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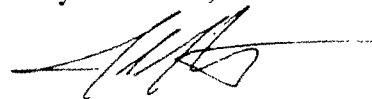
APPLICATION OF DOUBLE § BEFORE THE STATE OFFICE
DIAMOND UTILITY COMPANY, INC. § OF
FOR WATER AND SEWER § ADMINISTRATIVE HEARINGS
RATE/TARIFF CHANGE §

DOUBLE DIAMOND UTILITY COMPANY, INC.'S REPLY BRIEF

TO THE HONORABLE ADMINISTRATIVE LAW JUDGES:

COMES NOW, Double Diamond Utility Company, Inc. ("Double Diamond"), in the above styled and docketed water and wastewater rate proceeding and files this, its Reply Brief.

Respectfully submitted,


By: 
John J. Carlton

John J. Carlton
The Carlton Law Firm P.L.L.C.
4301 Westbank Drive, Suite B-130
Austin, Texas 78746
(512) 614-0901
Fax (512) 900-2855
State Bar No. 03817600

ATTORNEY FOR DOUBLE DIAMOND
UTILITY COMPANY, INC.

CERTIFICATE OF SERVICE

I hereby certify that I have served or will serve a true and correct copy of the foregoing document via hand delivery, facsimile, electronic mail, overnight mail, U.S. mail and/or Certified Mail Return Receipt Requested to all parties on this the 15th day of December, 2017.


John Carlton

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1. REPLY TO COMMISSION STAFF'S INITIAL BRIEF

I. INTRODUCTION AND SUMMARY

For purposes of simplifying the Judge's review of the parties' initial briefs and DDU's response, DDU has divided its reply brief in to three parts. This first part addresses the Commission Staff's initial brief. The second part addresses White Bluff Ratepayers Group's ("WBRG") initial brief, and the third part addresses the initial brief filed by The Cliffs Utility Committee ("TCUC").

With respect to the Commission Staff's initial brief, DDU agrees with some of the staff positions, but disagrees with many others. Commission Staff seems to arbitrarily decide which operating expenses should be excluded and which should just be reduced. In addition, Commission Staff completely ignores the expert testimony of Greg Scheig related to return on equity.

DDU disagrees with Commission Staff's revenue requirement assertions in Table 1 through Table 4 (related to White Bluff) and Tables 7 and 8 (related to The Cliffs) of their initial brief for the reasons set forth in this Section of DDU's Reply Brief.¹

II. REVENUE REQUIREMENT [PO ISSUES 3, 5, 6, 34]

A. Operations and Maintenance Expenses [PO Issues 20, 38] / Administrative and General Expenses [PO Issues 21, 25, 38] / Other Expenses [PO Issue 38]

1. White Bluff

a. Other Revenues

DDU agrees with Commission Staff's recommendation regarding the Nextlink revenues.

b. Other Volume Related Expenses

DDU agrees with Commission Staff's reclassification of Other Volume Related Expenses.

c. Employee Labor

For the reasons set forth in detail in DDU's Initial Brief, DDU strongly disagrees with Commission Staff's adjustments to Employee Labor. Commission Staff asserts that DDU failed

¹ Staff Initial Brief at 5-6.

to provide any description of job duties for employees, Jerry Whitworth or Danny Keeton, other than the description shown in Staff Exhibit 2A.² Commission Staff continues to argue that these employees' salaries are covered by tap fees even though they admit that only 1% of the salaries for these men is covered by tap fees, leaving 99% of their time uncompensated through rates.³ The Commission Staff asserts that DDU failed to produce a "more robust description."⁴ This is simply an incredible assertion.

As Mr. Gracy testified, DDU produced 859 pages of White Bluff system work orders in response to WBRG RFI 1-32 that "demonstrate that all employees work on every call, whether water or sewer, at different times."⁵ Mr. Gracy goes on to testify about the work that these men do for the utility.⁶ Ms. Sears never acknowledges that the response to WBRG 1-32 was produced and claims that Mr. Gracy's testimony was inadequate. As is shown by her testimony on cross-examination, Ms. Sears takes her position based upon a single discovery response, Staff 1-1, and determines that no other evidence will be sufficient to change her mind.⁷ In fact, the discovery responses provided by DDU and attached to Ms. Sears' testimony support Mr. Gracy's testimony and show that the employees of DDU worked 1,039 hours of overtime during the test year.⁸ While DDU is not seeking overtime compensation as part of its revenue requirement, the fact that there are 1,309 hours of overtime worked in White Bluff during the test year provides additional support for the need for all the employees and their salaries as requested by DDU. Furthermore, Ms. Sears' claims that she did not get enough information clearly reflect that she did not review the documentation produced by DDU in this case.

d. Contract Work

Commission Staff asserts that the Utility Manager's phone allowance should be reduced by 50%. DDU's requested cost is simply a "phone allowance," and DDU does not seek recovery for the Utility Manager's entire phone bill.⁹ As noted in DDU's initial brief, Mr. Gracy testified that the utility manager for White Bluff is on-call 24 hours a day, 7 days a week, and must have a

² Staff Ex. 2A at ES Workpaper 6.

³ Staff Initial Brief at 9.

⁴ Staff Initial Brief at 10.

⁵ Ex. DDU-8, Pre-filed Rebuttal Testimony of Randy Gracy, page 4 of 155, lines 12-13.

⁶ *Id.* at page 4 of 155, line 14 through page 5 of 155, line 4.

⁷ Tr. at 338:18-24 (Sears Cross) (Oct. 25, 2017).

⁸ Staff Ex. 2A at ES Workpaper 8, Bates 00009, Responses to Staff RFIs 1-5, 1-6, 1-7 and 1-8.

⁹ Ex. DDU-8, page 6 of 155, lines 1 to 9.

cell phone at all times in order respond to issues that arise with operation of the water and sewer systems at White Bluff.¹⁰

In addition, Commission Staff recommends reclassifying “the portion of resort G&A attributable to security from Miscellaneous Expense to Contract Work.”¹¹ DDU agrees with this reclassification, but would point out that Commission Staff’s statements later in its brief are incorrect regarding exclusion of the resort G&A.¹² In fact, the G&A expenses should be reclassified as stated by Commission Staff in this section, not removed.

e. Transportation Expense

Commission Staff continues to assert that nearly \$10,000 of fuel expense (slightly more than 2/3 of DDU’s total claimed fuel expense for White Bluff and for which DDU provided detailed records¹³) should be excluded because DDU should not recover the costs of two on-call vehicles traveling to and from the two on-call employees’ homes. As discussed in DDU’s initial brief, this is tantamount to arguing that costs a utility incurs for insurance expenses should be excluded if a claim is never filed on the insurance policy.¹⁴ Strangely, Commission Staff admits that having on-call vehicles is appropriate, but that only time spent responding to a call is acceptable. It is unclear to DDU how a utility could have on-call vehicles positioned for after-hours response, without paying for those vehicles to be driven to the employees’ homes. In addition, the record reflects that no personal use is allowed for these on-call vehicles,¹⁵ so DDU’s request is only for utility related expenses. The availability of the employees at a moment’s notice for after-hours response to utility system issues is insurance for the customers that the system will remain operational 24 hours a day and 7 days a week.

Commission Staff also recommends reclassifying vehicle lease expense of \$5,824 (\$2,912 for both water and sewer) and a tool box for \$850 from water to the asset list for DDU.¹⁶ DDU agrees with these reclassifications, but not simply because the amounts exceed \$750 as asserted by Commission Staff. When evaluating DDU’s Capitalization Policy,¹⁷ all of the factors must be considered. The tool box meets two of the three criteria.

¹⁰ Ex. DDU-8, page 6 of 155, lines 5-9.

¹¹ Staff Initial Brief at 12.

¹² Staff Initial Brief at 20.

¹³ Ex. DDU-8 (Attachment DDU-8B), page 23 of 155 through 149 of 155.

