1-17 and WBRG 1-19.

As illustrated on Table NDH-2 below, DDU proof of payment was provided for 26 of the 125 assets claimed as part of the rate base for White Bluff sewer. Of the 26 assets, only 3 were funded directly by DDU, the remaining assets were mostly funded by DDPC.

Table NDH-2	Number of Transactions	Original Cost	Net Book Value	Percent of NBV
DDPC Funded	22	$96,965.16	$55,751.16	3%
DDU Funded	3	25,624.64	24,029.64	1%
DDI FUNDED	1	415.24	29.24	0%
No Documentation	97	1,017,482.01	585,296.01	36%
Trended	2	1,706,848.61	977,148.61	60%
	125	$2,847,335.66	$1,642,254.66	

The fact that the check was written on an account held by DDU does not mean that these assets should be considered as the invested capital of the utility. The issue is whether the source of the capital used to purchase these assets originated from lot sales or from utility rates.

Q. DOUBLE DIAMOND PRODUCED SOME TAX DEPRECIATION SCHEDULES IN DISCOVERY TO SHOW THAT DDU PAID FOR SOME OF THE ASSETS. DO THESE SCHEDULES SUPPORT A CONCLUSION THAT THE ASSETS LISTED ON THE TAX SCHEDULES ARE PART OF DDU'S INVESTED CAPITAL?

A. No. Double Diamond produced some tax depreciation schedules as protected materials during discovery. Double Diamond did not provide any explanation of how the schedules support its contention regarding the appropriate level of invested capital in its discovery

responses or in its direct testimony. The tax depreciation schedules do not reconcile with the asset list provided by DDU in this docket.

Some particular assets on these schedules appear to be the same assets on DDU's asset list in this docket, but even those do not have the same installation dates or values. Well No. 4, which I previously discussed, is shown as being installed on February 22, 2001, at a cost of $163,215.41, but on the tax schedules it is described as being installed on September 1, 2001, at a cost of $222,306. "Ashbrook Sutton Hartley wwtp, " is shown on the exhibit in this case as being installed on August 1, 2008, at a cost of $436,650.00, but on the tax schedules it appears to be described as being installed on July 1, 2008, at a cost of $214,567.

These tax schedules do not conclusively show that the assets included in the depreciation schedules are the invested capital of the utility. Again, the issue is whether the capital used to obtain the assets was obtained from lot sales or out of utility funds. The depreciation schedules also include millions of dollars of assets assigned to DDPC. In my opinion, these DDPC assets could not have been acquired using utility funds because they are directly related to the development of lots for sale. There is nothing in the depreciation schedules that differentiates between the DDPC assets and the DDU assets. In the end, the depreciation amount in the schedule is used to reduce the tax liability for DDD by offsetting revenues from lot sales.

Q. DOES DOUBLE DIAMOND HAVE A REPORTING HISTORY RELATED TO DEVELOPER CONTRIBUTIONS OF ASSETS FOR THE WHITE BLUFF RESORT?

A. Below is a summary of the accounting for developer contribution of assets in prior rate change applications for the White Bluff Resort below:

- December 8, 1997 – Double Diamond filed an application to change rates for three utility systems: White Bluff, the Cliffs, and Oakwood. The application shows no contributions in aid of construction. Excerpts from the application are attached as Exhibit WBRG-1I. The case was settled.
- August 7, 2007 – Double Diamond filed an application to change water rates for three of its utility systems: the Retreat, the Cliffs, and White Bluff Resort. This application was heard by SOAH in Docket No. 582-08-0698. The matter went to evidentiary hearing in early 2009. As explained in the PFD, the application failed to identify developer contributions as a credit against the rate base for determination of return (I have included an excerpt of the PFD as WBRG-1J). During the hearing on the merits, two Double Diamond witnesses (Randy Gracy and Kevin Shea) admitted that it is the company's policy for the developer to contribute a portion of the utility system assets. The ALJ denied the application, finding that there "is credible evidence in the record, including testimony from Double Diamond's own witness that some portion of the amount Double Diamond claims as invested capital came from developer contributions."
- In October 2008, Double Diamond filed another rate change application to change water rates for these same three systems: the Retreat, the Cliffs, and White Bluff Resort. That application identified the net book value of developer contributions of assets of approximately $1.9M. This application was also referred to SOAH in Docket No. 582-09-4288. Testimony submitted by Double Diamond's expert witness,

Chris Ekrut, on March 1, 2010 in this matter stated that "it is my understanding that it has been the practice of the Utility's Parent Company to pay for 80% of the initial assets, including all distribution mains and lines, during the construction of a water and sewer system." I have included an excerpt of this testimony as WBRG-1K. This case settled.

- In February, 2009, Double Diamond filed a third rate change application to change sewer rates for these same three systems: the Retreat, the Cliffs, and White Bluff Resort. In that application, Double Diamond reflected a net book value of developer contributions in the amount of $1,119,399 for the three systems. This case settled.
- On August 1, 2016, Double Diamond submitted the initial application to change its rates for the White Bluff Resort in this case. The application identified only a tiny fraction of the developer contributions of assets previously identified by Double Diamond.
- In response to WBRG's Motion to Reject Application or Suspend Rates Based on Misrepresentations in the Application, filed on November 15, 2016, Double Diamond submitted a revised application to adjust developer contributions of assets. The revised application indicates the net book value of developer contributed water assets in the amount of $1,186,227 and the net book value of developer contributed sewer assets in the amount of $137,457.

This behavior by Double Diamond supports my position that Double Diamond has no records clearly showing that the assets should be treated as invested capital of the utility. The ratepayers in this case have repeatedly debated this issue with Double Diamond in the past,

and have shown repeatedly that there were developer contributions of assets that Double Diamond continues to misrepresent in its applications. This has come at a substantial cost to the ratepayers as they have funded the legal efforts in each of the past cases and this current case themselves. The ratepayers should not be forced to pay to clean up Double Diamond's inability to keep good records by having to pay for rate case expenses in this matter.

Q. YOU STATED THAT THE DEVELOPER CONTINUES TO TREAT THE CAPITAL OF THE UTILITY AS IF IT WERE THE CAPITAL OF THE DEVELOPER. WHAT IS THE BASIS FOR YOUR STATEMENT?

A. Double Diamond's audited financial statements for the year ending December 27, 2015, a loan from First Financial Bank secured by "utility assets" in the amount of $3,000,000 with a maturity date of July 7, 2017. This note is also identified in Schedule III-6 of the Application,[6] which shows that the loan issued on March 7, 2013. As explained by Double Diamond in its response to WBRG 2-19, the assets pledged as collateral for this loan are "the water and wastewater utility assets located within White Bluff[7]".

The proceeds from this loan do not appear to have been used for utility purposes. In examining the utility system assets that were acquired since 2013, as recorded in DDU's tax depreciation schedule for 2015, DDU installed infrastructure investment was $263,304; a fraction of the loan that had been issued. Based upon information presented in the Application, DDU has not operated with negative cash flow for White Bluff since

[6] Exhibit DDU-2 at 83, Bates DDU-001738.
[7] DDU response to WBRG 2-19

that time, indicating to me that the funds from this note were not used to install new utility system infrastructure, nor were they used for utility operations expenses. When asked for an itemized accounting of the spending of the funds obtained from this loan, DDU responded "the requested information does not exist.[8]"

Additionally, the term of this note is highly unusual for a utility of this size. The note is a short-term (4 year) balloon note for $3,000,000. There is no likelihood that DDU could generate sufficient profits in the four-year period to repay this debt. Requested return from White Bluff, as set out in the Application, is only $215,209. Requested return from the Cliffs, as set out in the Application, is only $93,091. While DDU does have one additional system, the Retreat, which is a smaller system than the Cliffs and White Bluff, I do not see how they could possibly generate enough profit from utilities in four years to fund this note. In my opinion, this loan was not for utility purposes. Instead, the loan was used to generate funds for development purposes.

Simply put, the developer used the invested capital in the utility system as if it was the developer's invested capital. This action is consistent with WBRG's position that all of the assets of the utility were contributed by the developer. Double Diamond cannot claim that the investment is invested capital in the utility when Double Diamond uses the capital for non-utility purposes. The lines between the developer and the utility are

[8] DDU response to WBRG 3-4

blurred to such a degree that one cannot clearly distinguish between the multiple Double Diamond Companies.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATION FOR TREATMENT OF WHITE BLUFF UTILITY SYSTEM ASSETS FOR RATE MAKING PURPOSES.

A. As I have outlined above, the Double Diamond Companies has comingled business activities between the developer and the utility, they have clearly not reported utility system assets as part of the DDU depreciation schedules, and the developer entities have treated the claimed capital of the utility entity as capital available to the developer entities. Most importantly, the developer of the subdivision committed to property owners (ratepayers) that the developer would construct the utility system using funds generated through real estate sales. The ratepayers funded the investment in utility plant through the purchase price of their lots. They should not be forced to pay for the investment a second time through utility rates. As a result, I recommend that 100% of the system assets be treated as developer contributions. As such return on rate base should be set at $0, resulting in $0 for income tax expenses. I will further illustrate the resultant impacts on the revenue requirements later in my testimony.

C. OTHER FLAWS IN DOUBLE DIAMOND'S RATE BASE

1. FLAWED TRENDING ANALYSIS

Q. HAS THE APPLICANT RELIED UPON A TRENDING ANALYSIS IN THE ESTABLISHMENT OF ITS RATE BASE?

A. Yes. Ms. Harkins's testimony describes the trending work that she had completed on behalf of the applicant[9].

Q. PLEASE DESCRIBE THE FLAW YOU HAVE IDENTIFIED WITH THE TRENDING ANALYSIS PERFORMED BY THE APPLICANT.

A. Ms. Harkins stated in her testimony "using a conservative approach, I used a date in which construction data was made available for each of the systems. I used 1985 for The Cliffs and 1991 for White Bluff." [10] This is consistent with the date of initial development of the White Bluff Resort described by Mr. Gracy whereby he indicated "DDD acquired and began development of the White Bluff project in 1990."[11]

Ms. Harkins did correctly assume an installation date of 1/1/1991 for Well No. 1 and the 58,000-gallon storage tank for the water system. However, in reviewing DDU-5D which summarized the trended water assets, Well No. 2 and the Pipe Installed were given an installation date of 1/1/1996, not 1991 as described in Ms. Harkins's testimony. In reviewing DDU-5H which summarized the trended wastewater assets, all of the trended wastewater assets were given an assumed installation date of 1/1/1996, not 1991 as Ms. Harkins indicated.

Q. HOW DOES THIS IMPACT THE STATED RATE BASE?

[9] Direct Testimony of V. Harkins 7:11-16
[10] Direct Testimony of V. Harkins 9:1-3
[11] Direct Testimony of R. Gracy 5:13

A. As described by Ms. Harkins, in performing her trending analysis, she applied an index value for the date of installation to the estimated current costs of the trended infrastructure to arrive at an estimated original cost in the installation year. By using an incorrect installation date, Ms. Harkins used an incorrect index value, which arrived at an incorrect estimate of the original cost of the facilities. I have summarized the Handy Whitman index values for 1996 versus 1991 below.

Table NDH -3 Asset	HW Line No.	1991 HW Index	1996 HW Index
Small Treatment Plant Equipment	17	311	338
PVC Mains	38	184	189

Essentially, Ms. Harkins's analysis determined an estimate of original costs had the facilities been installed in 1996. But, as Ms. Harkins has stated, the facilities were assumed to be installed in 1991, not 1996.

I have updated Ms. Harkins trending study to include the corrected Handy Whitman index values on the Table NDH-4 below.

Table NDH-4 Asset	Installation Date	Current Cost	Current HW Index	install HW Index	HW Line No.	Trended Original Cost
Well No. 2	1/1/91	125,000	596	311	17	$65,227
Pipe	1/1/91	4,823,327	379	184	38	2,341,668
Less Invoiced Pipe						(206,485)
Net Water						$2,200,409

Grinder Station receiving tank and pump (520 total), $2,766 each	1/1/91	1,438,320	596	311	17	$750,533
Less Tap Fees Trended ($2,500 @520)	1/1/91	(1,300,000)	596	311	17	(678,356)
Pipe	1/1/91	3,793,934	379	184	38	1,841,910
Less Invoiced Pipe						(263,556)
Net Sewer						$1,650,531
Total Water/Wastewater						$3,850,940

Ms. Harkins arrived at a trended original cost for these assets in the amount of $3,972,778. This error inflated the original cost of the trended facilities by $121,838.

Q. HOW DID THIS ERROR IMPACT ANNUAL DEPRECIATION EXPENSES?

A. As I have detailed in the Table NDH-5 below, annual depreciation expense has been over-stated by $4,628 for water and $4,923 for wastewater. The overstated depreciation expense was partially due to the overstated original cost of facilities. However, the larger impact was due to the fact that some of the trended assets had a useful life of 20 years.

Table NDH-5 Asset	Application Stated Annual Depreciation Expense	Corrected Annual Depreciation Expense	Total Over Stated Annual Depreciation
Well No. 2	$3,356	$-	$3,356
Pipe	48,106	46,833	1,273
Less Invoiced Pipe	(4,130)	(4,130)	-
Net Water	$47,332	$42,704	$4,628
Grinder Station receiving tank and pump (520 total), $2,766 each	$40,785	$-	$40,785

Less Tap Fees Trended ($2,500 @520)	(36,862)	-	(36,862)
Pipe	37,839	36,838	1,001
Less Invoiced Pipe	(5,271)	(5,271)	-
Net Sewer	$36,490	$31,567	$4,923
Total Water/Wastewater	$83,822	$74,271	$9,552

Q. HOW DID THIS ERROR IMPACT THE NET BOOK VALUE OF THESE ASSETS?

A. As detailed on the Table NDH-6 below, the net book value was overstated by $252,412 for water and $188,404 for wastewater. This was due to the incorrect original cost as well as five additional years of accumulated deprecation that was not reflected in the depreciation schedules.

Table NDH-6 Asset	Application Stated Net Book Value	Corrected Net Book Value	Total Over Stated NBV
Well No. 2	$3	$-	$3
Net Pipe	1,319,415	1,067,006	252,409
Net Water	$1,319,418	$1,067,006	$252,412
Grinder Station receiving tank and pump (520 total), $2,766 each	$14	$-	$14
Less Tap Fees Trended ($2,500 @520)	-	-	-
Net Pipe	977,134	788,744	188,390
Net Sewer	$977,148	$788,744	$188,404
Total Water/Wastewater	$2,296,567	$1,855,751	$440,816

Q. HOW DID THIS ERROR IMPACT ANNUAL RETURN FOR THESE ASSETS?

A. As I have addressed previously in my testimony, I believe that all of the claimed assets were developer contributed. Furthermore, as I will address later in my testimony, I do not

believe the requested rate of return of 8.42% is reasonable. However, for comparative purposes, I have outlined below, using DDU's claimed percentage of developer contributions and requested rate of return, the corrected annual return that would be allowable from the trended assets by just correcting the installation date to 1/1/1991. As can be seen below, this error has resulted in an over-stated return in the amount of $17,003 for water and $15,864 for wastewater.