¹⁴ DDU Initial Brief at 11-12.

¹⁵ Ex. DDU-15 (DDU’s Written Response to Commission Staff’s Request for Information 1-14).

¹⁶ Staff Initial Brief at 13.

¹⁷ Staff Ex. 6 at DDU16-015961.

f. Other Plant Maintenance

Commission Staff continues to assert that \$18,806 should be removed from water and \$83,962 should be removed from sewer expenses in this category. DDU agrees with some of Commission Staff's adjustments, but strongly disagrees with others. DDU's position is set forth in detail in its initial brief.¹⁸

For water, DDU does not agree with the exclusion of \$709 in expenses, which are shown on the detailed trial balance as having occurred during the test year and being related to repair and maintenance of the water system.¹⁹ DDU agrees with some of the reclassification of assets to rate base, but disagrees with reclassification of \$4,386.29. Ms. Harkins testified that these three invoices were more appropriately expenses and should not be capitalized.²⁰

Of even greater significance, Commission Staff asserts that \$72,259.16 of recurring expenses for grinder pumps should be reclassified as capital assets.²¹ Commission Staff even claims this recommendation is "in line" with DDU's Capitalization Policy.²² Once again, Commission Staff picks and chooses among the facts that it believes will support its position without justification or expertise. Commission Staff even asserts that because the costs exceed \$750, the repairs extend the life of the grinder pumps and, amazingly, that there is "no evidence that these types of repairs are typical, recurring expenses."²³ DDU acknowledges that the costs of many of the grinder pump repairs exceed \$750, but this factor is simply one of three that DDU uses to determine whether to capitalize an asset. The other factors include the extension of the useful life of the asset and, importantly, "whether the repair is a typical recurring expense."²⁴ DDU's engineering expert, Dr. Victoria Harkins – a registered professional engineer in Texas with 20 years of experience in the utility industry²⁵ - was the sole witness in the proceeding with any experience in the operation and maintenance of grinder pumps.²⁶ In fact, Dr. Harkins was the only

¹⁸ DDU's Initial Brief at 13-14.

¹⁹ Ex. DDU-4, Pre-filed Direct Testimony of Tim Grout (Attachment DDU-4E), pages 143-144 of 166 (electrical parts \$500 and ITC services \$209.43).

²⁰ Ex. DDU-9, Pre-filed Rebuttal Testimony of Victoria Harkins, page 4 of 527, line 21-page 5 of 527, line 4.

²¹ Staff's Initial Brief at 14; Ex. DDU-9, page 5 of 527, line 17-page 6 of 527, line 5.

²² Staff Ex. 6 at DDU16-015961.

²³ Staff's Initial Brief at 14.

²⁴ Staff Ex. 6 at DDU16-015961.

²⁵ Ex. DDU-5, Pre-filed Direct Testimony of Victoria Harkins (Attachment DDU-5A), page 12 of 52 through page 23 of 52.

²⁶ Tr. at 484:6-7 (Harkins Redirect) (Oct. 26, 2017).

witness with any experience at all in designing and operating utility systems.²⁷ No other witnesses challenged her expert testimony on this topic. Dr. Harkins explained at length the challenges of maintaining grinder pumps in a wastewater system.²⁸ Based upon her review of 10 years of grinder pump invoices, Dr. Harkins testified that the grinder pump costs are recurring costs every year and that those cost should be expensed not capitalized.²⁹ She also provided testimony about how the costs should be treated if the Commission Staff decides to require recurring grinder pump repair costs to be capitalized.³⁰

DDU has filed several rate applications and has always treated the grinder pumps and grinder pump repairs as recurring expenses.³¹ There has been no change in treatment of these costs by DDU that would dictate a change in the recovery of these costs. They have been treated and continue to be appropriately treated as annual expenses. The chart below summarizes the recurring grinder pump expenses established by DDU Exhibit 9C:

Chart 1

Grinder Pump Repairs	Years
\$42,919.78	2006
\$12,597.06	2007
\$26,695.77	2008
\$43,908.94	2009
\$36,844.20	2010
\$52,306.80	2011
\$54,267.63	2012
\$75,981.59	2013
\$39,325.74	2014
\$86,376.15	2015

²⁷ Tr. at 343:16 through 344:10 (Sears Cross) (Oct. 25, 2017); Tr. at 304:23 through 306:3 (Mathis Cross) (Oct. 25, 2017).

²⁸ Tr. at 484:12 through 485:12 (Harkins Direct) (Oct. 26, 2017).

²⁹ Tr. at 488:20-25, 490:19-491:18, 493:12-494:10 (Harkins Cross) (Oct. 26, 2017).

³⁰ Ex. DDU-9, page 4 of 527 through page 5 of 527.

³¹ Tr. at 473:5-16 (Gracy Cross) (Oct. 26, 2017).

As one can see, DDU incurs recurring expenses related to grinder pump repairs. Dr. Harkins' recommendation to classify these costs as expenses because of their recurring nature is reasonable and justified.

g. Professional Services

DDU also agrees with Commission Staff's proposed three-year amortization of the wastewater permit renewal costs as a recurring expense related to White Bluff sewer.³²

Commission Staff also recommends removing \$2,907 in costs for a CCN application related to The Cliffs. While DDU agrees with reclassifying this costs as an expense for The Cliffs, DDU does not agree with complete removal of the costs. Investor owned utilities are required to obtain a certificate of convenience and necessity in order to operate legally in Texas.³³ Utilities like DDU must incur these costs in order to do business. Commission Staff's assertion that this cost should not be recovered is not reasonable. At a minimum, DDU's costs should be amortized over some period of time. DDU proposes the same three-year period use for the wastewater permit costs.

h. Insurance Expenses

Commission Staff recommends removing expenses related to worker's compensation,³⁴ and DDU agrees with this adjustment.

Commission Staff also asserts that DDU's premium for an umbrella insurance policy should be removed because a portion of the umbrella coverage relates to an underlying policy for spa and ski insurance.³⁵ DDU does not agree with this exclusion. DDU's Initial Brief addresses this issue.³⁶ DDU's requested expense is reasonable and necessary for the reasons stated therein.

i. Regulatory Expenses

Commission Staff recommends removing expenses related to the Prairieland Groundwater Conservation District from the revenue requirement calculations.³⁷ DDU agrees with this adjustment and that a pass-through provision should be included on the tariff consistent with PUC Subst. Rule 24.21(b)(2)(B)(iii).

³² Staff Initial Brief at 15.

³³ Texas Water Code §13.242.

³⁴ Staff Initial Brief at 17.

³⁵ Staff Initial Brief at 17.

³⁶ DDU Initial Brief at 15-16.

³⁷ Staff Initial Brief at 18.

Commission Staff also recommends normalizing expenses for water tests that occur every three years.³⁸ DDU agrees with this adjustment.

j. Miscellaneous Expenses

Commission Staff recommends that equipment lease expenses be removed, and DDU agrees.³⁹ Commission Staff recommended reclassification of G&A related to security to Contract Work, and DDU agrees.⁴⁰ Commission Staff also recommended removal of \$500 in sewer tap fee expense from this category, and DDU agrees.⁴¹

Commission Staff asserts that DDU's requested resort overhead allocation should be removed.⁴² DDU strongly disagrees with this removal for the reasons set forth in its Initial Brief that will not be repeated here.⁴³ However, Commission Staff's Initial Brief implies that DDU's allocation of costs was unsupported. Mr. Gracy testified at length about how the allocations were developed based upon historical costs.⁴⁴ Commission Staff expressed concern that some of the allocated costs were appropriately less than 3%, but Mr. Gracy explained that the 3% allocation was a weighted average with some costs appropriately allocated to the utility being more than 3% and some being less.⁴⁵ The overall impact is that allocation of 3% of resort overhead, or \$12,000/year, is reasonable for the services that the utility receives from the resort as described by Mr. Gracy.

2. The Cliffs

a. Transportation

Commission Staff asserts that certain fuel expenses should be excluded.⁴⁶ DDU disagrees for the reasons asserted in its Initial Brief, which will not be restated here.⁴⁷

b. Miscellaneous Expenses

³⁸ *Id.* at 18-19.

³⁹ Staff Initial Brief at 21.

⁴⁰ *Id.* at 20.

⁴¹ *Id.*

⁴² *Id.* at 19.

⁴³ DDU Initial Brief at 16-17.

⁴⁴ Tr. 474:4 through 477:2 (Gracy Cross) (Oct. 26, 2017).

⁴⁵ Tr. 476:23 through 477:2 (Gracy Cross) (Oct. 26, 2017).

⁴⁶ Staff Initial Brief at 21-22.

⁴⁷ DDU Initial Brief at 12-13.

Commission Staff asserts that the allocated resort overhead for The Cliffs be excluded for the reasons stated in relation to White Bluff.⁴⁸ DDU disagrees for the reasons asserted above and those set forth in its Initial Brief, which will not be restated here.⁴⁹

B. Depreciation [PO Issues 12, 27]

Commission Staff asserts that adjustments to the depreciation schedule must be made as a result of reclassifying certain costs as either expenses (from assets) or assets (from expenses).⁵⁰ DDU disagrees with many of the reclassifications for the reasons stated above and in its Initial Brief. Final depreciation figures are dependent upon the determinations related to the reclassifications.

C. Taxes [PO Issues 28, 31]

i. Federal Income Tax Expense [PO Issue 30]

Commission Staff asserts that the White Bluff and The Cliffs utility systems should be treated separately for federal income tax purposes.⁵¹ DDU disagrees. As Mr. Joyce testified on rebuttal, Commission Staff cannot have it both ways. While they assert that the federal income tax calculations should be made as though they are separate entities, they also assert that White Bluff and The Cliffs should be treated as combined for purposes of cash working capital, capital structure and return on debt.⁵² Commission Staff appears to simply continue to choose treatment of costs in the way that reduces DDU's requested revenue requirement when it suits them to do so. DDU requests consistency and not some arbitrary picking and choosing of treatment of its utility systems.

ii. Other Assessments and Taxes [PO Issue 29]

Commission Staff recommends reducing Other Taxes by \$2,148 for water, and \$5,025 for sewer. These adjustments were related to payroll taxes. Although DDU agrees with adjusting payroll taxes to reflect appropriate employee labor costs, DDU does not agree with Commission Staff's adjustments to employee labor expenses, as discussed above and in its Initial Brief.

⁴⁸ Staff Initial Brief at 22.

⁴⁹ DDU Initial Brief at 17.

⁵⁰ Staff Initial Brief at 22.

⁵¹ *Id.* at 25.

⁵² Ex. DDU-11, Rebuttal Testimony of Jay Joyce, page 14 of 106, lines 13-15.

Commission Staff also adjusted other taxes for the removal of the sales tax and title tax for the 2014 Ford.⁵³ DDU agrees with Commission staff's adjustment to the sales and title tax for the 2014 Ford because it is included in the asset depreciation schedule.

D. Return on Invested Capital [PO Issues 9, 10, 15, 16, 18, 19]

There are mathematical errors in the columns "Staff Recommended."⁵⁴ It appears that Commission Staff changed the cash working capital amounts but did not revise the totals.⁵⁵ Presumably these corrections will be incorporated into the final number runs. While DDU does not agree with the figures presented in the invested capital tables,⁵⁶ this is because of DDU's disagreement with Commission Staff's reclassification of costs discussed above, and the calculation of cash working capital, and ADFIT discussed below.

1. Plant in Service – Original Cost

Other than the issues discussed in DDU's Initial Brief and above, DDU agrees with Commission Staff's proposed Plant in Service – Original Cost.⁵⁷

2. Accumulated Depreciation

Other than the issues discussed in DDU's Initial Brief and above, DDU agrees with Commission Staff's proposed Accumulated Depreciation.⁵⁸

3. Cash Working Capital

Commission Staff asserts that White Bluff and The Cliffs should both have cash working capital calculated at 1/12 of operating expenses.⁵⁹ DDU disagrees. As discussed above in relation to Federal Income Taxes, Commission Staff should be consistent in treatment of the utility systems as either combined or separate entities. It is not reasonable to bounce back and forth simply to achieve a reduction in revenue requirement.

⁵³ Ex. Staff-2, page 24, lines 18-20.

⁵⁴ Staff Initial Brief at 26.

⁵⁵ Staff Initial Brief, footnotes 147 and 150, at 27.

⁵⁶ Staff Initial Brief at 26-27.

⁵⁷ *Id.* at 28.

⁵⁸ *Id.*

⁵⁹ *Id.* at 28-29.

4. Developer Contribution

DDU agrees with Commission Staff's proposed treatment of developer contributions.⁶⁰

5. Accumulated Deferred Federal Income Tax [ADFIT]

Commission Staff asserts that Accumulated Deferred Federal Income Tax (ADFIT) must be considered when calculating the rate base. While DDU agrees with this assertion, DDU does not agree with Commission Staff's calculations for the reasons set forth in detail in its Initial Brief.⁶¹ In addition, DDU disagrees with Commission Staff's assertion that normalization rules do not apply. In fact, Commission Staff's assertion is simply not supported by any testimony or evidence in the record, which is why there is none cited.⁶² The Commission's rules state that federal income taxes are allowable on a normalized basis.⁶³

In addition, Commission Staff's proposed exclusion of net operating loss from the ADFIT calculations is inconsistent with Commission precedent. The Commission has conclusively found that inclusion of net operating loss in the ADFIT calculations is "reasonable and appropriate".⁶⁴

III. RATE OF RETURN

A. Return on Equity [PO Issue 8]

Commission Staff asserts that return on equity should be set at 8.79%.⁶⁵ DDU strongly disagrees. Commission Staff simply restated Ms. Sears' testimony, ignoring and failing to address the comprehensive testimony of DDU's expert, Greg Scheig. Mr. Scheig has been providing expert analysis of return on equity for over 25 years.⁶⁶ He is a Certified Public Accountant and holds a Master of Business Administration, Finance and Accounting, along with numerous other relevant certifications.⁶⁷

⁶⁰ *Id.* at 29.

⁶¹ DDU Initial Brief at 19-20.

⁶² Staff Initial Brief at 30-31.

⁶³ PUC Subst. Rule 24.31(b)(1)(D).

⁶⁴ Application of Lone Star Transmission, LLC, for Authority to Establish Interim and Final Rates and Tariff, Docket 40020, Document 767 (Order on Rehearing, Findings of Fact 65 and 66 and Conclusions of Law 15 and 16). See Proposal for Decision for discussion of ADFIT, net operating loss and normalization, Document 715 at 54-55.

⁶⁵ Staff Initial Brief at 32.

⁶⁶ Ex. DDU-10, Pre-filed Rebuttal Testimony of Greg Scheig, page 3-page 4 of 123.

⁶⁷ Ex. DDU-10 (Attachment DDU-10A), page 39 of 123 through page 50 of 123.