Table NDH-7	Application Stated Value	Corrected Value	Total Over Stated Amount
Total Net Book Value - Water	$1,319,418	$1,067,006	$252,412
Total Net Book Value - Wastewater	977,148	788,744	188,404
	$2,296,567	$1,855,751	$440,816
Less DDU Claimed Developer Contribution of Assets			
Well No. 2	$-	$-	$-
Net Pipe	263,883	213,401	50,482
Net Water	$263,883	$213,401	$50,482
Grinder Station receiving tank and pump (520 total), $2,766 each	$-	$-	$-
Less Tap Fees Trended ($2,500 @520)	-	-	-
Net Pipe	-	-	-
Net Sewer	$-	$-	$-
Total Water/Wastewater	$263,883	$213,401	$50,482
Adjusted NBV - Water	$1,055,535	$853,605	$201,930
Adjusted NBV - Wastewater	977,148	788,744	188,404
	$2,032,684	$1,642,349	$390,334
Application Requested Rate of Return	8.42%	8.42%	8.42%

Return - Water	$88,876.06	$71,873.55	$17,002.51
Return - Wastewater	82,275.89	66,412.27	15,863.62
	$171,151.95	$138,285.82	$32,866.13

1

2 **Q. HOW DID THIS ERROR IMPACT INCOME TAX EXPENSE?**

3 A. As Federal Income tax is a product of return, income tax expense was also over-stated as
4 a result of this error. As can be seen on the Table NDH-8 below, income taxes were over-
5 stated by $3,593 for water and $3,353 for wastewater.

Table NDH-8	Application Stated Value	Corrected Value	Total Over Stated Amount
Return - Water	$88,876.06	$71,873.55	$17,002.51
Return - Wastewater	82,275.89	66,412.27	15,863.62
	$171,151.95	$138,285.82	$32,866.13
Less Interest			
Water	$35,360.43	$28,595.77	$6,764.66
Wastewater	32,734.47	26,422.93	6,311.54
	$68,094.90	$55,018.71	$13,076.19
Taxable Return			
Water	$53,515.63	$43,277.78	$10,237.85
Wastewater	49,541.42	39,989.34	9,552.09
	$103,057.06	$83,267.12	$19,789.94
Effective Tax Rate	26%	26%	
Gross Up Factor	1.35	1.35	
Grossed up Federal Tax			
Water	$18,783.99	$15,190.50	$3,593.49
Wastewater	17,389.04	14,036.26	3,352.78
Total	$36,173.03	$29,226.76	$6,946.27

Q. PLEASE SUMMARIZE THE TOTAL REVENUE REQUIREMENT IMPACT DUE TO THE ERROR IN THE TRENDING ANALYSIS ALONE.

A. This one error resulted in an overstatement of water revenue requirements in the amount of $25,224, and wastewater revenue requirements in the amount of $24,140.

Table NDH-9	Application Stated Value	Corrected Value	Total Over Stated Amount
Water			
Annual Depreciation Expense	$47,332	$42,704	$4,628
Return	88,876	71,874	17,003
Federal Income Tax Expense	18,784	15,191	3,593
	$154,992	$129,768	$25,224
Wastewater			
Annual Depreciation Expense	$36,490	$31,567	$4,923
Return	82,276	66,412	15,864
Federal Income Tax Expense	17,389	14,036	3,353
	$136,155	$112,016	$24,140

Q. WHAT ARE YOUR RECOMMENDATIONS FOR ADJUSTMENTS TO CORRECT THIS ISSUE?

A. In correcting for this error, the assets must be trended using the correct installation date of 1/1/1991. As I have outlined previously, I believe all assets should be considered as developer installed assets, which would result in $0 annual return on investment and $0 income tax expenses. As a result, the only additional correction to revenue requirements

that must be made to correct this error would be a reduction to depreciation expense as outlined on the table above. In the event the utility is allowed some return on investment, the corrected installation date should be used to determine original cost and net book value of these utilities, as I outlined in the Table above.

2. ERRORS IN RECORDING DEVELOPER CONTRIBUTION OF ASSETS

Q. PLEASE DESCRIBE DOUBLE DIAMOND'S STATED POSITION WITH REGARD TO DEVELOPER CONTRIBUTIONS OF ASSETS.

A. With respect to the water system, according to Mr. Gracy "the original system included Well #1, a 58,000-gallon ground storage tank, a pump station, the land these facilities were located upon, and the initial distribution lines to serve White Bluff Subdivision, Phase 1. The company treated 80% of the cost of these facilities and the distribution lines as developer contributions to DDU and considered DDU to have paid the remaining 20% of the cost."[12]

With respect to the wastewater system, Mr. Gracy has stated "the original system included the first 50,000 gallon per day phase of the treatment plant and the collection system necessary to serve the White Bluff Subdivision, Phase 1. Just like the water system, the company treated 80% of the cost of these facilities and the distribution lines as developer contributions to DDU and considered DDU to have contributed the remaining 20% of the cost."[13]

[12] Direct Testimony of R. Gracy 6:1-5
[13] Direct Testimony of R. Gracy 8:19-23

Q. DID THE APPLICATION REFLECT DEVELOPER CONTRIBUTIONS IN THE MANNER IN WHICH MR. GRACY DESCRIBED ABOVE?

A. No, it did not, the analysis performed by Mr. Joyce contained errors whereby for some of the 80% developer contributions of assets described by Mr. Gracy were not correctly reflected. In particular, Mr. Joyce showed the initial White Bluff sewer investment as 100% utility contributed rather than split 80%/20% between the developer and the utility.

Q. PLEASE DESCRIBE THE ERRORS YOU HAVE IDENTIFIED.

A. In reviewing Mr. Joyce's analysis, he recorded the sewer pipe and the "grinder station receiving tank and pump" as 100% contributed by DDU instead of 20% as described by Mr. Gracy. These errors are shown on Exhibit DDU-6C page 49 (DDU16-011336), Total Pipe Installed - $1,628,405.39, 100% DDU and page 51 (DDU16-011338), Grinder Station Receiving Tank and Pump - $78,443.22, 100% DDU.

Q. HOW DID THIS IMPACT THE CLAIMED RETURN ON INVESTMENT?

A. As described above, these same assets were trended by Ms. Harkins and thus had errors in their computation of original cost and net book value due to the utilization of an incorrect installation date in performing the analysis. For the purposes of addressing this question, I have relied upon the Application stated net book value – while this value is incorrect as previously described, I believe this provides an indication of the degree to which this error has impacted the requested rates.

The Application claimed original cost of the sewer Pipe Installed was $1,628,405.39, with a net book value of $977,134.39. 100% of this was treated as utility contributed assets. Applying the Application requested return on rate base of 8.42%, DDU has requested $82,274.72[14] in revenue requirements associated with return on investment for this one line item. Applying an effective tax rate of 26% and a gross of factor of 1.35 as claimed in the application, DDU has requested an additional $17,389 to be included in the revenue requirements for income taxes associated with return on this one line item.

As Mr. Gracy testified, 80% of these facilities should have been treated as developer contributions of assets. As such, the return on rate base has been overstated by a minimum of $65,820[15] and income taxes have been overstated by $13,911.

Table NDH-10	Application Claimed Value	Correct Value	Overstated Amount
Net Book Value	$977,134	$977,134	$-
Less Developer Contribution	-	(781,708)	781,708
Adjusted Rate Base	$977,134	$195,427	$781,708
Requested Return	8.42%	8.42%	
Requested Return	$82,275	$16,455	$65,820
Less Interest Expense	$32,734	$6,547	$26,187
Total Taxable Return	$49,541	$9,908	$39,633

[14] 8.42% Return on Rate Base X $977,134.39 Application Stated Net Book Value of Sewer Pipe Installed = $82,274.72 Requested Return on Sewer Pipe Installed

[15] $82,274.72 Requested Return on Sewer Pipe Installed X 80% Developer Contribution = $65,819.77 Minimum Overstated Return

Effective Tax Rate	26%	26%	
Gross Up Factor	1.35	1.35	
Total Income Tax Expense	$17,389	$3,478	$13,911
TOTAL Revenue Requirement Impact	$99,664	$19,933	$79,731

In totality, this single error accounts for an overstated revenue requirement of nearly $80,000. DDU has requested an increase in wastewater revenues of $186,674 above test year actual revenues, this error alone accounts for over 43% of the requested increase for White Bluff sewer.

Q. WHAT ARE YOUR RECOMMENDATIONS FOR CORRECTING THIS ISSUE?

A. As I described previously, I believe that 100% of the assets should be considered as developer contributions and thus corrections for this issue were made previously in my testimony. However, in the event return on these assets is awarded, the return should be adjusted to 80% developer contributions as testified by Mr. Gracy, and outlined on the Table above.

3. INCONSISTENCIES BETWEEN DDU STATED TREATMENT OF DEVELOPER CONTRIBUTIONS AND ACTUAL FUNDING OF FACILITIES

Q. PLEASE DESCRIBE DOUBLE DIAMOND'S STATED POSITION WITH REGARD TO DEVELOPER CONTRIBUTIONS OF ASSETS.

A. As I have described above, Mr. Gracy has stated that the developer contributed 80% of the cost of the original facilities and the distribution/collection lines and the remaining 20% to be utility funded[16]. He further described, "as potential for additional connections increased, supply, treatment, storage and pumping facilities were expanded or added to the system to comply with TCEQ regulations and provide a reliable water supply for the projects. These new supply, treatment storage and pumping facilities or components were constructed as 100% DDU projects with no contribution from development side of the company."[17] He described a similar policy for the wastewater system.[18]

Q. THROUGH THE COURSE OF THIS PROCEEDING, HAS DDU PROVIDED INFORMATION THAT WOULD CONTRADICT THIS CLAIM?

A. Yes. In response to WBRG 3-5 DDU stated "utility infrastructure has been installed by Double Diamond Inc (DDI), Double Diamond Properties Construction (DDPC) or Double Diamond Utilities (DDU) at various times.

[16] Direct Testimony of R. Gracy 6:1-6 and 8:19-24
[17] Direct Testimony of R. Gracy 6: 10-14
[18] Direct Testimony of R. Gracy 9: 4-8

Before 1996, most all of infrastructure was constructed and paid for by DDI. DDPC and DDU were created in December 1996. In 1997, DDPC began paying for most of the infrastructure, and DDU paid for a few items. Payment for utility infrastructure is identified and itemized in the invoices whose bates numbers are referenced on the asset list previously produced. As of the 2007-2008 rate case before the Texas Commission on Environmental Quality, most of the initial utility infrastructure was completed, and DDU began paying for all utility assets and operations. The same contractors and employees worked for each entity that paid for the infrastructure."[19] This response suggests that 100% of assets before 1997 should be treated as 100% developer contributed, that 80% of assets between 1997 and 2008 should be treated as developer contributed, and that 100% of the assets after 2008 should be treated as 100% utility contributed.

Q. IN YOUR REVIEW OF DOCUMENTS SUBMITTED IN THIS CASE, WHICH OF THE "DOUBLE DIAMOND COMPANIES" FUNDED UTILITY INFRASTRUCTURE IN THE WHITE BLUFF RESORT?

A. I had requested proof of payment for all of the assets included in the rate base through discovery. In response to this request, proof of payment was received for 69 of the 190 water system and 26 of the 125 sewer system assets included in the rate base for White Bluff in the form of check stubs. As detailed in Tables NDH-1 and NDH-2 above, only 4 of the water system assets and 3 of the sewer system

[19] DDU response to WBGR 3-5

assets were funded by DDU, the remaining assets for which proof of payment was submitted were funded by DDI or DDPC. I have not received proof of payment for 99 of the sewer system assets and 121 of the water system assets.

As previously discussed, 61% of the water system assets were trended and constructed before DDU existed (prior to December 1996); 60% of the sewer system assets were trended and constructed before DDU existed. These assets had to have been funded by the developer as the utility did not exist prior to that point in time.

Double Diamond provided documentation demonstrating that DDU directly funded only 3% of water system assets and 1% of sewer system assets. The remaining assets were either funded by DDI (the developer) or DDPC (the construction company for the developer), or documentation of the funding entity has not been provided.

Q. DDU HAS CLAIMED THAT DDU DID NOT EVEN EXIST UNTIL 1996 AND YET DEVELOPMENT OF WHITE BLUFF BEGAN IN 1990/1991, WHAT PORTION OF THE CLAIMED RATE BASE WERE CONSTRUCTED PRIOR TO DECEMBER 1996?

A. As illustrated on Table NDH-11 below, approximately 66% of the claimed net book value of the water system assets for White Bluff was installed before December, 1996.

Table NDH-11	Original Cost	Annual Depreciation Expense	Net Book Value	Percent of NBV
Prior to December 1996	$2,448,978	$50,150	$1,445,001	66%
1997-2007	883,797	36,921	383,220	18%
2007-2015	459,182	23,006	360,008	16%
	$3,791,956	$110,077	$2,188,228	

As illustrated on Table NDH-12 below, approximately 61% of the claimed net book value of the wastewater system assets for White Bluff was installed before December, 1996.

Table NDH-12	Original Cost	Annual Depreciation Expense	Net Book Value	Percent of NBV
Prior to December 1996	$1,753,021	$37,342	$1,006,591	61%
1997-2007	499,376	17,881	240,945	15%
2007-2015	594,939	29,477	394,719	24%
	$2,847,336	$84,700	$1,642,255	

Stated another way, 66% of the water system infrastructure and 61% of the wastewater system infrastructure was installed prior to the utility even existing. Yet, DDU has claimed these assets as part of their rate base.

4. DDU MAY NOT ACTUALLY OWN A PORTION OF THE FACILITIES

Q. PLEASE DESCRIBE EXHIBIT WBRG-1L.

A. Exhibit WBRG-1L is a true and correct copy of a Warranty Deed conveying the tracts listed on "Exhibit A" from Double Diamond, Inc. to White Bluff Property Owners Association, Inc. dated December 20, 1995[20]. The list of tracts included in "Exhibit A" in Exhibit WBRG-1L include Tract 2 in White Bluff Four Subdivision[21]. The White Bluff Property Owners Association, Inc., is legally distinct from Double Diamond.