Mr. Scheig points out that Ms. Sears' analyses have mathematical errors and do not adequately account for the risk of an illiquid common stock equity investment in a small private company such as DDU.⁶⁸ Ms. Sears' reliance on only two limited analyses, excluding other recognized financial models, results in a return on equity that does not adequately compensate DDU's equity investors for the risk of an illiquid common stock equity investment in a small private company such as DDU.⁶⁹

As Mr. Scheig noted, the Constant Growth DCF model relied upon by Ms. Sears is based upon very simplistic assumptions which limit its reliability. Those assumptions are (1) a single, constant growth rate into perpetuity and (2) investors depend on dividends as their sole source of returns.⁷⁰ But, as Mr. Scheig testified, many growth companies never pay dividends, reflecting the expectation that equity capital will earn a higher rate of return for investors by reinvesting it in the business, rather than by paying a dividend.⁷¹ In addition, Mr. Scheig notes that Ms. Sears "mechanically" averaged disparate growth rates for each comparable company, in her barometer group in her DCF analyses. She did this without using informed judgment, resulting in an unsupportable conclusion. For example, San Jose Water, Ms. Sears' table shows two estimates of 14.0% and 3.0% for the same company into perpetuity, which she averages to a single estimate of 8.50%.⁷² Simply averaging two growth rates, without any additional analyses, does not automatically result in a reliable conclusion.⁷³

Mr. Scheig also noted significant problems in Ms. Sears' CAPM analyses. Ms. Sears' CAPM analyses should not be considered reliable based on her assumptions of risk-free rate inputs, equity risk premia, and failure to consider a small stock risk premium.⁷⁴ With regard to her risk-free rate inputs, Ms. Sears used a 10-year US Treasury bond yield, as opposed to the standard 30-year bond yield.⁷⁵ This is problematic because the 30-year bond yield is consistent with the longer-term asset lives of utility systems and a 10-year Treasury bond yield with a lower yield to maturity does not adequately compensate DDU investors for the risk of an equity investment.⁷⁶ Had Ms.

⁶⁸ Ex. DDU-10, page 6 of 123, lines 2-4.

⁶⁹ *Id.* at 7 of 123, lines 6-9.

⁷⁰ *Id.* at 7, line 12 through 9, line 5.

⁷¹ *Id.* at 8.

⁷² Staff Exhibit 2, Attachment ES-9 (Emily Sears Direct).

⁷³ Ex. DDU-10, page 10 of 123, lines 7-14.

⁷⁴ *Id.* at 11, lines 9-10.

⁷⁵ *Id.* at 12, lines 3-9.

⁷⁶ *Id.*

Sears' used 2018-2022 Blue Chip forecast rate of 3.80% from her own testimony, this would have increased her concluded ROE by approximately 100 basis points to 9.68%.⁷⁷ With regard to her equity risk premia, Ms. Sears used a historical ERP of 5.82% in her CAPM analyses. However, in her Attachments ES-13 and ES-14, she calculated an expected return for the market of 11.06% equates to a forward-looking ERP of 8.25% (11.06% from ES-13 less the 2.81% risk-free rate from ES-14).⁷⁸ An 8.25% forward-looking ERP is a more reasonable input for the CAPM analysis because the CAPM is a forward-looking model.⁷⁹

Ms. Sears' application of the CAPM is more appropriate for larger public utilities given her beta inputs are from large public companies, and small private companies like DDU, require an adjustment for small stock risk and lack of liquidity.⁸⁰ To adjust for this difference, a small stock risk premium (SSRP) must be utilized.⁸¹ Mr. Scheig explains that the SSRP increases inversely to entity size, and is in addition to the required systematic (i.e., market) risk.⁸²

Ms. Sears' failure to address these issues in her analyses makes them unreliable. And Commission Staff's failure to address, much less acknowledge, the concerns raised by Mr. Scheig indicates that Ms. Sears' simply has no rebuttal to his expert opinions.

B. Cost of Debt [PO Issues 8, 14]

Commission Staff recommends that the weighted cost of debt be set at 4.91%.⁸³ DDU agrees with this recommendation provided that Commission Staff's recommended capital structure is also used.

C. Capital Structure [PO Issue 7]

Commission Staff recommends that a hypothetical capital structure of 47.27% debt and 52.73% equity be used for DDU.⁸⁴ DDU agrees with the recommendation provided that Commission Staff's recommended capital structure is also used.

⁷⁷ *Id.* at lines 10-15.

⁷⁸ *Id.* at lines 18-23.

⁷⁹ *Id.* at 13, lines 1-2.

⁸⁰ *Id.* at lines 11-14.

⁸¹ *Id.* at 21, lines 13-15.

⁸² *Id.* at 29, lines 4-6.

⁸³ Staff Initial Brief at 34.

⁸⁴ *Id.* at 35.

D. Overall Rate of Return [PO Issue 8]

Commission Staff asserts that the overall rate of return should be set at 6.76%.⁸⁵ DDU strongly disagrees with this rate of return based upon the unreasonably low rate of return on equity recommended by Commission Staff.

IV. RATE DESIGN [PO ISSUES 1, 2, 4, 35, 36, 37]

DDU agrees with Commission Staff's methodology for rate design, but DDU disagrees with the resulting rates because of the adjustments made by Commission Staff that DDU disputes and discusses above and in its Initial Brief.

V. RATE CASE EXPENSES [PO ISSUES 38]

DDU understands that Commission Staff agrees with Mr. Joyce's testimony on rate case expense.⁸⁶

VI. INTERIM RATES AND EFFECTIVE DATE [PO ISSUES 39, 40, 41]

DDU agrees with Commission Staff's position on interim rates and effective date.

VII. ISSUES NOT ADDRESSED [PO ISSUES 11, 13, 17, 22, 23, 24, 26, 32, 33]

Preliminary Order issues 11, 13, 17, 22, 23, 24, 26, 32, 33 do not apply to this proceeding.

⁸⁵ *Id.* at 31.

⁸⁶ Ex. DDU-11, page 13 of 106.

2. REPLY TO WHITE BLUFF RATEPAYERS GROUP'S INITIAL BRIEF

I. INTRODUCTION AND SUMMARY

DDU disagrees with all of the claims made by the White Bluff Ratepayers Group (“WBRG”) in its Initial Brief. In several places, WBRG cites to evidence in the record that was stricken or never admitted.

II. REVENUE REQUIREMENT [PO ISSUES 3, 5, 6, 34]

A. Operations and Maintenance Expenses [PO Issues 20, 38] / Administrative and General Expenses [PO Issues 21, 25, 38] / Other Expenses [PO Issue 38]

1. Salaries

WBRG asserts that DDU requested “known and measurable changes” in Employee Labor (although WBRG refers to these costs as “salaries”). This assertion is wrong. DDU is claiming Employee Labor costs in White Bluff for five employees. These employee costs are adjusted to reflect full staffing. As shown on the detailed sheet for the White Bluff employees, there was employee turnover during the test year and not all individuals on the list were employed during or for the full test year.⁸⁷ Mr. Joyce testified that the reason for the amount listed in the known and measurable column on table I-1 in the application⁸⁸ was that there was a difference between the actual test year cost and the adjusted test year costs, which had been adjusted for full staffing.⁸⁹ Mr. Gracy confirmed this during his testimony.⁹⁰

2. Regulatory Fees

WBRG asserts that the Prairieland Groundwater District fees should be excluded from the revenue requirement. As discussed in response to Commission Staff’s adjustment on this issue, DDU agrees that the groundwater district fees included as part of regulatory fees in Schedule II-

⁸⁷ Staff Exhibit 2A, Workpaper 5.

⁸⁸ Ex. DDU-2, White Bluff – Water and Sewer Rate Increase Applications, including Verifications (Totals, Water and Sewer), page 6 of 151 (Table I-1).

⁸⁹ Tr. at 206:15-21 (Joyce Cross) (Oct. 24, 2017).

⁹⁰ Tr. at 104:14-17 (Gracy Cross) (Oct. 24, 2017).

18 should be removed from the revenue requirement and that a pass-through provision should be included on the tariff consistent with PUC Subst. Rule 24.21(b)(2)(B)(iii). DDU does not agree with WBRG's assertion that the Prairieland Groundwater District fees are required to be excluded from this schedule. The application actually states, "Do not include THE REGULATORY ASSESSMENT; it is a pass-through cost."⁹¹ The instructions mean to exclude the Regulatory Assessment, which is referenced on the tariff sheet that states "Regulatory Assessment of 1% added to base rate and gallonage charges."⁹²

3. Professional Fees

WBRG asserts that \$2,907 in professional fees for a CCN application be removed because the costs relate to The Cliffs.⁹³ DDU agrees as noted in response to Commission Staff's recommended adjustment above.

B. Depreciation [PO Issues 12, 27]

i. Improper Known and Measurable Adjustment / Inappropriate Use of Trended Original Cost Study

a. Improper Use of Trended Original Cost Study

WBRG asserts that DDU is requesting unsupported known and measurable changes for annual depreciation expenses.⁹⁴ WBRG also asserts that these changes should be disallowed because the trending study done by Dr. Harkins was inappropriate.⁹⁵ DDU strongly disagrees with both these assertions.

WBRG cites the Commission rules about trending.⁹⁶ What WBRG fails to recognize or point out is that Dr. Harkins' testimony clearly states that she completed the trending study because there were no invoices supporting the original costs for the trended assets.⁹⁷ This is consistent

⁹¹ Ex. DDU-2, page 27 of 151.

⁹² *Id.* at 151.

⁹³ WBRG Initial Brief at 6.

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Id.* citing PUC Subst. Rule 24.31(c)(2)(B)(i).

⁹⁷ Ex. DDU-5 at 8, lines 10-15.

with the requirements of the rule. WBRG argues that Mr. Grout admitted there were sufficient historical records to determine the costs of the trended assets.⁹⁸ WBRG mischaracterizes and twists Mr. Grout's testimony. Mr. Grout's testimony was related to "whether the collection system and distribution, the lines, at White Bluff ... were recorded in an account balance somewhere."⁹⁹ Mr. Grout responded that those costs were included in the balance sheet if they were included on the depreciation list.¹⁰⁰ Mr. Grout then stated that any costs entered on the balance sheet were likely supported by an invoice.¹⁰¹ What WBRG fails to mention, is that Mr. Grout also testified that within DDU's financials, "you can go into the balance sheet and look at detail; but unfortunately, a lot of that detail is one-line, lump-sum numbers."¹⁰² WBRG argues that Mr. Grout's testimony is proof positive that there are historical records of the cost of the utility lines with White Bluff. This conclusion does not follow from his testimony as WBRG argues. In fact, Mr. Grout's testimony supports the idea that while there may be lump sum entries in the financials, there is no detail on particular assets. This is exactly what Dr. Harkins found, and this is why she completed the trending study for the assets that had no supporting documentation. The Commission Rule plainly states that original cost can include "cost of plant and equipment allowed in the cost of service that has been estimated by trending studies or other means, which has no historical records for verification purposes..."¹⁰³ As Dr. Harkins testified, the use of trending study in this situation was proper.¹⁰⁴

b. Error in Trending Study

WBRG also attempts to assert that there is an error in the trending study.¹⁰⁵ WBRG's claim is based upon the dates Dr. Harkins used for her trending analysis. WBRG is simply confused. Dr. Harkins testified that she used several different dates in her trending studies, and those dates are set forth in her studies, including: 1985 for some of The Cliffs water and sewer facilities; 1991 for some White Bluff water facilities; and 1996 for the White Bluff water and sewer facilities and

⁹⁸ WBRG Initial Brief at 7.

⁹⁹ Tr. 158: 10-13 (Grout Cross) (Oct. 24, 2017).

¹⁰⁰ Tr. 158: 16-18 (Grout Cross) (Oct. 24, 2017).

¹⁰¹ Tr. 158: 22 (Grout Cross) (Oct. 24, 2017).

¹⁰² Tr. 157: 14-17 (Grout Cross) (Oct. 24, 2017).

¹⁰³ PUC Subst. Rule 24.31(c)(2)(B)(i).

¹⁰⁴ Tr. 196:8-21 (Harkins Cross) (Oct. 24, 2017).

¹⁰⁵ WBRG Initial Brief at 8.

for some of the Cliffs sewer facilities.¹⁰⁶ Dr. Harkins never claimed that she used 1991 for all trended assets. With respect to the lines, Dr. Harkins testified that she used 1996, which is consistent with the dates shown in her studies footnoted above.¹⁰⁷ WBRG is confused.

WBRG also asserts that Dr. Harkins never explained why 1996 was a conservation date. But the record indicates otherwise. Dr. Harkins testified that 1996 was conservative because it was in the middle of the dates of all the construction of lines in White Bluff.¹⁰⁸ Using the date proposed by WBRG would severely understate the value of the assets because not all the lines were installed on one day. As stated by Dr. Harkins, the lines were installed over the course of many years.¹⁰⁹ Thus, the use of January 1, 1996, as a date for trending the line work is a conservative approach resulting in a better estimate of the aggregate original costs of the lines.

ii. Fully Depreciated Assets

WBRG asserts that some fully depreciated assets were included in the annual depreciation.¹¹⁰ To the extent there are annual depreciation amounts included in the test year depreciation expense for assets that were fully depreciated prior to the test year, DDU agrees with WBRG.

C. Taxes [PO Issues 28, 31]

i. Federal Income Tax Expense [PO Issue 30]

WBRG takes the position that the federal income tax calculation needs to be adjusted once a final determination is made on amount of return.¹¹¹ DDU agrees.

ii. Other Assessments and Taxes [PO Issue 29]

WBRG takes no position on this issue.¹¹²

¹⁰⁶ Ex. DDU-5 at 9 of 52, lines 2-3; Ex. DDU-5D (White Bluff Water); Ex. DDU-5E (The Cliffs Water); Ex. 5-H (White Bluff Sewer); Ex. DDU-5-I (The Cliffs Sewer).

¹⁰⁷ Tr. 193:24 (Harkins Cross) (Oct. 24, 2017).

¹⁰⁸ Tr. 194:15-25 (Harkins Cross) (Oct. 24, 2017).

¹⁰⁹ *Id.*

¹¹⁰ WBRG Initial Brief at 9.

¹¹¹ WBRG Initial Brief at 9.

¹¹² *Id.*

D. Return on Invested Capital [PO Issues 9, 10, 15, 16, 18, 19]

i. Property Not Belonging to DDU

WBRG asserts that the property identified as WB4 TR2 is not owned by DDU.¹¹³ However, WBRG's own exhibit shows otherwise.¹¹⁴ The tax records show DDU as the owner as reflected in Dr. Harkins answer to discovery. A 1995 deed is insufficient to demonstrate that DDU is not currently the owner. Dr. Harkins testified that she completed a comprehensive review of DDU's prior rate base files and all new items invoiced and included in rate base.¹¹⁵

The property, and the utility system assets located and operating on that property are properly part of the utility's infrastructure and should be included in rate base.

ii. Inappropriate Use of Trended Original Cost Study

As discussed above, WBRG's assertions that there are errors in Dr. Harkins' trending study are wrong. Consequently, there is no "inappropriate use of trended original cost study."

iii. Rate Base: 100% Developer-Contributed Assets

a. Overview

Rate Base is the issue that WBRG focused on during the hearing. WBRG asserts that 100% of DDU's assets should be treated as developer contributed assets, thereby eliminating any return on investment for DDU. DDU strongly disagrees with WBRG's assertion.

Essentially, WBRG argues that the *Sunbelt* case requires this treatment.¹¹⁶ However, WBRG does not read *Sunbelt* correctly. As stated in DDU's Initial Brief, *Sunbelt* does not apply because DDU has not written off the costs of constructing its White Bluff and The Cliffs utility systems claimed as rate base, as the developer did in the *Sunbelt* case. The facts are easily distinguishable.

Sunbelt Utilities was a partnership composed of five corporations that were owned and controlled by one individual, William S. O'Donnell, and his immediate family. All of the

¹¹³ WBRG Initial Brief at 10.

¹¹⁴ Exhibit WBRG 1M at WBRG000137, DDU's response to WBRG RFI 1-.

¹¹⁵ Ex. DDU- 5, page 7 of 52, lines 4-10.