Q. DOES DOUBLE DIAMOND CLAIM THIS PROPERTY AS PART OF ITS RATE BASE?

A. Yes. The original cost of the tract, WB4 TR2, is included in Double Diamond's rate base as "land."[22] Furthermore, WB4 TR2, includes the Stand Pipe, Pressure Tank, Booster Room, Parts Room, Well Room, and Ground Storage Tank (EST 2000), as can be seen on WBRG-1L. Each of these facilities has been included in DDU's requested rate base. However, as can be seen on this Warranty Deed, the property was deeded to the Property Owner's Association in 1995. As such, DDU has requested depreciation expense and return on facilities they deeded to the Property Owner's Association.

Q. PLEASE IDENTIFY THE AMOUNT OF RATE BASE AND DEPRECIATION EXPENSE THAT ARE ASSOCIATED WITH THIS PROPERTY.

[20] DDU response to WBRG 3-7
[21] DDU response to WBRG 3-8
[22] DDU response to WBRG 3-9

A. As detailed on the table below, DDU has requested net book value in the amount of $88,565 and annual depreciation in the amount of $2,060 for these assets.

Table NDH-13	Date of Installation	Original Cost	Annual Depreciation	Net Book Value
WB 4 2.30AC Water Tanks	Land	$17,700	$-	$17,700
water piping gst	1/11/00	299	6	203
storage tank, 250,000 gallons	9/29/00	71,887	1,438	49,954
piping for new storage tank	10/27/00	3,189	64	2,218
Hydro-pneumatic pressure tank - 6000 gallon	7/16/99	27,576	552	18,490
		$120,651	$2,060	$88,565

5. FULLY DEPRECIATED ASSETS INCLUDED IN DEPRECIATION EXPENSE

Q. HAVE YOU IDENTIFIED ANY ASSETS THAT HAVE BEEN INCLUDED IN DDU'S CLAIMED DEPRECIATION EXPENSES THAT HAVE BEEN DEPRECIATED?

A. Yes. In my review of the depreciation schedule included in the application, I have identified that DDU included assets that have been depreciated, yet DDU has requested to include annual depreciation expense for those facilities in their total annual depreciation. The Tables below includes water and wastewater facilities whereby this occurred.

Table NDH-14 Water Assets	Date of Installation	Service Life (yrs) * **	Original Cost when installed $	Annual Depreciation	Accumulated Depreciation	Net Book Value
LONESTA Booster Pump	3/7/06	10	$1,034.40	$103	$1,011	$23
LONESTA O-Ring, Plug, Gasket,	8/28/06	10	$1,260.14	$126	$1,177	$83

Diaph, Etc						
Well No. 2	1/1/96	20	$67,114.09	$3,356	$67,111	$3
				$3,585		$110

Table NDH-15 Item	Date of Installation	Service Life (yrs)	Original Cost when installed $	Annual Depreciation	Accumulated Depreciation	Net Book Value
grinder station receiving tank and pump (520 total), $2,766 each	1/1/96	20	$78,443.22	$3,922	$78,429.00	$14
MCCLMECH Air Manifold- Fabricate & Install	12/16/06	10	$4,551.80	$455	$4,113.00	$438
WALLELE Electrical Bid	11/27/06	10	$3,550.00	$355	$3,228.00	$322
			$86,545.02	$4,732.00	$85,770.00	$775

Q. WHAT RECOMMENDATIONS DO YOU HAVE REGARDING THESE FACILITIES?

A. As the remaining net book value for these facilities is less than the annual depreciation expense, I recommend the annual depreciation expense allowed to be included in the revenue requirement be reduced by $3,475 for water and $3,957 for wastewater as outlined in the Tables below.

Table NDH-16 Water Assets	Requested Depreciation Expense	Corrected Depreciation Expense	Over Stated Depreciation Expense
LONESTA Booster Pump	$103	$23	$80
LONESTA O-Ring, Plug, Gasket, Diaph, Etc	126	83	43
Well No. 2	3,356	3	3,353
TOTAL	$3,585	$110	$3,475

Table NDH-17 Wastewater Assets	Requested Depreciation Expense	Corrected Depreciation Expense	Over Stated Depreciation Expense
grinder station receiving tank and pump (520 total), $2,766 each	$3,922	$14	$3,908
MCCLMECH Air Manifold- Fabricate & Install	455	439	16
WALLELE Electrical Bid	355	322	33
TOTAL	$4,732	$775	$3,957

IV. RETURN ON RATE BASE

Q. PLEASE DESCRIBE WHAT IS MEANT BY THE TERM "RETURN ON RATE BASE"

A. As previously described, the rate base is the value of property on which the utility is permitted to earn a return. The return on the rate base is the profit the utility earns on the rate base. The rate of return, typically stated in a percentage, is applied to the rate base to calculate the amount of return that is included in the revenue requirement. The rate of return is the weighted average of the cost of debt and the cost of equity.

Q. HAVE YOU IDENTIFIED ISSUES WITH THE REQUESTED RETURN ON RATE BASE?

A. Yes. DDU has used an incorrect interest rate for their cost of debt. Secondly, DDU has claimed a higher return on equity than I believe to be reasonable given their track record and management.

Q. PLEASE DESCRIBE WHY THE INTEREST RATE USED BY DDU AS THEIR COST OF DEBT WAS INCORRECT.

A. DDU used 6% for the cost of their debt. This amount is evidently the interest rate that DDU has for a short-term balloon note for which DDU pledged as collateral the utility assets at White Bluff. As I have previously described, while DDU used the White Bluff utility assets as collateral, there is no evidence that these monies were actually used for utility purposes and there is no evidence that this represents all of the utility system related debt. As such, I do not believe it was appropriate to utilize this interest rate for the cost of DDU debt. DDU is a wholly owned subsidiary of DDD, as I have discussed, there has been substantial financial comingling of the Double Diamond Companies. Given this circumstance, and the fact that the $3M balloon note was not used for utility purposes and does not represent utility system debt, it is my recommendation that the cost of debt for DDD should be used for the purposes of this analysis. In examining DDD financial statements, the weighted average cost of outstanding DDD remaining debt balances as of December 27, 2015 was 4.96%.[23] I believe this is the appropriate cost of debt to be utilized for determination of allowable return.

Q. WHAT RATE OF RETURN ON EQUITY DID DDU REQUEST?

A. DDU has requested a return on equity in the amount of 11.49%.

[23] DDD's weighted average cost of debt derived from information contained on DDU003586..

Q. DO YOU BELIEVE THIS IS REASONABLE AMOUNT OF RETURN?

A. No, I do not. DDU used the PUC default calculation to determine their requested rate of return. However, I believe this return should be reduced by 2%, pursuant to Texas Water Code §13.184(b), to reflect the poor achievements of the company as it relates to water accountability.

Q. PLEASE ELABORATE ON YOUR CONCERNS RELATED TO WATER ACCOUNTABILITY.

A. As can be seen on Schedule II-1(a), DDU reported a 50% unaccounted for water during the test year. In my experience, this is an extremely high unaccounted for percentage. This level of unaccounted for water has real economic consequences for the ratepayers. Assuming that the water is actually lost, then Double Diamond's volumetric water costs at White Bluff ($81,592) are twice as high as they should be. Another possibility is that Double Diamond is providing water on an unmetered basis to some customers. Given that Double Diamond owns a large number of meters and connections at White Bluff, there is a possibility that Double Diamond is providing water to itself for free. I believe the utility should be provided with some incentive to better account for its water use by reducing the allowable return in this amount, and the allowable return on equity should be 9.49%.

Q. PLEASE OUTLINE YOUR RECOMMENDED RETURN ON RATE BASE.

A. Using the same equity structure proposed by the Applicant and adjusting the return on equity to 9.49% and cost of debt to 4.96%, I have determined a recommended return on rate base of 6.96%.

Table NDH-18	Percentage of Rate Base Funding	Rate	Weighted Average
Equity	44.16%	9.49%	4.19%
Debt	55.84%	4.96%	2.77%
Total Capitalization			
Return on Rate Base			6.96%

Q. PLEASE IDENTIFY YOUR RECOMMENDED RETURN FOR THE WHITE BLUFF SYSTEMS.

A. As I have previously described, I recommend that 100% of the assets for the White Bluff system be treated as developer contributed. As a result, return would be $0. However, in the event an alternative rate base is used, the weighted average return of 6.96% should be applied to that rate base to determine allowable return.

V. OVERSTATED O&M EXPENSES

Q. PLEASE DESCRIBE ISSUES IDENTIFIED WITH REQUESTED O&M.

A. Although my review of O&M items was limited, and thus additional adjustments may be necessary, I did identify two issues with the Operations and Maintenance expenses

claimed by DDU. I have identified that salaries claimed in the application were overstated, as were regulatory fees.

Q. PLEASE DESCRIBE THE ISSUE YOU'VE IDENTIFIED WITH SALARIES.

A. In reviewing the application, DDU has claimed $80,520 in salaries for White Bluff water and $91,440 in salaries for White Bluff sewer; which includes a $415 adjustment for water and a $20,472 adjustment for sewer for "known and measurable" changes. DDU has not provided an explanation for these known and measurable changes. It appears these salaries are for 7 individuals, which have been split between White Bluff water and sewer. In reviewing Mr. Gracy's testimony, he has identified only 4 individuals working at the White Bluff system. It is unclear why 3 additional employees were included in the revenue requirements than were identified by Mr. Gracy as having worked at White Bluff.

Q. WHAT ARE YOUR RECOMMENDATIONS FOR ADJUSTMENTS FOR SALARIES?

A. I recommend that salaries be adjusted downward to at a minimum the test year amount as DDU has failed to justify this as a "known and measurable" change. Water revenue requirements should be reduced by $415 and sewer revenue requirements should be reduced by $20,472, as DDU has not properly justified these adjustments.

Q. PLEASE DESCRIBE THE ISSUE YOU'VE IDENTIFIED WITH REGULATORY FEES.

A. As can be seen on Exhibit DDU-4E page 148 and 149, the Detail Trial Balance submitted by White Bluff, a portion of the regulatory fees claimed in the application included regulatory assessment fees. Regulatory assessment fees are pass-through fees that should not be included in the revenue requirements. The revenue requirements should be reduced by $22,046.55 to properly reflect these pass-through expenses.

VI. RECOMMENDED REVENUE REQUIREMENTS

Q. PLEASE IDENTIFY YOUR RECOMMENDED REVENUE REQUIREMENT.

A. Based upon the reasons I have outlined above, I am recommending the following adjustments to the revenue requirements:

Table NDH-19

	Water	Wastewater
Total Operating Expense	$294,813	$277,819
Less Salaries Adjustment	(415)	(20,472)
Less Regulatory Fees	(22,047)	-
Total Allowable Operating Expense	$272,351	$257,347
Annual Depreciation Expense	$110,077	$84,700
Less Adjustment for Trending Error	(4,628)	(4,923)
Less Fully Depreciated Assets	(122)	(49)
Total Depreciation Expense	$105,326	$79,728
Taxes Other than Income	$64,171	$58,106
Return on Investment	$86,485	$128,724
Less 100% Developer	(86,485)	(128,724)

Contributions		
Total Return	$-	$-
Income Tax Expense	$18,378	$27,354
Less 100% Developer Contributions	(18,378)	(27,354)
Total Income Tax Expense	$-	$-
Total Revenue Requirement	$441,849	$395,181
Test Year Revenues	$473,455	$390,030
Actual Revenue Over/(Under)	$31,606	$(5,151)

As can be seen on the table above, based upon recommended adjustments to the revenue requirements, DDU's currently effective rates over-recover from the water utility by $31,606 and should be reduced to reflect the appropriate revenue requirement. DDU's currently effective wastewater rates under-recover by $5,151 and should be increased to recover this slight shortfall.

VII. RATE CASE EXPENSES

Q. PLEASE IDENTIFY HOW YOU BELIEVE RATE CASE EXPENSES SHOULD BE CONSIDERED IN THIS CASE.

A. DDU initially submitted an erroneous application that included misrepresentations of rate base from the previous rate case as well as developer contributions on August 1, 2016. DDU later submitted a revised application making corrections for these issues, which were identified by WBRG. I believe for the purpose of assessing whether rate case expenses should be allowed, the revenue requirements that were initially submitted

should be used for measurement. These errors were made by DDU; ratepayers should not pay the price for their misrepresentations and inaccuracies. These misrepresentations were material, and had the ratepayers not protested, could have resulted in customers paying higher fees that were not justified.

DDU decreased the requested revenue requirements for the water utility from $647,863 to $573,923; a $73,940 reduction in revenue requirements from their originally submitted application and the revised application. Test year actual revenues for the water utility were $473,455. The original application indicated a revenue-shortfall of $174,408. The revised application reduced the shortfall to $100,469. In other words, the errors pointed out by the ratepayers prior to the hearing on the merits or submittal of testimony resulted in a reduction of the water revenue requirements by 42%. This is before any of the additional items I have pointed out above.

I recommend that for the purpose of determining whether DDU should be granted rate case expenses, the originally submitted revenue requirements should be utilized: $647,863 for water and $582,287 for wastewater.

Furthermore, in the event rate case expenses are awarded, I believe that expenses associated with corrections to the application associated with these misrepresentations should not be included in recoverable expenses. These additional expenses were incurred due to errors and misrepresentations of the applicant; the costs of these issues should not

be borne by the ratepayers. Based on the lack of detail provided in Double Diamond's testimony, I did not have the information necessary to specifically identify the expenses associated with these misrepresentations.

Q. BASED UPON THIS RECOMMENDATION, SHOULD DDU BE ABLE TO RECOVER RATE CASE EXPENSES?

A. No, as I have outlined above, I recommend a water revenue requirement that is less than test year actual revenues and a wastewater revenue requirement that is only $5,151 more than test year revenues.

Q. DO YOU HAVE ANY ADDITIONAL RECOMMENDATIONS WITH REGARD TO RATE CASE EXPENSES?

A. As I have outlined above, I do not recommend that rate case expenses be rewarded in this case. However, I would point out that in the event that rate case expenses were awarded, I recommend that rate case expenses be allocated between White Bluff and the Cliffs at a rate of 50% White Bluff and 50% the Cliffs. Fundamentally, DDU has submitted two separate applications – one for White Bluff, and a second for the Cliffs. These are separate systems, with separate costs of service. I recommend that the determination of whether rate case expenses are allowable be made on an individual system basis, with the rate case expenses being allocated 50% to the Cliffs and 50% to White Bluff.

VIII. CONCLUSION

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, at this time. However, I would like to reserve the right to amend my testimony as may be necessary throughout these proceedings.