¹¹⁶ Ex. WBRG-1 (Attachment WBRG 1-C) (*Sunbelt Utilities v. Public Utility Commission*, 589 S.W.2d 392, at 393 (1979)).

associated companies had common ownership. Each of the related utility companies was a partner of Sunbelt and profits or losses of Sunbelt were to be shared in proportion to the number of connections in each subdivision.¹¹⁷

The development company division of Sunbelt installed the utilities, streets, sidewalks and curbs in each subdivision, so as to make the property marketable. The lots were then transferred to a related building corporation. The developer then took advantage of the federal income tax laws and wrote off in one year the entire cost of the utility system (*emphasis added*).¹¹⁸

Sunbelt filed an application and statement of intent to raise rates with the Commission. The Commission excluded nearly \$800,000 from the asserted rate base of \$2,374,262 because the sums had been written off by the development companies prior to transferring ownership to the related utility corporations for each subdivision.¹¹⁹

The Commission concluded that since the entire cost of the utility system was expensed by the development companies against the amount realized by the sale of the lots, the rate payers had already paid for the utility system and these costs should be excluded from the rate base and the Supreme Court agreed.¹²⁰

In *Sunbelt*, the developer constructed the utility system and then took advantage of the federal income tax laws and wrote off in one year the entire cost of the utility system.¹²¹ DDU's utility assets are still on its parent company's books as depreciable, which means that they have not been written off for tax purposes.

The facts surrounding DDU's utility infrastructure were set forth in detail in DDU's Initial Brief.¹²² Essentially, the consolidated financials, depreciation schedules from the tax return and the original costs requested as part of rate base in the applications support one another. Given that the assets are still on the books as depreciable, they have not been written off like the *Sunbelt* assets were.

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ Ex. WBRG-1 (Attachment WBRG 1-C) (*Sunbelt Utilities v. Public Utility Commission*, 589 S.W.2d 392, at 393 (1979)), WBRG 000077-WBRG 000081.

¹²² DDU Initial Brief at 23.

b. DDU and the Developer are Essentially the Same Entity

WBRG asserts that, because DDU and the Developer are essentially the same entity, the utility assets must be excluded from rate base.¹²³ The law does not support this contention as discussed above. In addition, WBRG makes bald faced assertions that all the Double Diamond companies maintain a single set of financial records and file a joint tax return. Even if it was relevant, there is no evidence in the record to support this claim. If WBRG is asserting that Mr. Gracy provided such testimony, they are incorrect. Mr. Gracy testified that he didn't "have anything to do with preparing the tax returns, so how they are prepared is beyond [him]"¹²⁴.

c. DDU Failed to Prove the Assets Were Not Funded from Lot Sales

WBRG asserts that DDU failed to prove that its assets were not funded from lot sales.¹²⁵ WBRG's assertion misconstrues the holding of *Sunbelt* as discussed above. In addition, the evidence in the record demonstrates that the assets were not funded from lot sales because they are still shown on the consolidated financials, depreciation schedules from the tax return, and the original costs requested as part of rate base in the applications, and those documents support one another.¹²⁶ These are in fact the "accounting records supporting" the fact that the utility system costs requested by DDU for its rate base have not been written off for tax purposes as was done in *Sunbelt*.

d. The Record Shows the Developer Recovered the Cost of the Utility Assets Out of Lot Sales

WBRG asserts that the record shows that the developer recovered the cost of the utility infrastructure.¹²⁷ However, the record show exactly the opposite as described above. The utility system assets they are still shown on the consolidated financials, depreciation schedules from the tax return, and the original costs requested as part of rate base in the applications, and those documents support one another.¹²⁸

WBRG attempts to bolster its argument by pointing to a single lot sale contract for property within White Bluff. The relevant contract language cited by WBRG is: "Potable water will be

¹²³ WBRG Initial Brief at 12.

¹²⁴ Tr. 80:12-14 (Gracy Cross) (Oct. 24, 2017).

¹²⁵ WBRG Initial Brief at 12-13.

¹²⁶ DDU Initial Brief at 23.

¹²⁷ WBRG Initial Brief at 13-15.

¹²⁸ DDU Initial Brief at 23.

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...¹²⁹ The contract does not state that the seller will provide the service for free. It merely states that service will be made available. No purchaser of property can reasonably conclude that they will receive all utility services for free absent some specific provision to that effect. If WBRG truly believe this position, surely they would go to court to force DDU to provide the service for free. As Mr. Gracy testified, the developer is responsible for providing a lot of things in the project, but not necessarily paying for the service provided to the lot owners.¹³⁰

e. Developer's Use of Utility Capital

WBRG asserts that the existence of a loan secured by utility assets conclusively demonstrates that DDU's invested capital should be treated as developer contributions.¹³¹ WBRG's assertion is wholly misleading. Utilities across the state secure loans through the pledge of their assets as collateral for loans to make improvements and for other purposes. An asset built with these funds are treated as utility assets. The fact that a loan exists and is secured by utility assets does not render the collateral a developer contributed asset. WBRG make numerous arguments toward this conclusion, but cites no law, rules or guidance to support its assertion. The bottom line is DDU's assets continue to be shown in the consolidated financials, depreciation schedules from the tax return, and the original costs requested as part of rate base in the applications, and those documents support one another and the inclusion of these assets in rate base.¹³²

f. Conclusion

WBRG's efforts to claim that 100% of DDU's assets are developer contributions are creative, but not based upon the law. In any case, DDU has already included in its application a reduction in asset value for purposes of rate based from 100% to 20% for a significant portion of the assets. As Mr. Gracy testified, this was done to keep the utility costs down for the customers.¹³³

¹²⁹ Exhibit WBRG 1-G

¹³⁰ Tr. 84:22 through 85:6 (Gracy Cross) (Oct. 24, 2017).

¹³¹ WBRG Initial Brief at 16-17.

¹³² DDU Initial Brief at 23.

¹³³ Ex. DDU-3, Pre-filed Direct Testimony of Randy Gracy, page 8 of 27, lines 1-6.

iv. Rate Base: 80/20 Split Developer Contributions

a. Overview

WBRG asserts that DDU's allocation of assets on an 80% developer contributed and 20% utility contributed basis is not supported by the record.¹³⁴ However, DDU's testimony and evidence contains significant support for this position.

b. No Supporting Documentation

WBRG argues that Mr. Gracy's testimony regarding the 80/20 ratio for asset treatment is insufficient. However, Mr. Gracy has been with the utility for over 30 years.¹³⁵ While papers may be lost, Mr. Gracy has been present through all of it. His testimony regarding the 80/20 allocation has been consistent from case to case, so much so that Mr. Joyce relied upon Mr. Gracy's work to allocate the utilities' assets.¹³⁶

c. DDU Erred in Treating Initial Wastewater Assets as 100% DDU

WBRG raises the issue that some of the assets should have been allocated based upon the 80/20 ratio, but were instead allocated 100% to the utility.¹³⁷ As Mr. Gracy testified, while there were some general principals with regard to construction of assets before or after certain dates, the primary decision point was whether the improvement was required to build the original system or keep up with customer demand and aging of the system.¹³⁸ Some of the assets that remain as 100% utility prior to the 2007/2008 dates mentioned by Mr. Gracy and shown in Mr. Joyce's schedules, may have been more appropriately treated with an allocation that was not consistent with the 2007/2008 timeframe. Mr. Gracy discussed some of those assets under cross-examination by WBRG.¹³⁹

d. Not Consistent with DDU's Stated Rationale

WBRG asserts that any assets prior to the creation of DDU in 1996 should be treated as 100% developer contributed. DDU strongly disagrees. What WBRG fails to acknowledge is that Mr. Gracy testified that prior to the creation of DDU in 1996, there was still a utility company –

¹³⁴ WBRG Initial Brief at 17.

¹³⁵ Tr. 54:15-16 (Gracy Cross) (Oct. 24, 2017).

¹³⁶ Ex DDU-6, Pre-filed Direct Testimony of Jay Joyce, page 13 of 89, lines 1-4.