SOAH DOCKET NO. 473-17-0119.WS
PUC DOCKET NO. 46245

DIRECT TESTIMONY AND WORKPAPERS
OF NELISA HEDDIN

EXHIBIT WBRG-1A

Resume of Nelisa D. Heddin

Nelisa Heddin

Nelisa Heddin Consulting, LLC
President

Professional Background

Nelisa Heddin is an industry expert in financial planning and management for water and wastewater utilities; specializing in cost of service and rate design studies, impact fee analysis, cost benefit analysis, and annual and long-term budgeting. Ms. Heddin has nearly 15 years experience in providing consulting services to utilities of all sizes throughout the Southwest. Among Ms. Heddin's most recent clients are the West Travis County Public Utility Agency, the City of Corinth, the City of Webster, the City of Southside Place, and Travis County WCID #17. Ms. Heddin has a Masters of Business Administration with a specialty in Finance. She is a Past-Chair of the Texas AWWA Rates and Charges Subcommittee and has been invited to speak at numerous industry functions regarding water and wastewater rates, rate design, water loss, and capital financing.

Education

B.S., Biology, New Mexico State University, 1996
MBA, Finance, New Mexico State University, 1999

Professional Affiliations

American Water Works Association
Past Chairman Texas AWWA Rates and Charges Subcommittee
Texas Municipal League
Texas Government Financial Officers Association

Sample of Relevant Project Experience

Cost of Service and Rate Design Projects

Bistone Municipal WSC
City of Alamo Heights, Texas
City of Bastrop, Texas
City of Bonham, Texas
City of Burnet, Texas
City of Cameron, Texas
City of Copperas Cove, Texas
City of Corinth, Texas
City of Cuero, Texas
City of Del Rio, Texas
City of Friendswood, Texas
City of Garland, Texas
City of Gladewater, Texas
City of Horseshoe Bay, Texas
City of Idabel, Oklahoma
City of Krum, Texas
City of Lago Vista, Texas
City of Leon Vally, Texas
City of Little Rock, Arkansas
City of Lindale, Texas
City of Mexia, Texas
City of Midland, Texas
City of Missouri City, Texas
City of Moulton, Texas
City of Murphy, Texas
City of New Madrid, Missouri
City of North Lake, Texas
City of Pecos, Texas
City of Pflugerville, Texas
City of Phoenix, Arizona
City of Richmond, Texas
City of Selma, Texas
City of Southside Place, Texas
City of Sweet Water, Texas
City of Webster, Texas
City of Wortham, Texas
Eldorado Area WSD
Fair Management, LC
Gorforth SUD
La Ventana Utilities
MB Wastewater Services, LLC
Quail Valley Utility District
Southern Crossing Utilities
Travis County WCID #17
West Travis County Public Utility Agency
Whiterock Water Supply Corporation

Resume

CONSULTING

Impact Fee Studies

West Travis County Public Utility Agency
City of Southside Place, Texas
City of Cuero, Texas
City of Bastrop, Texas
City of Burnet, Texas
City of Corinth, Texas
City of Missouri City, Texas

Valuation Analysis

Central Texas UDC
West Travis County Public Utility Agency
U.S. Navy
City of Dallas, Texas
Green Valley SUD
City of Fort Worth, Texas

Operations and Management Reviews

Quail Valley Utility District
City of Waco, Texas
City of Bastrop, Texas
City of Uvalde, Texas
City of Gladewater, Texas
City of Galveston, Texas

Other Projects

Central Texas UDC - Facilities Acquisition Negotiations

City of Georgetown/ Chisholm Trail SUD - Regionalization Feasibility

City of Georgetown - Contract Assignment Consents

City of Lakeway – Review of Utility Rates of Lakeway MUD

City of Bee Cave - Litigation Support and Expert Witness Testimony

La Ventana - Litigation Support and Expert Witness Testimony

White Bluff Rate Payers - Litigation Support and Expert Witness Testimony

Canyon Lake Rate Payers – Litigation Support and Expert Witness Testimony

Publications and Presentations

Texas H2O, November/December 2004, "Finding the Water: How to Cope with HB3338"
Office of Rural Community Affairs, 2004 – *Water Related Training for Local Leaders*
Texas Water, 2004 – Professional Paper - *Water Audits, Water Loss and HB3338*
Texas Rural Water Association Annual Conference 2002– Presentation – *Encroachment Issues*
Incode Education Forum, 2007 – *Selling Utility Rate Studies*
Texas Water, 2006 – *Water Loss Determination*
Munis Education Forum, 2006 – *Utility Rate Analysis*
Incode Education Forum, 2006 – *Utility Rate Analysis*
TAWWA Rate Seminar, 2010 - *Utility Rate Analysis*
GFOAT, 2005 – *Capital Financing Seminar*
GFOAT Gulf-Coast Chapter, 2005 – Presentation – *The GFO's Water Challenges*

References

City of Corinth, Texas Cost of Service and Rate Design Study	
Project Description	In 2006, Nelisa Heddin conducted a Cost of Service and Rate Design study for the City of Corinth. As the City had difficulty getting rate recommendations passed in the past, Ms. Heddin worked closely with City staff to develop strategies that would ensure adoption by the City's elected officials and acceptance by the public. The analysis had to consider substantial capital improvements required on the system and developed rates to recover the revenues necessary to keep the system in compliance. Since the original analysis, Ms. Heddin has been invited to assist the City in evaluating rates in 2007, 2008, 2009, 2010 and 2014.
Project Completion	2006, 2007, 2008, 2009, 2010 and 2014
Project Highlights	Cost of Service and Rate Design Benchmarking Analysis Transitional Implementation Plan Capital Improvement Planning
Contact	Lee Ann Bunselmeyer City of Corinth, Texas Director of Finance (940) 498-3280 3300 Corinth Parkway Corinth, Texas 76208 lbunselmeyer@cityofcorinth.com

City of Southside Place, Texas Cost of Service and Rate Design Study	
Project Description	In 2008, Nelisa Heddin conducted a Cost of Service and Rate Design study for the City of Southside Place. The analysis evaluated the cost of providing services to residential and commercial customers and made recommendations to adjustments in rates based upon those costs. Ms. Heddin was asked to return in 2014 to conduct a follow-up study; she is scheduled to present recommendations to City Council in May, 2014.
Project Completion	2008, projected May, 2014
Project Highlights	Cost of Service and Rate Design Transitional Implementation Plan Capital Improvement Planning
Contact	David Moss City of Southside Place, Texas City Manager (713) 668-2341 6309 Edloe Ave Houston, Texas 77005 citymgr@southside-place.org

City of Webster, Texas Cost of Service and Rate Design Study	
Project Description	Nelisa Heddin started working with the City of Webster in 2004 when she conducted a Cost of Service and Rate Design study for the City. At that time, the City was not charging residential customers for water and wastewater services – they had a "live free in Webster" campaign. During the post-9/11 economic downturn, the City could no longer utilize tax-revenues to subsidize their utilities. Ms. Heddin worked closely with City staff to develop a transitional implementation plan which would slowly increase rates over time to achieve cost of service. Ms. Heddin has been asked to assist the City in subsequent studies in 2007 and 2013.
Project Completion	2004, 2007 and 2013
Project Highlights	Cost of Service and Rate Design Transitional Implementation Plan Capital Improvement Planning Public Education
Contact	Mike Rodgers, CPA City of Webster, Texas Director of Finance (281) 316-4102 101 Pennsylvania Ave Webster, Texas 77598 mrodgers@cityofwebster.com

Travis County WCID #17 Cost of Service and Rate Design Study	
Project Description	Nelisa Heddin conducted a cost of service and rate design study for Travis County WCID #17 in 2004 and then performed a subsequent study in 2013 for the District. The focus of the analysis was to derive strategies to allow the District to meet the many challenges of this rapidly growing system and to balance revenue recovery between tax rates, impact fees and rate revenues.
Project Completion	2004 and 2013
Project Highlights	Cost of Service and Rate Design Capital Improvement Planning Public Education
Contact	Deborah Gernes Travis County WCID #17 General Manager (512) 266-1111 Ext. 13 3812 Eck Lane Austin, Texas 78734 dgernes@wcid17.org

West Travis County Public Utility Agency Financial Manager Cost of Service and Rate Design Study	
Project Description	Nelisa Heddin became familiar with the West Travis County water and wastewater systems beginning in 2007 during a contested proceeding between the Lower Colorado River Authority (LCRA) and the City of Bee Cave and eventually testified on the equitability of the rates implemented by the LCRA before the State Office of Administrative Hearings (SOAH). Ultimately, the City of Bee Cave along with Travis County MUD #3 and Hays County purchased the systems and created the West Travis County Public Utility Agency (Agency) to own and operate the systems. Ms. Heddin assisted in the acquisition of the systems and the transition of the operation of the systems to the Agency. Ms. Heddin continues to serve as the Financial Manager for the Agency assisting with budgeting, revenue tracking, and the many challenges associated with this large, regional system. Ms. Heddin has completed 2 cost of service and rate design studies for the Agency – one in 2012 and a follow-up study in 2013. During the most recent study, Ms. Heddin assisted the Agency in developing a strategy to achieve equity among the Agency's 13 wholesale customers.
Project Completion	2012 - present
Project Highlights	Financial Manager Annual Budgeting Impact Fee Analysis Wholesale Rate Analysis Cost of Service and Rate Design Capital Improvement Planning Public Education
Contact	Don Rauschuber West Travis County Public Utility Agency General Manager (512) 413-9300 12117 Bee Cave Rd. Building 3, Suite 120 Bee Cave, Texas 78738 generalmanager@wtcpua.org

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PUC DOCKET NO. 46245

DIRECT TESTIMONY AND WORKPAPERS
OF NELISA HEDDIN

EXHIBIT WBRG-1B

Petition of Sunbelt Utilities for Authority to Change Rates, Docket No. 804, 3 PUC BULL 1167, Examiner's Report (March 22, 1978)

3 Tex. P.U.C. Bull. 1156, 1978 WL 51730 (Tex.P.U.C.)

Petition of Sunbelt Utilities for Authority to Change Rates and Application for Transfer of Certificate of Convenience and Necessity

Docket No. 804

Texas Public Utility Commission

March 22, 1978

*1 EXAMINER'S REPORT

BY THE COMMISSION:Cunningham, Hearings Examiner.

Procedural History

On October 5, 1977, Heather Glenn Company, Oakwilde Company, Northline Corporation, High Meadows Company and Woodland Oaks Company, all affiliated water and sewer companies serving within Harris County, Texas, filed a joint application to transfer their Certificates of Convenience and Necessity to a newly formed partnership, Sunbelt Utilities. On the same date Sunbelt Utilities (Sunbelt) filed with the Commission a statement of intent to alter its rates for consumers residing in unincorporated areas. The two causes were consolidated for purposes of hearing and order.

A pre-hearing conference was held on October 24, 1977. Appearances were made by the Applicant and the Staff. A motion to suspend the proposed rate change filed by the General Counsel was granted and the proposed rate change was suspended for one hundred twenty (120) days beyond the date on which the new rates were to take effect or until further order of the Commission. The Applicant's motion for temporary rates was denied. No protests were filed nor did anyone petition for intervenor status. The hearing was held on December 6, 1977. Subsequent to the hearing, at the request of the Examiner certain additional data was filed as a late filed exhibit by Sunbelt. The material was marked as Sunbelt Exhibit 2 and accepted into evidence without objection by the General Counsel. An Examiner's Report was written and submitted to the Applicant. Exceptions were filed to the Report by the Applicant. At the Commission's Open Meeting of February 7, 1978, the Examiner's Report with Exceptions was considered by the Commission. The Commission remanded the case to the Examiner with instructions to take additional evidence on the application. A second hearing was held on March 7, 1978.

Opinion

I. Transfer

The five companies that petitioned to transfer their certificates to Sunbelt are separate utility companies which are affiliated with other companies that primarily develop and market subdivisions. The companies' stated purpose in consolidating under the name of Sunbelt was to reduce costs. Ms. Blumenthal, the Staff Accountant, testified that upon investigation of the five utility corporations' books and records, she concluded that the granting of the proposed consolidation would result in extensive cross subsidization. She found that because of the ages of the various subdivisions, the net plant assets of the five subdivisions varied in value, forcing consumers in the older subdivisions to subsidize consumers in the newer subdivisions because the return and income tax elements in the later subdivisions' cost of service was less on a per connection basis than the newer subdivisions. She testified that she had not found higher corresponding cost of maintenance in the older subdivisions; however, data was not available for an accurate comparison.

The Examiner recognizes that a certain amount of cross subsidization would result if the consolidation is approved. There are certain savings attributable to consolidation in rate case expenses and bookkeeping. In addition, as Sunbelt has indicated, the consolidated system would provide a broader financial base if financing becomes necessary in the future. It appears that the detriments to consolidation are at least countered to some extent by advantages. Also general Commission policy has been to deal with the largest entity in rate matters where possible when there is no clear harm to consumers. The Examiner thus recommends that the transfer of the five listed utilities' Certificates of Convenience and Necessity to Sunbelt be approved. The five partners are transfering their assets to the partnership in exchange for an interest in the company. A discussion as to the value of those assets will be deferred until later in the opinion when Sunbelt's Rate Base is examined.

II. Rate Case

*2 Sunbelt Utilities is a water and sewer company providing service to 5,215 residential water customers of whom 4,316 are also sewer customers and 84 commercial water and sewer customers. The rate increase requested by Sunbelt represents an increase in adjusted gross operating revenues of approximately 36 percent.

The Sunbelt rate filing package presents certain problems unique to water and sewer utilities built by residential developers. First the various corporate partners wrote off for tax purposes the cost of four of the five utility systems as a cost of development. (Sunbelt Exhibit 1, Willis page 5) This presents a problem of valuation of these assests which have a zero tax basis. Secondly, Sunbelt's capital structure is 100 percent equity, completely eliminating risk associated with financial leverage but forcing the consumers to pay two dollars for each dollar of return earned. These problems will be analyzed in detail because of their importance and because the Commission has not as yet dealt with them.

A. Invested Capital

The various utility corporations that comprise Sunbelt share common ownership with the development corporation. The development corporation installed the utility system and transferred the assets without charge to the individual utility corporations as noted earlier as the development corporation had expensed for tax purposes the cost of four of the systems. (Sunbelt Exhibit 1, Schedule J)

Since this particular situation had not been examined prior to this case, the Examiner requested briefs from the applicant and General Counsel on the valuation issue. In particular the briefs were to examine the transfers from the developer to the utility corporation to determine if they should be treated as contributions in aid of construction. The briefs presented by the General Counsel and the applicant dealt with recent cases in other jurisdictions where such transfers were treated as contributions in aid of construction and deducted from the rate base. In Westwood Lake, Inc. vs Metropolitan Dade County Water and Sewer Board, 203 So. 2d, 363, 71 PUR 3d 260 (Fla. App., 3rd, 1967), both the Florida regulatory agency and the Florida court found that since the developer expensed the cost of the utility system against lot sales for income tax purposes; this conclusively showed that the entire cost of the utility had been recovered through lot sales. The court upheld the agency's conclusion that all utility costs incurred by the developer should be included as contributions in aid of construction and eliminated from the rate base. In Princess Anne Utilities Corporation vs State Corporation Commission, 179 S.E. 2d 714, 88, PUR 3d 519 (Va.App., 1971) and Greenfield Water Company, 53 PUR 3d 67 (N.J. Comm. 1964), the Commissions in Virginia and New Jersey afforded the same treatment to utilities under similar factual situations.

In the instant case, Sunbelt argued that the write-off of utility plant against lot sales for income tax purposes was not evidence that the development corporation had recovered its utility cost, but instead evidence that taxes were to be deferred to a later date. Mr. William S. O'Donnell, Vice President of each of the corporate utility partners and manager of the Sunbelt partnership, outlined the operations of the various corporations that make up the group of

companies hereafter referred to as Suburban. He testified that one of the development Corporations would purchase the undeveloped real estate and make improvements to include the installation of the water and sewer plant. He stated that the price of the lots would be set at the prevailing market price as negotiated by him representing the development corporation and his uncle representing the building corporation. Prior to the sale of lots to the building corporation the development corporation established a utility corporation and transferred the utility assets at zero cost. The development corporations report revenue from lot sales for income tax purposes. From the revenues are deducted the per lot allocation of street, drainage and utility improvements along with other associated costs of development. Mr. O'Donnel testified that the market price of the lots in the subdivision was not dependent to any extent on who owned the utilities. He introduced a summary of lot sales in four subdivisions each developed and built by Suburban companies. The summary represents lot sales from four subdivisions, Heather Glen, High Meadows, Fall Brook and Woodland Trails North; the first two served by private utility systems while the latter two are served by Municipal Utility Districts.

*3 The summary showed very slight price variation among lot prices for the four subdivisions during similar time periods. The company argued this demonstrated that the market controlled the price of lots and the fact that Suburban owned the utilities or not did not affect the lot price. Sunbelt further argued that having demonstrated that ownership of utilities did not affect lot price it followed that the company did not attempt to recover utility cost through lot sales. An expert real estate appraiser testified on behalf of Sunbelt that whether a utility system was privately owned or owned by a municipal utility district did not affect the value of the property. He did admit that the availability of utilities enhances the value of real estate.

In summary, Sunbelt argued that lot revenues had only been shielded from taxation by the write-off for tax purposes of the cost of utility plant.

The Staff Accountant, Ms. Blumenthal, testified that her analysis of the books and records of the various Suburban entities indicated that the development company had recovered a majority of the cost of the utility plant in the various subdivisions because the lots were sold with an allocation of a proportionate share of utility plant assigned to each lot. She felt that the write-off of utility plant against lot sale revenues for income tax purposes was an indication that the development company had recovered its costs of utility plant. The ultimate purchaser of the lot, the home purchaser, thus paid for his proportionate share of the utility plant with the purchase of his home. Applying the same rationale as the Virginia Court in the Princess Ann case it would be necessary to presume a donation of this interest back to the developer who in turn donates the interest to the utility corporation at the time the utility plant is transferred to the utility corporation as a contribution-in-aid of construction. The portion of capital classified as contribution-in-aid of construction would then be removed from rate base.

Examining the Act to determine what treatment would be appropriate from a strict interpretation of the law, one must study the provisions of Section 41 of the PURA which states in part that adjusted value of invested capital shall include "...not less than 60 percent nor more than 75 percent of original cost that is the actual money cost or the actual money value of any consideration paid other than money of the property at the time it shall have been dedicated to public use, whether by utility which is the present owner or by a predecessor, less depreciation..." Clearly the utility plant in the Sunbelt Corporation case is dedicated to public use when the first home buyer takes service. The transfer of the utility plant to the utility corporation occurs prior to the transfer of lots from the development company to the builder, therefore, prior to the time the property is dedicated to public use. The actual money cost paid by the utility corporation to the development corporation was zero. It could thus be argued that the actual money cost of the utility plant at the time it was dedicated to public use would therefore be zero.

*4 Viewing the various Suburban companies as a single entity for purposes of rate base analysis and assuming that the cost of the utility systems was recovered through lot sales, then it can be argued that the Suburban group has recovered the initial investment and to the extent utility revenues exceeded the cash expenses for utility operations in the time period between the utility plant's initial dedication to public use and the present, Suburban has earned a return on this

investment. In a traditional rate making context this would be comparable to allowing a utility that has recovered the cost of a certain expense item such as maintenance by including it as a cost of service item and then capitalizing this expense and charging the consumer depreciation and return for it in later years. Clearly, if this were attempted it would be rejected completely. Disallowing these expensed capital items, whose cost was recovered through lot sales, the following rate bases would result by subdivision:

Description	Heather Glen Company	Northline Corporation	High Meadows Company	Oakwilde Company
Water & Sewer Plant in Service	994,554	566,027	1,296,771	747,285
Accumulated Depreciation	(16,761)	(75,073)	(38,215)	(80,180)
Net Plant	977,793	490,954	1,258,556	667,105
Working Cash Allowance	11,070	13,077	21,729	16,915
Amount Recovered Through Lot Sales	(617,340)	(383,863)	(1,099,517)	(432,251)
Invested Capital	371,523	120,168	180,768	251,769

The total rate base for plant in service based on this analysis would be $924,228.
Sunbelt has proposed that its rate base be reduced so as to recognize the benefits the company received through the total write-off of its utility plant for tax purposes. The following rate base was recommended by Sunbelt in its initial filing: (Note: Sunbelt proposed reclassifying plant held for future use to plant in service at the subsequent hearing.)

Company	Water	Sewer
Utility Plant in Service	2,004,035	1,664,162
Property Held for Future Use	193,448	399,342
Total	2,197,483	2,063,504
Less accumulated Provision for Depreciation	649,747	296,135
Net Plant	1,547,736	1,767,369
Working Capital Allowance	36,751	29,646
Less Accumulated Deferred Income Tax	511,985	495,297
Sub Total	1,072,502	1,301,718

Total	2,374,220

The amount in the "plant held for future use" account represents the water and sewer system installed in Woodland Oaks Subdivision which was allegedly operational and serving consumers at the time of the hearing in December 1977. However, at the March, 1978 hearing, Mr. O'Donnel, managing partner of Sunbelt, testified that there were no consumers using the Woodland Oak's water and sewer facilities as of March 1978. He estimated that approximately 40 consumers would be in the subdivision by December 1978. Later he changed his testimony to say that the 40 would probably be living there by June 1, 1978. As of June 30, 1977, the end of the test year, the water and sewer plant for Woodland Oaks Subdivision was classified as Construction Work in Progress. The testimony originally presented with the rate filing package estimated 40 customers would be on the system by December 31, 1977. The estimated date was changed several times thereafter, as of the March, 1978 hearing no consumers were using the system. Although the Staff Engineer opinioned that the assets of Woodland Oaks were used and useful to the public, the Examiner questions this classification. The utility plant in Woodland Oaks was built to serve future customers. Existing consumers in four other subdivisions are not being served in any way by the Woodland plant. The sewer treatment plant and parts of the water system were built to accommodate Woodland Oak's maximum potential development of approximately 2,000 homes; however, 9 months after the close of the test year not one customer was benefiting from this half million dollar investment. The Examiner would conclude that the assets of Woodland Oaks are not being used by the public and as such the plant classified as plant held for future use should be eliminated from the rate base. The Examiner would further recommend that the investment in this plant be allowed to earn a reasonable return to be capitalized similar to AFUDC.

***5** The Examiner would conclude that Suburban has recovered a majority of its utility plant investment through lot sales and therefore the rate base should be reduced to recognize this prior recovery. The Examiner recommends that Sunbelt be allowed to earn a return on original cost rate base of $924,228.

B. Current Costs of Plant and Depreciation Rates

Mr. Petras, the Staff Engineer, recommended that both the current cost and depreciation rates proposed by the Applicant be adopted as reasonable. The Applicant's current cost study showed a net current cost of $4,573,499 (Sunbelt Exhibit I, Schedule E-1) The Examiner concurred and recommended that the Commission adopt both the depreciation rates used by Sunbelt (Sunbelt Exhibit I, Schedule D-2 page 1 of 1) and the net current cost figure.

C. Adjusted Value of Invested Capital

Sunbelt requested that the adjusted value of invested capital be based on a mixture of 60 percent original cost and 40 percent current costs. Using Sunbelt's proposed rate base reduction and this percentage mix the adjusted value of invested capital rate base is $3,139,686. (See Sunbelt Exhibit I, Schedule B)

The Staff Economist, Mr. Bruce Fairchild, recommended a mix of 68 percent original cost and 32 percent current costs based on his analysis of current inflationary factors within the economy. Applying this mixture to the company's proposed rate base minus the Woodland Oaks assets, its adjusted value rate base is computed as follows:

	Water	Sewer	Total
Plant Original Cost	1,967,875	1,636,762	
Less Accumulated Provision for Depreciation	649,747	296,135	

Less Accumulated Deferred Income Tax	511,985	495,297	
Working Capital Allowance	36,571	29,646	
Sub Total	842,714	874,976	
X Mix percentage of 68%	573,045	594,983	
Total			1,168,028
Net Current Cost	2,460,587	2,768,184	
Less Accumulated Deferred Income Tax	511,985	495,297	
Working Capital	36,571	29,646	
Sub Total	1,985,173	2,302,533	
X Mix percentage of 32%	635,255	736,810	
Total			1,372,066

This calculation results in an adjusted value rate base of $2,540,094.

If the Net Original Cost Rate Base calculated above which is based on recovery of utility costs through lot sales is used the adjusted value rate base becomes $1,402,708.

D. Return

Sunbelt requested a return of 10 percent on adjusted capital or 13.2 percent on its original cost rate base contending that this represented a fair return. Mr. Fairchild, the Staff rate of return expert, recommended a rate of return on equity of 12.30 percent. This would also require a 12.3 percent return on invested capital as the company is 100 percent equity financed.

Mr. Fairchild recommended 12.3 percent return on the basis of his analysis of the risk involved with investing in Sunbelt as opposed to alternative investments with varying degrees of risk. He testified that as a water and sewer utility there was very little business risk associated with Sunbelt. Also Sunbelt operates in a high growth area near Houston minimizing downside risk. Since Sunbelt's customers are primarily residential, there is little risk that they will find alternative sources of water and sewer. The risk of Sunbelt attributable to financial leverage is presently non-existent since the company has no debt in its capital structure. He found some risk of the City of Houston annexing part of the system without adequately compensating the investors. He concluded that Sunbelt was somewhat less risky than the average company.

In evaluating opportunity costs associated with investing in Sunbelt, Mr. Fairchild compared such an investment with an investment in long term utility bonds. Noting that such an investment currently yields a return of 8.58 percent, he further testified that an investment in these bonds was less risky than an investment in Sunbelt. He concluded that an average investor would want a premium of 35 to 40 percent over base yield to be attracted to Sunbelt. This led to his recommended range of return of between 11.58 to 12.58 percent. Comparing returns of other investor owned companies he found the average return over the past six years has been 8.35 percent with class A-1 water utilities averaging 9.45 percent. Based on his analysis he recommends a return of 12.3 percent.

*6 Mr. Fairchild also presented testimony on the reduced Cost of Service that could be achieved if Sunbelt's capital structure included debt. For purposes of illustration Mr. Fairchild imputed a capital structure to Sunbelt of 60 percent equity and 40 percent debt. He assumed that Sunbelt could secure debt at a cost of 10 percent. With debt in the capital structure he felt that the return on equity would have to increase to 13.25 percent. The composite return on the company's proposed rate base would drop to $283,720. The real savings to the consumer would come in Federal income tax expense which would decrease $95,334 from the $268,320 computed to provide a 12.3 percent return. Return plus income tax expense under the alternative structure would be $456,706. Under the company's current structure and proposed return the total would be $602,539. The difference of $145,833 is significant and for this reason the company should be encouraged to attempt to include long term debt in its capital structure.

The Examiner agrees that Sunbelt represents a company whose risk is below average. The Company argued that the investors were locked into their investment because there was no market for their stock. This is no doubt true, but some thought must be given to how the investors got into their locked in position. The investors in this instance are a group of stockholders whose primary concern is development and sale of residential subdivisions. The water and sewer systems are a necessary part of the overall investment providing the investors with an opportunity to earn a higher return on the more risky business of residential developments. For those investors to be paid a high premium over current utility bond yields seems unjustified.

The Examiner finds the 100 percent equity funding a rather expensive luxury for consumers but one which would tend to push down risk as discussed earlier along with necessary return. Because of the low risk factors discussed previously it would appear that a return of 12 percent on invested capital or net original cost rate base would be adequate. This would yield a dollar return of $213,771 using the company's adjusted rate base or $110,907 using the rate base recognizing the lot sale contribution. Since both the affiliated lumber and realty companies included a management fee in their contract charges it would appear that this would be sufficient management incentive if the lower rate base is approved without augmenting return by an amount for incentive.

E. Cost of Service

The following represents costs generally grouped as O & M by Sunbelt which were incurred during the test year as well as proposed adjustments:

Description	Test Year	Adjustment	Total
1. Operation & Maintenance Contracted Amount $.90/connection to $1.97/connection	$100,383	$124,912	$225,295
2. Cost of Maintenance outside contract	55,601	2,361	57,962
3. Customer Billing Contracted	98,390	827	99,217

4. Fuel & Purchased Power	74,504	9,573		84,077
5. Administration & General	27,479	9,643		37,122
6. Rate Case Expense	-	25,038	a1	25,038
7. Annual Audit and Rate Evaluation	-	13,000		13,000
8 Chemicals	12,473	113		12,586
TOTAL	$368,830	$185,467		$554,307

a1 Total $50,075 amortized over two years.

*7 The following is a list of charges used to compute the $1.97/customer/month charge for system maintenance:

Description		
Direct Labor		79,046
Supervision		56,020
Total Salaries and Wages		135,066
Fringe Benefits (20%)		27,013
Rent of Equipment		40,200
Sub Total		202,279
Profit Margin @15%		30,340
Total Cost		232,619
Number of Customers - Water	5,215	
Number of Customers - Sewer	4,316	9,830

$$\text{Monthly Cost per Connection} = \frac{232,619}{9,830} = \$1.97$$

1. Each of the utility corporations had a maintenance contract with the Suburban Homes Lumber for maintenance of the water and sewer systems at a charge of $.90 per connection. This charge did not include repair of major breaks, outside labor required or materials other than normal maintenance. After consulting with the outside experts and realizing that the City of Houston had raised rates twice since September 1, 1975, Sunbelt proposed to up the maintenance charge to

$1.97/connection representing a 119 percent increase. It was pointed out that other companies charge more thus justifying the enormous increase.