¹³⁷ WBRG Initial Brief at 17-18.

¹³⁸ Tr. 67:10-20 (Gracy Cross) (Oct. 24, 2017).

¹³⁹ Tr. 71:3 through 78:12 (Gracy Cross) (Oct. 24, 2017).

Double Diamond, Inc.¹⁴⁰ Consequently, there was still a reason for the 80/20 split. DDU acquired the utility assets from Double Diamond, Inc. in about 1996 when it was created.¹⁴¹

e. Conclusion

DDU provided support in the record for the allocation of its assets between developer contributions and utility assets as shown in the application.¹⁴² WBRG is the only party to dispute this treatment, and WBRG's arguments are not supported by the law or the record in the case.

v. Rate Base: Use and Useful/Prudence

WBRG raises an entirely new issue in its Initial Brief related to Use and Useful/Prudence.¹⁴³ There is no evidence in the record contradicting Dr. Harkins expert testimony that she made a used and useful determination for each of the utility assets in all four systems based upon her review of the systems.¹⁴⁴ The maps attached to Mr. Gracy's testimony also show water and wastewater systems at The Cliff and White Bluff that are fully interconnected and looped.¹⁴⁵ The interconnection of these distribution and collection systems is one of the reasons cited by Dr. Harkins for treating all of the facilities as used and useful.¹⁴⁶ WBRG blatantly mischaracterized Dr. Harkins testimony in its Initial Brief.¹⁴⁷ Her testimony actually stated that the lines were looped and provide water further along the system, those lines are used and useful.¹⁴⁸ In addition, Dr. Harkins was unwilling to testify about whether the lines on a single street on a map were not used and useful.¹⁴⁹ This is exactly the opposite of what her testimony is cited for by WBRG. Consequently, all of the DDU assets included in DDU's proposed rate base are used and useful.

Perhaps more confusing is WBRG's off-hand assertion related to prudence of construction. The Courts have concluded that prudence is:

¹⁴⁰ Tr. 69: 18-20 (Gracy Cross) (Oct. 24, 2017).

¹⁴¹ Tr. 57:10-12 (Gracy Cross) (Oct. 24, 2017).

¹⁴² Ex. DDU-1, The Cliffs – Water and Sewer Rate Increase Applications, including Verifications (Totals, Water and Sewer); Ex. DDU-2.

¹⁴³ WBRG Initial Brief at 19.

¹⁴⁴ Ex. DDU-5, page 7 of 52, lines 17-20 and page 10 of 52, lines 10-11; Tr. 197:9 through 198:2 (Harkins Cross) (Oct. 24, 2017).

¹⁴⁵ Ex. DDU-3, Attachments 3B, 3C and -3D.

¹⁴⁶ Tr. 197:9-16 (Harkins Cross) (Oct. 24, 2017).

¹⁴⁷ WBRG Initial Brief at 20, footnote 71.

¹⁴⁸ Tr. 197:9-162 (Harkins Cross) (Oct. 24, 2017).

¹⁴⁹ *Id.*

The exercise of that judgment and the choosing of one of that select range of options which a reasonable utility manager would exercise or choose in the same or similar circumstances given the information or alternatives available at that point in time such judgment is exercised or option is chosen.¹⁵⁰

As the record reflects, 85 to 90 percent of the lots in White Bluff are sold.¹⁵¹ Any of those lot owners could request utility service from DDU at any time and choose to build a house. DDU must be prepared to provide that service in accordance with its CCN. Having the system built and in place, and ready to extend service, is a reasonable option for the utility, particularly when considering that much of the DDU infrastructure has been treated as developer contributed capital.

vi. Conclusion: Return on Invested Capital

DDU is entitled to a rate base determination as it has proposed. WBRG's attempt to carve out rate base through various creative, but ultimately legally unsupported arguments, should be denied.

III. RATE OF RETURN

A. Return on Equity [PO Issue 8]

WBRG return on equity should be reduced by following the guidance of the Texas Commission on Environmental Quality prior to the rate regulation program being transferred to the Commission.¹⁵² The rules of the Commission require a different procedure for determining return on equity. Return on equity should be set either by applying the formula in the application forms¹⁵³ or by completing a study to determine the appropriate return on equity, as conducted by Mr. Scheig.¹⁵⁴

¹⁵⁰ *Gulf States Utilities Company v. Public Utility Commission of Texas*, 841 S.W.2d 459, 476 (Tex. App.—Austin 1992, writ denied).

¹⁵¹ Tr. 63:2-3 (Gracy Cross) (Oct. 24, 2017).

¹⁵² WBRG Initial Brief at 21-22.

¹⁵³ Ex. DDU-6, page 16 of 89, lines 15-20.

¹⁵⁴ Ex DDU-10 and Attachment DDU-10B.

B. Cost of Debt [PO Issues 8, 14]

WBRG asserts that the cost of debt should be 4.96%.¹⁵⁵ DDU Commission Staff recommends that the weighted cost of debt be set at 4.91%. DDU agrees with either of these recommendations provided that Commission Staff's recommended capital structure is also used.

C. Capital Structure [PO Issue 7]

WBRG asserts that DDU's capital structure should be 0% equity and 100% debt based upon the loan that is secured by the DDU assets.¹⁵⁶ To reach this conclusion, WBRG twists Mr. Scheig's testimony. Mr. Scheig did not testify that DDU has taken a loan out and distributed the funds to its shareholders. He did testify that a hypothetical utility could do that, but it would damage the equity of the utility and that does not typically happen.¹⁵⁷ DDU's capital structure should not be restructured for many reasons, not the least of which is that DDU did not do what WBRG argues must be done to support its 0% equity assertion.

D. Overall Rate of Return [PO Issue 8]

DDU disagrees with WBRG's assertion regarding overall rate of return. See DDU's rebuttal testimony for DDU's proposed overall rate of return.¹⁵⁸

IV. RATE DESIGN [PO ISSUES 1, 2, 4, 35, 36, 37]

WBRG took no position on rate design.

V. RATE CASE EXPENSES [PO ISSUES 38]

VI. INTERIM RATES AND EFFECTIVE DATE [PO ISSUES 39, 40, 41]

WBRG takes no position on these issues.

¹⁵⁵ WBRG Initial Brief at 22.

¹⁵⁶ *Id.* at 23.

¹⁵⁷ Tr. 425:15-21 (Scheig Cross) (Oct. 25, 2017).

¹⁵⁸ Ex. DDU-11 (Attachment DDU-11A), pages 35 of 106 through page 38 of 106.

VII. ISSUES NOT ADDRESSED [PO ISSUES 11, 13, 17, 22, 23, 24, 26, 32, 33]

Preliminary Order issues 11, 13, 17, 22, 23, 24, 26, 32, 33 do not apply to this proceeding.

VIII. CONCLUSION

WBRG concludes by proposing a revenue requirement for both White Bluff and The Cliffs. DDU disagrees with the proposals.

- A. Table 1:** The Trending error adjustment does not agree with the trending adjustment on page 50 of Heddin testimony in Table NDH-19. WBRG now claims all of known and measurable changes to depreciation should be excluded, but this wasn't excluded in Ms. Heddin's testimony and no witness recommends this treatment.

The test year water revenues are wrong--\$473,455 should be \$470,400, which is \$465,237 in Rate Revenues at Current Rates from p. 95 of DDU-2 plus \$5,163 in "Other Revenues" from p. 53 of DDU-2.

- B. Table 2:** WBRG fails to add \$2,907 removed from WB in Table 1 to The Cliffs for CCN mapping revisions.

The Cliffs water: Test year depreciation was \$45,823, with a known and measurable change of +32,620 = \$78,443. WBRG uses \$45,823. Table 2 removes the known and measurable change adjustment just like she did on Table 1 for WB water and sewer.