2. Ms. Blumenthal found that the sum for maintenance performed outside the contract included a charge of $3,394 for installation of meters and recommended this be deducted as not a proper expense.

3. The Billing Cost is also a contracted service provided by Suburban Homes Realty at a cost of 10 percent of collections.

4. Fuel and purchased power was increased to recognize an increase in cost of electricity.

5. Administration and General expenses reflect higher insurance costs primarily.

6. Rate case expense through February 21, 1978 was $50,075, an additional $14,563 was estimated to cover expenses through the completion of the hearing. The company proposed amortizing the amount of a two year period with the balance earning 10 percent until expensed. Ms. Blumenthal recommended amortizing over a 3 year period and reducing the amount by $8,370, the amount attributed to creating the financial books for the companies reasoning that this was a one time non-recurring expense.

7. The audit credit and rate evaluation expense is a projected future expense which Ms. Blumenthal recommended be disallowed as not being an actual expense and too speculative to measure.

8. Chemicals expense related to chemical treatment for water and sewer.

Making the adjustments recommended by Ms. Blumenthal, the total Operation and Maintenance Expense is reduced by $22,676 resulting in a total of $531,720 to be included in the cost of service.

Depreciation expense to be allowed will be dependent on whether the rate base is reduced by lot sale recovery or not. If not the total depreciation expense of $111,155 is reasonable. This represents a depreciation rate of approximately 3 percent. If this rate is applied against the net plant reduced by lot sale recovery the depreciation expense is computed to be $861,437 x 3 percent equals $25,843.

***8** The Company has proposed that income tax expense be "flowed through" to the consumers which would result in a flowing through of higher taxes while the tax write- offs inured solely to the benefits of the owners. For this reason the Examiner recommends that income tax expense be normalized. Again depending on which rate base treatment is approved income tax expense will be either $93,480 or $23,290.

The total cost of service using the rate base approach generally recommended by Sunbelt with adjustments recommended by the Examiner including other taxes not discussed totaling $69,171 would be $1,019,292 leaving a revenue deficiency of $36,758. If the rate base is reduced to take into effect the recovery of utility plant through lot/home sales the cost of service becomes $760,931 leaving a revenue excess of $221,603.

F. Rate Design

The company proposed to increase its sewer rates from $2.53/month/customer (Including 2,000 gallons pegged to water consumption) with a charge of $.76/1,000 gallons after that to $7.58 for the first two thousand and $ .95/1,000 gallons after the first two thousand. The water rates were to be increased from the current $4.48/customer/month for the first two thousand gallons with a commodity charge of $1.13/1,000 gallons for consumption over 2,000 but less than 18,000 and $.99/1,000 gallons for consumption in excess of 20,000 gallons per month to a charge of $6 70/customer/month to include the first 2,000 gallons of usage and a level commodity charge of $.81/1,000 for consumption over 2,000 gallons in

one month. The new rates were designed to generate the company's proposed cost of service. Using the same approach as proposed by the company with the lower cost of service recommended by the Examiner the new water and sewer rates would be computed as follows:

	Water	Sewer
Commodity Costs	$ 47,244	$ 59,259
Customer Costs	98,244	60,180
Capacity Costs	244,920	241,720

(See Sunbelt Exhibit I Schedule P)

a. Commodity Charge = $\frac{\text{½ Customer Costs + ½ Capacity + Commodity}}{\text{Total Consumption}}$

Sewer Commodity Charge = $\frac{215{,}205}{366{,}551}$ (Consumption in 1,000 gals) (Sunbelt Exhibit I Schedule P) = $.60/1,000 gal.

Water Commodity Charge = $\frac{218{,}826}{443{,}316}$ (Consumption in 1,000 gal) (Sunbelt Exhibit I Schedule P) = $.50/1,000 gal.

b. Service Availability =

$\frac{\text{½ Capacity Costs + ½ Customer Costs}}{\text{No. of Connections x 12 Months}}$ + Commodity for 2,000 gal.

Water Service Availability = $\frac{\$171{,}582}{5215 \times 12}$ + 2(.50) = $3.75/customer/month

Sewer Service Availability = $\frac{155{,}950}{4316 \times 12}$ + 2(.60) = $4.20/customer/month

The recommended water rates are $3.75 per customer per month for the first 2,000 gallons of usage and a level commodity charge of $.50 per 1,000 gallons for usage over 2,000 gallons. The recommended sewer rates are $4.20 per customer per month for the first 2,000 gallons of water usage and a level commodity charge of $.60/1,000 gallons of water usage over 2,000 gallons.

***9 Findings of Fact**

1. Heather Glenn Company, Oakwilde Company, Northline Corporation, High Meadows Company and Woodland Oaks Company are affiliated companies holding certificates for water and sewer operations in Harris County Texas.
2. The five companies listed in Finding of Fact No. 1 applied to transfer their Certificates of Convenience and Necessity to a newly formed partnership Sunbelt Utilities in exchange for an interest in the partnership.

3. Since the partnership will be composed of the seperate certificate holders and operations will remain as before, the transferee has the capacity to continue to provide service to the public.

4. Sunbelt is a partnership providing water and sewer utility service to approximately 5,000 consumers in Harris County.

5. The net current cost of Sunbelt is $4,573,499.

6. The depreciation rates proposed by Sunbelt and recommended by the Staff Engineer as listed in Sunbelt Exhibit I Schedule D-2 are reasonable and should be adopted.

7. The invested capital of Sunbelt is $924,228 as computed by the Examiner in paragraph II A of the Opinion.

8. The adjusted value of invested capital of Sunbelt is $1,402,708 as computed in Paragraph C of the Opinion.

9. The test period operating revenues of Sunbelt are $982,534 as reflected in Sunbelt Exhibit I, Schedule K.

10. A reasonable return on invested capital is 12.0 percent or $110,907 as discussed in paragraph D of the Opinion.

11. The Cost of Service for Sunbelt is $760,931 as discussed in paragraph E of the opinion.

12. The revenue excess of Sunbelt is $221,603.

13. The rates to be charged by Sunbelt are as follows: Water Rate - $3.75 per month per customer which includes the first 2,000 gallons of water usage and a level charge of $.50 per 1,000 gallons of water consumed for usage over 2,000 gallons; Sewer Rate - $4.20 per customer per month which includes the first 2,000 gallons of water usage and a level charge of $.60 per 1,000 gallons of water usage over 2,000 gallons.

Conclusions of Law

1. The Commission has jurisdiction of this matter pursuant to art. 1446c, §§ 43 and 59 V.A.C.S.

2. Sunbelt has the burden of proof to establish its revenue deficiency which would be collected under the proposed rates.

3. Sunbelt has failed to prove that it has a revenue deficiency.

APPROVED on the 22d day of March, 1978.

End of Document

SOAH DOCKET NO. 473-17-0119.WS
PUC DOCKET NO. 46245

DIRECT TESTIMONY AND WORKPAPERS
OF NELISA HEDDIN

EXHIBIT WBRG-1C

Sunbelt Utilities v. PUC
589 S.W.2d 392 (Tex. 1979)

589 S.W.2d 392
Supreme Court of Texas.

SUNBELT UTILITIES, Appellant,
v.
PUBLIC UTILITY COMMISSION of Texas, Appellee.

No. B-8252.
|
Oct. 31, 1979.
|
Rehearing Denied Dec. 12, 1979.

Direct appeal was taken from judgment of the District Court, No. 53, Travis County, Lowry, J., upholding Public Utility Commission's order excluding developer's cost of utility system from rate base. The Supreme Court, Barrow, J., held that: (1) evidence supported finding that purchasers of lots in subdivisions had paid developer's cost of utility system as part of purchase price of their lots; (2) exclusion of developer's cost from utility's rate base did not amount to unconstitutional confiscation of utility's property; and (3) utility was not entitled to depreciation on property contributed to it in aid of construction.

Affirmed.

West Headnotes (5)

[1] Public Utilities
Value of Property;Rate Base

For purposes of utility rate base, "contributions in aid of construction" are donations or contributions in cash, services or property from others for construction purposes.

1 Cases that cite this headnote

[2] Public Utilities
Value of Property;Rate Base

Consumer contributions in aid of construction should be excluded from a utility's rate base. Vernon's Ann.Civ.St. art. 1446c, §§ 39, 41(a).

1 Cases that cite this headnote

[3] Public Utilities
Evidence

Evidence supported finding of Public Utility Commission that purchasers of lots in subdivisions had paid developer's cost of utility system as part of purchase price of their lots, in case in which utility sought to include developer's cost in its rate base. Vernon's Ann.Civ.St. art. 1446c, §§ 39, 41(a).

Cases that cite this headnote

[4] Public Utilities
Value of Property;Rate Base

Utility was not entitled to rate of return on developer's cost of utility system, where purchasers of lots in subdivisions had paid that cost as part of purchase price; thus that cost was properly excluded from utility's rate base and such exclusion was not unconstitutional confiscation of utility's property. U.S.C.A.Const. Amend. 5; Vernon's Ann.St.Const. art. 1, § 17.

1 Cases that cite this headnote

[5] Public Utilities
Evidence

Substantial evidence supported holding that utility was not entitled to depreciation on property contributed to it in aid of construction, in determining rate base. Vernon's Ann.Civ.St. art. 1446c, §§ 39, 41(a); U.S.C.A.Const. Amend. 5; Vernon's Ann.St.Const. art. 1, § 17.

2 Cases that cite this headnote

Attorneys and Law Firms

*392 David Claflin, Austin, Kronzer, Abraham & Watkins, W. James Kronzer, Houston, for appellant.

Mark White, Atty. Gen., Joyce Beasley, Asst. Atty. Gen., Austin, for appellee.

Opinion

BARROW, Justice.

[1] This is a direct appeal raising a question of first impression in Texas on the issue of contributions in aid of construction in utility rate base making. [1] The principal question presented is whether the Commission properly excluded the developer's cost of the utility system from the rate base because the rate payers had already paid for this system as a part of the purchase price of their lots. We agree that these ***393** costs were properly excluded as contributions in aid of construction. Accordingly, we affirm the judgment of the district court which upheld the Commission's order.

1 "Contributions in aid of construction" may be defined as donations or contributions in cash, services or property from states, municipalities or other governmental agencies, individuals, and others for construction purposes. See State ex rel. Util. Com'n v. Heater Util., Inc., 288 N.C. 457, 219 S.E.2d 56 (1975).

Sunbelt Utilities, a partnership composed of five corporations which are owned and controlled by William S. O'Donnell and his immediate family, filed an application and statement of intent to raise rates with the Public Utility Commission of Texas. The Commission excluded nearly $800,000 from Sunbelt's asserted rate base of $2,374,262 because these sums had been expensed (written off) by the development companies prior to gratuitous transfer of the utility systems to the "brother-sister" utility corporations for each subdivision. The development companies exercised their option under rules of the Internal Revenue Service to write off in the year of sale of the lots the cost of the utility system. All of these companies have common ownership. Each of the five related utility companies is a partner in Sunbelt and the profits or losses of Sunbelt are to be shared in proportion to the number of connections in each subdivision.

The statute grants a utility the right to earn a reasonable rate of return on its invested capital. Art. 1446c s 39. [2] The adjusted value of the utility's invested capital is the foundation of the rate base. Art. 1446c, s 41(a); Southwestern Bell Tel. v. Public Utility Com'n, 571 S.W.2d 503 (Tex.1978). See Webb, Utility Rate Base Valuation in an Inflationary Economy, 28 Baylor L.Rev. 823 (1976); Nichols & Fields, Rate Base Under PURA: How Firm is the Foundation?, 28 Baylor L.Rev. 861 (1976). As a hypothetical example, assume that the adjusted value of the utility's invested capital is $1,000. This will be the rate base. Assume further the utility is granted a twelve percent rate of return. It will then earn $120 on its adjusted value of invested capital. There is no dispute here as to the valuation of the utility system or the twelve percent rate of return found by the Commission.

2 All statutory references are to Texas Revised Civil Statutes Annotated.

[2] Sunbelt does not question the rule which is well established in other jurisdictions that contributions by a customer in aid of construction are properly excluded from the rate base. Under this rule the utility is not allowed to earn a rate of return on property acquired from or paid for by the rate payer. See Du Page Utility Co. v. Illinois Commerce Com'n, 47 Ill.2d 550, 267 N.E.2d 662 (1971); State ex rel. Util. Com'n v. Heater Util., Inc., 288 N.C. 457, 219 S.E.2d 56 (1975); 1 Priest, Principles of Public Utility Regulation at 177 (1969). The parties have not cited us a Texas case on this point and we have found none. However, we believe this rule is correct and here hold that consumer contributions in aid of construction should be excluded from a utility's rate base.

This brings us to the pivotal question in this case: Were the developer's costs of constructing the utility system recovered from the rate payers as a part of the purchase price of their lots? Sunbelt agrees that if the developers recovered the cost of the system in the lot sales price, such recovery should be carried over to the Sunbelt partnership because of the identity of ownership between the developer companies and the utility companies.

The crucial facts are undisputed. The development company in each subdivision installed the utilities, streets, sidewalks, and curbs so as to make the property marketable. The lots were then transferred to a related building corporation. Since most of the financing for the home construction was to be from the Veterans Administration or Federal Housing Administration, the utility system for each subdivision was deeded to a utility company for that subdivision under a trust indenture as required by the FHA. The developer took advantage of a provision of the federal income tax laws and wrote off in

one year the entire cost of the utility system.[3] In *394 Willow Terrace Development Co. v. Commissioner of Internal Revenue, 345 F.2d 933 (5th Cir. 1965), the court overruled the Commissioner and upheld the developer-taxpayer's right to deduct the cost of the water and sewage disposal system from the sums realized from sale of the property in the subdivision. Likewise here, the entire cost of the utility system was expensed against the amount realized from sale of the lots.[4] That is, the development corporation deducted the water and sewer systems' cost from lot sales revenue to determine taxable income and paid a lesser amount of federal income tax than would have been paid had the tax write-off not been taken.

3 As a general proposition, expenditures for capital items such as water and sewer systems would not be treated as current expenses because the useful life of the systems extends beyond the period the expenditures were made. However, developers are accorded the right to charge off these expenses in one year rather than capitalize them.

4 Some of the lots were not so treated and this part of the expense was included without objection in the rate base. However, the parties have briefed the question as if all costs were recovered by the developer.

Since the development companies were in a forty-eight percent tax bracket, Sunbelt urges that it received only this percentage of the development costs and should be entitled to include the remainder in its rate base. On the other hand, the Commission concluded that since the entire cost of the utility system was expensed by the development companies against the amount realized from sale of the lots, the rate payers had already paid for the utility system and these costs should be excluded from the rate base.

While this problem is one of first impression in this state, it has been considered by courts and regulatory bodies in other states. The uniform rule followed in these cases is that when a developer has recovered all or a part of the cost of the utility system through the sale of lots, the regulatory body has excluded that amount from the utility's rate base. The recovery of this cost by the developer in its sale of lots is treated as a contribution in aid of construction. See Florida Cities Water Co. v. Board of Cty. Com'rs, 334 So.2d 622 (Fla.App.2d 1976); Westwood Lake v. Metropolitan Dade Co. W. & S. Bd., 203 So.2d 363 (Fla.App.3d 1967); Du Page Utility Co. v. Illinois Commerce Com'n, supra; Killarney Water Co. v. Illinois Commerce Com'n, 37 Ill.2d 345, 226 N.E.2d 858 (1967); State ex rel. Util. Com'n v. Heater Util., Inc., supra; Princess Anne Util. C. v. Commonwealth ex rel. S.C.C., 211 Va. 620, 179 S.E.2d 714 (1971); In Re Green-Fields Water Co., 53 PUR3d 670 (N.J.Bd. of Public Utility Commissioners 1964).

Sunbelt urges that these cases are distinguishable because there was no substantial evidence to support an agreement that a part of the purchase price of the lots included the costs of the utility system. Mr. O'Donnell specifically denied that the utility costs were included in the sales price of the lots and, in fact, said they were not considered in determining the price of the lots. He pointed out that a few of the lots in one of the subdivisions were in a metropolitan water district and that these lots were sold for essentially the same price. Nevertheless, he conceded that the availability of the utility systems made the lots marketable as home sites. Necessarily, this increased the value of the lots. It would be folly for any developer to say that he did not take into consideration the cost of making the subdivision marketable when he determined the price necessary to make a profit. Furthermore, it is undisputed that the entire cost of the utility system was expensed by the developer against the sum realized from the sale of the lots. Having been fully written off, the developer had a zero rate base insofar as these costs are concerned when the system was transferred without cost to the utility company.

An argument similar to that urged by Sunbelt was rejected in Princess Anne Util. C. v. Commonwealth ex rel. S.C.C., supra. In doing so, the court said:

> "It is true that there was no actual testimony before the Commission relating to what it seems made up the prices of the homes purchased by those who became customers of the utility company. *395 But it would be wholly unrealistic to say that the costs of the sewerage facilities contributed by the land development companies were not passed on to those customers. As the Commission pointed out in its opinion, it is common practice in real estate development to finance construction of sewerage facilities by the contribution method employed in this case, with the cost of such construction reflected in the prices paid by the purchasers of homes in the finished development. That the same result occurred in this case there can be no doubt. Neither the Commission nor this court

needs testimony to tell it what is a matter of common knowledge.

"Thus, to allow the utility company a return on contributions in aid of construction would have the effect of requiring the customers to pay twice for the same property. This would be unjust. Such contributions were, therefore, properly excluded by the Commission in determining rate base."

Also, in Florida Cities Water Co. v. Board of Cty. Com'rs, supra, it was said that "a reasonable inference may be drawn that the source of these monies (to build the facilities) came from the sale of the lots." See also Du Page Utility Co. v. Illinois Commerce Com'n, supra.

[3] [4] We conclude that the finding of the Commission, that the purchasers of the lots in the subdivisions had paid the developer's cost of the utility system as a part of the purchase price of their lots, is reasonably supported by substantial evidence. See Southwestern Bell Tel. v. Public Utility Com'n, supra. Sunbelt is therefore not entitled to a rate of return on this contributed property and this cost was properly excluded from its rate base. This exclusion did not amount to an illegal confiscation of Sunbelt's property in violation of the 5th Amendment to the United States Constitution or of Art. 1, s 17 of the Texas Constitution.

[5] Sunbelt argues that if we should conclude that these expensed costs of the utility system are found to be contributions in aid of construction, it should, in any event, be entitled to depreciation on this contributed property. We have not found any Texas authority on this question and the authorities in other states are divided. In Princess Anne Util. C. v. Commonwealth ex rel. S.C.C., supra, depreciation was not allowed by the Commission on contributed property for the reason that where there was no investment, there was nothing to be recovered through depreciation. The court held that the Commission had not abused its discretion in denying depreciation. On the other hand, the court in Du Page Utility Co. v. Illinois Commerce Com'n, supra, held that the Commission had not abused its discretion in allowing depreciation on the contributed property for the reason that Du Page would be required to replace the system from time to time.

The Examiner's Report which was adopted by the Commission held, without discussion of the question, that depreciation expense should not be allowed on the costs excluded from the rate base. We agree that this holding is reasonably supported by substantial evidence.

The judgment of the trial court is affirmed.

All Citations

589 S.W.2d 392

End of Document

SOAH DOCKET NO. 473-17-0119.WS
PUC DOCKET NO. 46245

DIRECT TESTIMONY AND WORKPAPERS
OF NELISA HEDDIN

WBRG-1D

Double Diamond Corporate Structure

Parent Corporation

Company	Shareholder	Director(s)	Officers
Double Diamond – Delaware, Inc. DE Charter No. 8254222 FEIN52-2017265 PIN G977-626 1105 N. Market St., Suite 1140 Wilmington, DE 19801	R. Mike Ward - 94.8% ESOP- 5.2%	R. Mike Ward R. Jeffrey Schmidt Donald R. McLamb	R. Mike Ward/President Donald R. McLamb/Asst. V. P. Kevin Shea/Secretary Shawna Shumate/Asst. Sec.

Subsidiary Corporations

Company	Shareholder	Director(s)	Officers
Double Diamond, Inc. (fka Double Diamond-TX, Inc) TX Charter No.144584300 FEIN 75-2711595 5495 Belt Line Rd. Suite 200 Dallas, TX 75254	DD-Del., Inc	R. Mike Ward	R. Mike Ward/President Keith Brock/Vice President & Treasurer Kevin Shea, Vice President Shawna Shumate/Secretary Jennifer Pickens/Vice President (execution only)

Company	Shareholder	Director(s)	Officers
Double Diamond Properties Construction Co. TX Charter No. 142738600 PA Charter No. 2806512 FEIN 75-2684578 PA Tax/Box No.2000537 5495 Belt Line Rd. Suite 200 Dallas, TX 75254	DD-Del., Inc.	R. Mike Ward Randy Gracy	Randy Gracy/President R. Mike Ward/Vice Pres. Shawna Shumate/Secretary

Double Diamond Utilities Co. TX Charter No. 01427171 FEIN 75-2684599. 5495 Belt Line Rd. Suite 200 Dallas, TX 75254	DD-Del., Inc.	R. Mike Ward Randy Gracy	Randy Gracy/President R. Mike Ward/Vice Pres. Shawna Shumate/ Sec

Rock Creek Club Corp. TX Charter No. 800603557 EIN 30-0350400 5495 Belt Line Rd. Suite 200 Dallas, TX 75254	DD-Del. Inc.	R. Mike Ward	R. Mike Ward/President Kevin Shea – Vice President Shawna Shumate - Sec.

Company	Shareholder	Director(s)	Officers
Rock Creek Golf, Inc. TX Charter No. 800851222 EIN 26-0842273 5495 Belt Line Rd. Suite 200 Dallas, TX 75254	DD-Del. Inc.	R. Mike Ward	R. Mike Ward/President Kevin Shea VP Shawna Shumate – Sec.

Rock Creek Resort, Inc. TX Charter No. 800603567 EIN 32-0169527 5495 Belt Line Rd. Suite 200 Dallas, TX 75254	DD-Del. Inc.	R. Mike Ward	R. Mike Ward/President Kevin Shea - VP Shawna Shumate – Sec

Rock Creek Yacht Club, Inc. TX Charter No. 800779914 EIN 20-8538507 5495 Belt Line Rd. Suite 200 Dallas, TX 75254	DD-Del. Inc.	R. Mike Ward	R. Mike Ward/President Kevin Shea -VP & Treas. Randy Gracy/VP & Sec.

SOAH DOCKET NO. 473-17-0119.WS
PUC DOCKET NO. 46245

DIRECT TESTIMONY AND WORKPAPERS
OF NELISA HEDDIN

EXHIBITWBRG-1E

DDU Certificate of Incorporation (December 30, 1996)

0022990262

ARTICLES OF INCORPORATION

OF

DOUBLE DIAMOND UTILITIES CO.

FILED
In the Office of the
Secretary of State of Texas

DEC 3 0 1996

Corporations Section

The undersigned natural person of the age of eighteen (18) years or more acting as incorporator of a corporation under the Texas Business Corporation Act, hereby adopts the following Articles of Incorporation:

ARTICLE ONE

The name of the corporation is Double Diamond Utilities, Co.

ARTICLE TWO

The period of its duration is perpetual.

ARTICLE THREE

The purpose for which the corporation is organized is the transaction of any and all lawful business for which corporations may be incorporated under the Texas Business Corporation Act.

ARTICLE FOUR

The aggregate number of shares which the corporation shall have authority to issue is One Hundred Thousand (100,000) at the par value of One Dollar ($1.00).

ARTICLE FIVE

The corporation will not commence business until it has received for the issuance of shares consideration of value of One Thousand Dollars ($1,000.00) consisting of money, labor done or property actually received.

ARTICLE SIX

The street address of its initial registered office is 3500 Maple Avenue, Suite 1400, Dallas, Texas 75219, and the name of its initial registered agent at such address is William Palmer.

ARTICLE SEVEN

The number of directors constituting the initial board of directors is two (2), and the name and address of the persons who are to serve as the director until the first annual meeting of the shareholders or until his successor is elected and qualified are:

0 0 2 2 9 9 0 2 0 6 3

R. Mike Ward
3500 Maple Avenue, Suite 1400
Dallas, Texas 75219

Randy Gracy
3500 Maple Avenue, Suite 1400
Dallas, Texas 75219

ARTICLE EIGHT

The name and address of the incorporator is:

William Palmer
3500 Maple Avenue, Suite 1400
Dallas, Texas 75219

Signed this 30th day of December, 1996.

William Palmer

SOAH DOCKET NO. 473-17-0119.WS
PUC DOCKET NO. 46245

DIRECT TESTIMONY AND WORKPAPERS
OF NELISA HEDDIN

EXHIBIT WBRG-1F

Double Diamond Website

ABOUT US

EAGLE ROCK RESORT
BLUE MOUNTAINS, PA

LOST LAKE RESORT
FORESTBURGH NY

ROCK CREEK
LAKE TEXOMA TX

THE CLIFFS RESORT
POSSUM KINGDOM LAKE TX

THE RETREAT
CLEBURNE TX

WHITE BLUFF RESORT
LAKE WHITNEY, TX

VOTE

Double Diamond Companies

Double Diamond is a premier developer of residential golf communities. With over 16,000 acres of land extended across six upscale resort properties, we provide an ideal and attainable lifestyle for families of all ages.

Double Diamond Companies was established in 1972 and since that time have been based in Dallas, Texas. Double Diamond's executive team consists of experienced industry leaders specializing in all facets of resort design, development, operation, marketing, and acquisitions. Challenging golf courses, timeless architecture, superb locations and unprecedented consumer appeal are the hallmarks of the company.

SOAH DOCKET NO. 473-17-0119.WS
PUC DOCKET NO. 46245

DIRECT TESTIMONY AND WORKPAPERS
OF NELISA HEDDIN

WBRG-1G
White Bluff Real Estate Sales Contract

REAL ESTATE SALES CONTRACT

THE STATE OF TEXAS §
§
COUNTY OF HILL §

WHITE BLUFF SUBDIVISION

This REAL ESTATE SALES CONTRACT is entered into effective *«mmddyy»* by and between DOUBLE DIAMOND, INC., a Texas corporation, 5495 Belt Line Road, Suite 200, Dallas, Texas 75254 (hereinafter referred to as the "Seller") and

NAME(S) *«PURCHNAME» «RELATION» «PURCHNAME2»*

STREET ADDRESS *«ADDRESS»*

CITY, STATE & ZIP *«CITYSTZIP»*

TELEPHONE *«TELE»*

(hereinafter referred to as the "Purchaser," whether one or more) upon the following terms and conditions:

1. SALE AND PURCHASE. Seller hereby promises and agrees to sell and convey to Purchaser, and Purchaser hereby promises and agrees to purchase from Seller the surface estate only of:

LOT(S) *«LOT»* of the WHITE BLUFF «SECTION» SUBDIVISION, according to the subdivision plat thereof filed for record in the Plat Records of Hill County, Texas,

(such lot(s) referred to hereinafter as the "Property").

2. PURCHASE PRICE. The purchase price for the Property shall be *$«purprice»* (the "Purchase Price").

3. METHOD OF PURCHASE. Purchaser elects to purchase the Property:

___ by payment of the Purchase Price in full.

___ by deferred installments (the "Deferred Payment Plan") which includes a cash down payment of *$«downpmt»* made this date, and Purchaser's promise to pay Seller, its successors and assigns, the original principal balance of *$«amtfin»*, bearing interest at the rate of «ANNUALRATE» («Annual_Rateno») percent per annum for and payable in a total of *«NOMONYR1»* consecutive monthly installments of *$«INSTPMTYR1»*, as more fully described and evidenced by that certain promissory note executed contemporaneously herewith by Purchaser (the "Note"). All payments due under the Note shall be made in Dallas County, Texas at Seller's address unless another address shall be furnished to Purchaser by Seller. A late fee of $25.00 is charged on all accounts if not paid within 15 days of each monthly due date. Prior to conveyance of title to the Property, Seller shall retain legal title to the Property as security for Purchaser's full performance of all the terms and conditions herein. After conveyance of title to the Property, as security for full performance by Purchaser of all applicable terms, conditions and obligations herein, Seller shall retain a deed of trust lien covering the Property, as provided in that certain Deed of Trust executed contemporaneously herewith by Purchaser (the "Deed of Trust"). Said Deed of Trust shall also secure other and future indebtedness, if any, of Purchaser to Seller.

4. DELIVERY OF DEED. Within 180 days of the date of this Contract, Seller shall deliver to Purchaser a General Warranty Deed (the "Deed") conveying fee simple title to the Property (save and except oil, gas and other minerals) free and clear of any liens (other than Purchaser's deed of trust lien if the Property is purchased from Seller under the Deferred Payment Plan) but subject to all reservations, restrictions, easements and rights-of-way which may affect the Property as recorded in the Public Records of Hill County, Texas.

5. CLOSING COSTS AND RECORDING FEES. Purchaser agrees to pay Seller $25.00 for recording fees and costs of filing the documents to be recorded hereunder. No other closing fees or costs are payable by Purchaser.