But for The Cliffs sewer, WBRG keeps the DDU's known and measurable change because it is negative. Test year depreciation was \$38,159, known and measurable change of (8,896) = \$29,263. She uses \$29,263. DDU disagrees with these calculations in general, but certainly the items should be treated consistently.

In Table 2, both water and sewer, WBRG uses wrong number for application revenue requirement: For water, WBRG uses \$426,113 instead of \$429,016 shown on DDU-1, p. 53. For sewer, WBRG uses \$317,357 instead of \$319,774 (DDU-1, p. 101). WBRG uses Line 36 of Schedule 1 instead of Line 32. These calculations are confusing and misleading. They should not be given any weight.

3. REPLY TO TCUC'S INITIAL BRIEF

In general, DDU has a difficult time following The Cliff Utility Committee's ("TCUC") Initial Brief as it does not follow the outline format agreed to by the parties. DDU will provide its response following the format that TCUC used.

In addition, TCUC attaches Exhibits 15 through 22. None of these documents were offered by TCUC or admitted at hearing. DDU objects to their inclusion in the record. To the extent that Exhibit 15 is an attempt to summarize the DDU assets at The Cliffs based upon DDU-12, it has serious flaws. These documents cannot be relied upon in this proceeding and should be disregarded.

In the Executive Summary, TCUC states, "DDU has asked for a water and sewer rate increase that amounts to over 58%..." TCUC provides no source for this 58% calculation, and DDU's requested rate increase is not 58%. TCUC continues with several allegations that are not supported by evidence in the record, such as the claim that there is more than 50% of water not sold to customers and unaccounted for. In addition, TCUC make unsupported claims that DDU's water quality in The Cliffs is below industry standards. There is no evidence in the record regarding this claim.¹⁵⁹

TCUC sets forth three items for consideration. The first, regarding the original purchase price of the system, is not supported by any evidence in the record. TCUC's proposed Exhibit 5 was not admitted because it could not be authenticated. The second, regarding a trending study, is a statement by a lay witness about expert matters. The statement should be disregarded as TCUC is unqualified to opine on this issue. The third, regarding an "asset adjustment", is confusing. TCUC does not define what it means by this term. Regardless, this proceeding will establish DDU's rate base as of the test year.¹⁶⁰

TCUC's argument in the final paragraph asserts facts that are not in the records and should be disregarded. DDU understands that TCUC is a pro se party, but the rules of procedure and evidence must be followed. TCUC's assertions as to how much DDU paid for the assets and what

¹⁵⁹ TCUC Initial Brief at 1.

¹⁶⁰ *Id.* at 2.

that amount entailed is not in evidence. Finally, TCUC's statement that "DDI negotiated a note with lien which has since been paid-in-full" is not supported by evidence.¹⁶¹

IX. INTRODUCTION

TCUC again asserts that "DDU has asked for a water and sewer rate increase that amounts to over 58%..." TCUC provides no source for this 58% calculation, other than a statement that it is based upon summertime usage. DDU's requested rate increase is not 58%.¹⁶²

X. JURISDICTION

DDU agrees with TCUC that the Commission has jurisdiction over this rate proceeding.

XI. PROCEDURAL HISTORY

Although the procedural history is not significant to the issues in the proceeding, DDU must clarify that it did not withdraw its original application. DDU submitted an amended application.

XII. OVERVIEW OF PROPOSED RATE INCREASE

TCUC does not calculate the gallons billed or rate in a manner consistent with ratemaking analysis, resulting in unreliable figures for purposes of evaluating the proposed rates in comparison to the current rates.

XIII. APPLICABLE LAW

E. Original Cost / Contributions in Aid of Construction

DDU does not contest TCUC's citation of the law in this Section.

¹⁶¹ *Id.*

¹⁶² *Id.* at 3-4.

F. Return

DDU does not contest TCUC's citation of the law in this Section.

G. Expense Adjustments

DDU does not contest TCUC's citation of the law in this Section.

XIV. MAJOR ISSUES

H. Rate Base

TCUC's claims regarding the purchase of The Cliffs are not supported by any evidence in the record, and they should be disregarded.¹⁶³ TCUC Exhibit 19 was never offered at the hearing, admitted in the record, nor does it summarize evidence that was admitted.

iii. "Original Cost" Pre-Acquisition Assets

TCUC's statement that purchase price for Cliffs was \$1.8 million is not supported by any evidence in the record and should be disregarded.¹⁶⁴ As stated above, TCUC Exhibit 19 was never offered at hearing nor admitted to the record. TCUC cannot rely upon it for argument at this time. In any case, the document does not make it clear that it is related to The Cliffs.

TCUC Exhibit 15 excludes about half of assets that are coded for 8090 and 8091 for The Cliffs water and sewer.¹⁶⁵ TCUC attempts to rely upon the notations "TC" or "The Cliffs" in description the asset description, instead of the appropriate department code. DDU understands that TCUC is excluding assets that have been fully depreciated, but the reason for this is unclear when trying to determine original cost. In addition, TCUC ignores additions to rate base since 1993. TCUC may not be aware, but original Costs can include new assets that are placed into service in the system.¹⁶⁶

TCUC's assertions regarding original costs of assets is not supported by the record. TCUC also appears to not understand that TCUC is proposed an 80/20 split of the assets between

¹⁶³ TCUC Initial Brief at 6.

¹⁶⁴ *Id.* at 6.

¹⁶⁵ *Id.* at Exhibit 15.

¹⁶⁶ PUC Subst. Rule 24.31 (c)(2)(A) and (B).

developer contributed and utility owned. This split results in a significant reduction in return for DDU that The Cliffs customers benefit from. TCUC's assertions that the net book value of The Cliffs' assets is \$129,377.40 is not supported by any evidence in the record.¹⁶⁷ Further, TCUC fails to recognize that the \$898,290 cited from the 2007 TCEQ Order from 2007 relates to water system assets only.

TCUC is clearly confused about what "original cost" means in the regulatory environment. Its argument regarding that cost should be disregarded.

iv. *Developer Contributions vs. Utility Contributions*

Similarly, TCUC appears to not be following the process used by DDU to allocate assets between developer contributions and utility assets. Those matters are discussed in detail in DDU's Initial Brief¹⁶⁸ and in this Reply Brief, above.

v. *Consideration of "Unaccounted For" Water*

Once again, TCUC tries to rely upon documents that were never offered into evidence or admitted into the record.¹⁶⁹ TCUC's argument on this issue should be disregarded as a result and the documents excluded from the record. In addition, TCUC makes unsupported assertions regarding the "rapid decline" of The Cliffs systems. Finally, TCUC attempts to submit new evidence into the record though Exhibit 22. This document was never offered into evidence or admitted into the record. Consequently, it should be disregarded and excluded from the record. TCUC makes reference to a request for reimbursement sent to Randy Gracy (newly filed exhibit #22), that remains unpaid – but it is, again, new evidence that is not in the record.

¹⁶⁷ See the discussion above of the flaws in Exhibit 15.

¹⁶⁸ DDU's Initial Brief at 21-24.

¹⁶⁹ TCUC Exhibits 17 and 18.

XV. AGREEMENT WITH WBRG / COMMISSION STAFF

TCUC states its agreements with the positions asserted by WBRG and Commission Staff.¹⁷⁰ For the reasons stated in Parts 1 and 2 of this Reply Brief related to the Commission Staff's position and WBRG's position, DDU disagrees with TCUC's position.

PRAYER

WHEREFORE, PREMISES CONSIDERED, Double Diamond respectfully requests this Honorable Administrative Law Judge recommend approval of its 2016 Rate Application as requested.

Respectfully submitted,

By:  _____

John J. Carlton
The Carlton Law Firm P.L.L.C.
4301 Westbank Drive, Suite B-130
Austin, Texas 78746
(512) 614-0901
Fax (512) 900-2855
State Bar No. 03817600

ATTORNEY FOR DOUBLE DIAMOND
UTILITY COMPANY, INC.

¹⁷⁰ TCUC Initial Brief at 12.