6. TAXES. Purchaser shall be responsible for paying property taxes next due and payable after the date of this Contract. Purchaser agrees and promises to promptly pay, when due, all such property taxes and other taxes which may hereafter be taxed against the Property.

7. TITLE INSURANCE. Seller does not provide title insurance covering the Property. Purchaser should either obtain title insurance from a title company authorized to do business in Hill County, Texas or have the abstract covering the Property examined by an attorney of Purchaser's choice.

8. CENTRAL WATER & SEWER SYSTEMS. Potable water will be provided to all lots in the subdivision from a central water system. Sewage collection and disposal will be provided to all lots in the subdivision (except lots 1-40, 42, 49-71, 73-101, 119-142, 324-370, 373-396, 398-425, 439-453, 520-528, 608-642, 650-652 and 659-767 of the White Bluff Subdivision, lots 1-60 of the White Bluff Five Subdivision, lots 1 - 88 of the White Bluff Thirty Subdivision, lots 1-70 of the White Bluff Thirty-Three Subdivision and lots 1-77 of the White Bluff Thirty-Six Subdivision) from a central sewer system. Purchaser will be responsible for installing and

maintaining an individual septic tank system on the lots herein above listed which are not served by the central sewer system.

9. ROADS, RECREATIONAL FACILITIES AND CENTRAL SYSTEMS. The following is Seller's good faith estimate with respect to, and the obligation to provide and complete, certain items within the White Bluff Subdivision:

ITEM	YEAR OF COMPLETION	PARTY RESPONSIBLE FOR PROVIDING	PARTY RESPONSIBLE FOR MAINTAINING
A Roads	Complete	Seller	Property Owners Assn. ("POA")out of annual maintenance fee funds
B. Recreation Facilities 4 swimming pools, 3 tennis courts, recreational pavilion, 2 R V. parks, marina facilities with 73 boat slips, and exercise facilities.	Complete	Seller	POA out of maintenance fee funds
C. Amenities two eighteen-hole golf courses	Complete	Seller	POA out of maintenance fee funds
two club houses with pro-shops, 47 room hotel and convention center, and 34 rental condominiums	Complete	Seller	Seller's Affiliated Companies
D. Central Water System (1) Water lines	Complete	Seller	Double Diamond Utilities Co. ("Utility Co.")
(2) Water wells and storage tanks Phases 1 and 2 (483-1400 lots)	Complete	Seller	Utility Co.
Phase 3 (if needed - all remaining lots)	Complete	Seller	Utility Co.
E Central Sewer System (1) Sewer lines	Complete	Seller	Utility Co.
(2) Storage & Treatment Plants Phases 1 and 2 (183-640 lots)	Complete	Seller	Utility Co.
Phase 3 (if needed - all remaining lots)	Complete	Seller	Utility Co

10. PREPAYMENT OF NOTE. Purchaser may prepay the principal amount remaining due in whole or in part without penalty. Any partial prepayment shall be applied against the principal amount outstanding and shall not postpone the due date of any subsequent monthly installments or change the amount of such installments, unless the holder of the Note shall otherwise agree in writing Accrued interest hereon shall be calculated on the basis of a 360-day year composed of twelve 30 day months and charged through the date of payoff. The above notwithstanding, in no event whatsoever shall the amount paid or agreed to be paid hereunder exceed the maximum rate of interest permitted under applicable law. If, from any circumstance whatsoever, fulfillment of any provision hereunder shall involve transcending the limit of validity prescribed by law, then the obligation to be fulfilled shall automatically be reduced to the limit of such validity.

11. DEFAULT. If Purchaser defaults in making any payment(s) or in discharging any obligation under this Contract, Seller may (a) accelerate and mature the full amount then remaining unpaid, after giving Purchaser a refund of any unearned finance charge; (b) seek foreclosure of Seller's lien and security interests; (c) pursue other remedies available to it by law or contract; or (d) terminate this Contract and retain any payments made; and seek reimbursement for any reasonable attorneys fees and court costs incurred in exercising any of the foregoing remedies. Seller agrees to give Purchaser written notification of any default or breach of this Contract and Purchaser shall have 30 days from receipt of such notification to correct such default or breach, or such additional time as may be required by applicable law.

12. PROPERTY OWNERS' ASSOCIATION. Purchaser shall, upon purchase of the Property, be a member of the White Bluff Property Owners Association (the "Property Owners Association") Purchaser agrees and promises to (a) comply with the rules and regulations prescribed by the Property Owners Association and the restrictive covenants affecting the Property, (b) pay the prescribed annual maintenance fees to the Property Owners Association when due, and (c) pay any prescribed late fees if maintenance fees are not paid when due.

13. ASSIGNMENT Purchaser agrees that no future sale, transfer, lease or disposition of the Property shall be consummated unless and until the name and address of such purchaser or transferee has been properly provided to the Property Owners Association. Seller shall have the right to assign any of its interests or obligations contained in this Contract to any reasonably responsible third party.

NOTICE

ANY HOLDER OF THIS CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

14. WAIVER OF TRIAL BY JURY. Seller and Purchaser knowingly and conclusively waive all rights to trial by jury, in any action or proceeding relating to this contract.

15. **NO RELIANCE ON REPRESENTATIONS.** PURCHASER AGREES THAT A FULL INSPECTION OF THE LOT HAS BEEN MADE, THAT HE OR SHE IS ACCEPTING THE LOT AS IS AND RELYING SOLELY ON HIS OR HER OWN JUDGMENT IN PURCHASING THE LOT. PURCHASER ACKNOWLEDGES THAT HE OR SHE **HAS NOT RELIED** ON ANY PLANS, REPRESENTATIONS, BROCHURES, ADVERTISEMENTS, COVENANTS, WARRANTIES OR STATEMENTS OF ANY KIND WHATSOEVER, WHETHER MADE BY SELLER, ITS AGENTS, ASSIGNS, OR OTHERWISE, EXCEPT THOSE SPECIFICALLY SET FORTH IN THIS CONTRACT, THE PROPERTY REPORT, OR THE COVENANTS AND RESTRICTIONS.

16. NOTICES. Any notice to Purchaser shall be deemed effective, given and completed upon deposit of the notice in a post-paid envelope, addressed and mailed to Purchaser at the most recent address as shown in the records of Seller. Any notice to Seller or its assignee (other than notice of cancellation) will be effective, given and completed only upon receipt of written notice by Seller or its assignee.

17. DELAY. No act, delay, omission or course of dealing between Seller and Purchaser will be a waiver of any of Seller's rights or a bar to the exercise of any right or remedy of Seller on any subsequent occasion unless such waiver be in writing and signed by Seller. All rights and remedies of Seller hereunder are cumulative and may be exercised singularly or concurrently in addition to those otherwise available by law or equity.

18. JOINT AND SEVERAL. The obligations of Purchaser will be the joint and several agreement of all parties signing this Contract as Purchaser.

19. INVALIDITY OF PROVISIONS. If any provision of this Contract is invalid or unenforceable under any law, the provision is and will be totally ineffective to that extent, but the remaining provisions will be unaffected.

20. GOVERNING LAW AND EXCLUSIVE JURISDICTION. This contract shall be interpreted in accordance with the laws of the State of Texas. Seller and Purchaser agree that any dispute arising under or in connection with this contract or related to any matter which is the subject of this contract shall be subject to the exclusive jurisdiction of the state and/or federal courts located in Dallas County, Texas.

21. BINDING EFFECT. This Contract shall be binding upon and inure to the benefit of the heirs, successors and/or assigns of the parties hereto.

22. ENTIRE AGREEMENT. The terms, covenants and conditions appearing herein contain the entire agreement between Seller and Purchaser and cannot be varied except by the written agreement of the parties.

23. AUTHORITY OF SELLER'S REPRESENTATIVE. The authority of Seller's representatives is limited to securing purchasers for the Property upon the terms and conditions that are set forth herein and not otherwise, and the sales representatives have no power or authority to make any change, alteration, modification, stipulation, inducement, promise or any representation whatsoever other than those herein stated. Seller reserves the right to disapprove and reject this Contract upon review at its home office. If rejected, all monies paid shall be returned to Purchaser.

Purchaser hereby acknowledges that: (i) this Contract was completed as to all provisions and disclosures before it was signed by Purchaser and a duplicate copy thereof was delivered to Purchaser at the time of signing; and (ii) Purchaser has made a personal on-the-lot inspection of the Property.

YOU HAVE THE OPTION TO CANCEL YOUR CONTRACT OF SALE BY NOTICE TO THE SELLER UNTIL MIDNIGHT OF THE SEVENTH DAY FOLLOWING THE SIGNING OF THIS CONTRACT.

IF YOU DID NOT RECEIVE A PROPERTY REPORT PREPARED PURSUANT TO THE RULES AND REGULATIONS OF THE OFFICE OF INTERSTATE LAND SALES REGISTRATION, CONSUMER FINANCIAL PROTECTION BUREAU, IN ADVANCE OF YOUR SIGNING THE CONTRACT, THE CONTRACT OF SALE MAY BE CANCELLED AT YOUR OPTION FOR TWO YEARS FROM THE DATE OF SIGNING.

SELLER DOUBLE DIAMOND, INC ,	PURCHASER(S)
By: _____ Seller's Representative	_____ *«PURCHNAME»*
and _____ Kevin Shea, Vice President	_____ *«PURCHNAME2»*

ACKNOWLEDGEMENTS

STATE OF TEXAS §
COUNTY OF HILL §

This instrument was acknowledged before me on _____, 20___ by *«PURCHNAME» «RELATION» «PURCHNAME2».*

_____
Notary Public in and for the State of Texas

THE STATE OF TEXAS §
COUNTY OF DALLAS §

This instrument was acknowledged before me on _____, 20____by Kevin Shea, Vice President of Double Diamond, Inc , a Texas corporation, on behalf of said corporation.

_____
Notary Public in and for the State of Texas

SOAH DOCKET NO. 473-17-0119.WS
PUC DOCKET NO. 46245

DIRECT TESTIMONY AND WORKPAPERS
OF NELISA HEDDIN

WBRG-1H
DDU Discovery Excerpt
(DDU16-010153 – DDU16-010156)

KYLE HARRISON & SONS WELL SERVICE, INC.

Water Well Drilling   Pump Sales and Service
P.O. Box 986
Lampasas, Texas 76550
Phone (512) 556-3162

Customer's Acct. No. ______ Date 2/22/2001

Name WHITE BLUFF

Address 62 MISTY VALLEY CIRCLE
WHITNEY TX 76692

SOLD BY	CASH	C.O.D.	CHARGE	ON ACCOUNT	MDSE. RETD.	PAID OUT	WE ACCEPT
DH							VISA/MC

QUAN.	DESCRIPTION	PRICE	AMOUNT
	CONTRACT AMOUNT		150486.54
	ADD FOR 125 HP PUMP		12728.87
			163215.41
	LESS DRAW ON CONTRACT 11/29/00	-	50000.00
			113215.41
	Less 10%	-	16,321.54
	of 163,215.41		
			96,893.87
	Received At		
	FEB 22 2001		
	White Bluff		
	A service charge of 1½% per month will apply on all past due accounts. See Reverse Side.		
	All claims and returned goods MUST be accompanied by this bill.	TAX	
17447	Received By	TOTAL	96,893.87

DDU009951

WBRG000096

Double Diamond Properties C Vendor No : **KYLEHA** Check No : **4420** **05/29/01**

Kyle Harrison & Sons Well Srvc

Reference	*Invoice Date*	*Gross Amount*	*Description*	*Net Amount Paid*
Invoice 17447A	02/22/01	16,321.54	Invoice 1056	16,321.54
Totals :		**16,321.54**		**16,321.54**

Double Diamond Properties Const
10100 N. Central Expressway, Suite 4
Dallas, TX 75231

Chase Bank of Texas
Dallas, Texas 32-116/1110

Check Amt	$ 16,321.54
Check Date	05/29/01
Check No	4420

Pay **** SIXTEEN THOUSAND THREE HUNDRED TWENTY ONE AND 54/100 DOLLARS

To the order of : Kyle Harrison & Sons Well Srvc
P. O. Box 986
Lampasas, TX 76550

*** COPY ***

Your Signature Here

DDU009952

WBRG000097

Accounts Payable Coding Form

Vendor #
Vendor Name: KYLE HARRISON & SONS WELL SERVICE, INC.
Vendor Address:
New vendor
or address change:

Company: DDC
Department: CONSTRUCTION
Location: WHITE BLUFF
HIGHLIGHT "SPECIAL SITUATIONS ONLY"
Return check to. ***MELISSA DOUD***
Date required: ***RUSH – 5/31/01***

Invoice #	Invoice Date	Amount	Job #	Cost Code	Company	G/L Acct. #	DEPT.	G/L Comment (20 Characters)	Amount
17447A	2/22/01	16,321.54	9211	02510		1650-0090		#3 DRAW - 10% RETAINER FEE ON WELL	16,321.54
	Grand Total:	16,321.54						Grand Total:	16,321.54

Check Stub Comment:
Manager Comments: JOB #9211 - WATER WELL #4 AT W.B. (JOB IS COMPLETE - ALL LIEN WAIVERS RECEIVED & ALL WELL REPORTS RECEIVED)
Explain variance to budget:

Prepared by: *MELISSA DOUD* *Melissa Doud* *5/23/01*
DATE PREPARED
Approved by: *RANDY GRACY*
Print Name
Signature

Field Batch #:

Accounting Use Only
Acctg Approval: 5/25/01
A/P Batch #: 1056

DDU009953

WBRG000098

KYLE HARRISON & SONS WELL SERVICE, INC.

Water Well Drilling Pump Sales and Service
P.O. Box 986
Lampasas, Texas 76550
Phone (512) 556-3162

Customer's Acct. No. _____ Date 2/22/2001

Name WHITE BLUFF

Address 22 MISTY VALLEY CIRCLE

WHITNEY TX 76692

SOLD BY	CASH	C.O.D.	CHARGE	ON ACCOUNT	MDSE. RETD.	PAID OUT	WE ACCEPT
DH							VISA/MC

QUAN.	DESCRIPTION	PRICE	AMOUNT
	CONTRACT AMOUNT		150,486.54
	ADD FOR 125 HP PUMP		12728.87
			163215.41
	LESS DRAW ON CONTRACT 11/25/00		- 50000.00
			113215.41
	less 10%		- 16,321.54
	of 163,215.41		
			96,893.87
	Received At		
	FEB 22 2001		
	White Bluff		
	A service charge of 1½% per month will apply on all past due accounts. See Reverse Side.		
		TAX	
17447A	Received By	TOTAL	96,893.87

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DDU009954

WBRG000099