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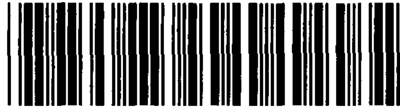

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APPLICATION OF DOUBLE	§	BEFORE THE STATE OFFICE
DIAMOND UTILITY COMPANY, INC.	§	OF
FOR WATER AND SEWER	§	ADMINISTRATIVE HEARINGS
RATE/TARIFF CHANGE	§	

WHITE BLUFF RATEPAYERS GROUP'S EXCEPTIONS TO THE PROPOSAL FOR DECISION

TO THE HONORABLE PUBLIC UTILITY COMMISSION OF TEXAS:

White Bluff Ratepayers Group ("WBRG") hereby files these exceptions to the Proposal for Decision ("PFD"). Pursuant to letter from the Commission dated March 12, 2018, the deadline for exceptions is March 28, 2018. Therefore, this pleading is timely filed. In support of its positions, WBRG would show the following:

INTRODUCTION

On February 13, 2018, the Administrative Law Judge ("ALJ") issued the PFD in this proceeding. WBRG commends the ALJ for the thorough review of the record and the well-reasoned decision. WBRG supports the ALJ's recommendations but makes the following limited exceptions to the PFD.

WBRG'S EXCEPTIONS

I. INTRODUCTION/JURISDICTION, NOTICE AND PROCEDURAL HISTORY/BACKGROUND

The PFD omits some of the procedural background that provides necessary context regarding DDU's approach to this filing. The PFD as written fails to acknowledge the magnitude of the misrepresentation contained in DDU's original application and the role that WBRG's motion played in correcting this misrepresentation.

On November 15, 2016, WBRG filed its Motion to Reject Application or Suspend Rates Based on Misrepresentations in the Application. In that motion, WBRG asserted that DDU's application should be rejected because of material misrepresentations in the application. DDU's initial application in this matter identified only **$5,684** in developer contributions for White Bluff water system. DDU's prior rate application filed in October 2008, however, identified approximately **$2 million** in developer contributions for the White Bluff water system. The prior

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application was supported by an affidavit from DDU's president. The misrepresentation contained in DDU's current application ($5,684 rather than $2 million) was a material misrepresentation for which DDU's application should have been rejected. This was not a simple oversight, as DDU's management and counsel were the same in 2008 as in this matter.

WBRG filed its motion with the intent of having the application rejected and to obtain refunds of the increased rates based on the misrepresentations. Instead, in a spirit of cooperation and with the hope of finally resolving the long-standing issues relating to DDU's rate base, WBRG agreed to allow DDU to amend its application. On November 29, upon DDU's agreed motion, the ALJ suspended the effective date of rate/tariff change to allow DDU to amend the Applications and the parties to discuss settlement, and ordered DDU to refund all amounts collected by DDU as a result of the proposed increase that had become effective on October 1, 2017.

The record clearly reveals that DDU knew that it was filing an application containing material misrepresentations regarding its rate base, and that it amended its application only on the threat of having the application rejected. The PFD should be amended to reflect the record.

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]

Miscellaneous Expenses

DDU allocates a portion of certain resort expenses from its sister company to DDU. DDU explains that the systems are located within the resort properties and that DDU uses some of the resorts resources.[1] The allocated costs include portions of the salaries of the resort's general manager, receptionist, HR employee, and other costs. According to Mr. Gracy, it would cost more $12,000 for DDU "to hire those persons and rent space solely for DDU's use."[2]

WBRG argued that these allocated costs are affiliate transactions that should not be allowed in the cost of service unless they meet the statutory test. Pursuant to Texas Water Code § 13.185(e), any payment to an affiliated interest for costs of services may not be allowed except to the extent that the Commission finds the payment to be reasonable and necessary, and this finding must include "specific statements setting forth" the costs and a finding that "the price to

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[1] PFD at 23.
[2] PFD at 24.

the utility is no higher than prices charged" by the affiliate to its other affiliates. One purpose of this rule is to keep parent corporations from shifting costs from unregulated affiliates to regulated affiliates.

In the PFD, the ALJ recommends that the Commission reject WBRG's argument based on the ALJ's determination that the allocated expenses are not affiliate transactions because: (1) it is "unclear that DDU actually makes any payments to the resort for these costs," and (2) that the record does not demonstrate that the resort is an affiliate.[3] The ALJ is mistaken as to both of these bases.

An expense that is incurred by an affiliated interest and "allocated" to a utility, and included as part of the cost-of-service, is a "payment" to an affiliated interest. What else could it be? If DDU is not "paying" the resort for the use of these employees and facilities, then the allocated costs should not be included as part of DDU's revenue requirements. If the allocation is going to be viewed as an expense, it must be treated as a payment to the resort.

The position taken by the ALJ would create bad policy because it would allow affiliates to structure their transactions as "allocations" to avoid having to make the demonstrations required by the affiliate transaction standard (Texas Water Code § 13.185(e)). For example, under the ALJ's approach, a corporate parent could allocate a greater share of its G&A costs to its regulated utilities, rather than to its unregulated affiliates, so long as the costs were "reasonable and necessary." This would be directly contrary to the requirement in the statute that the utility prove that the price to the utility is no higher than prices charged to other affiliates. The Commission needs to review transfers to affiliates regardless of whether they are paid in cash or allocated.

Additionally, it is unquestioned that an affiliate of DDU's owns and operates the resort. As set out in Ms. Heddin's testimony, all of the Double Diamond entities associated with the resorts (both White Bluff and The Cliffs) are wholly owned subsidiaries of Double Diamond, Delaware, Inc. (DDD).[4] All of these entities are "affiliates" of DDU under Texas Water Code §13.002(2)(D) because they are corporations that are owned (more than 5%) by a corporation (DDD) that owns more then 5% of DDU. Allocations among any of these Double Diamond entities are payments to affiliates.

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[3] PFD at 26

[4] Ex. WBRG-1 at 10-12; WBRG-1D; WBRG-1F.

The proposed conclusion of law number 8 is legally and factually incorrect because and should be deleted. "Allocations" are payments for purposes of Texas Water Code § 13.185(e), and the resort entity is an "affiliate" under Texas Water Code § 13.002(2). Therefore, because the ALJ did not make all of the findings required by Texas Water Code § 13.185(e), the allocated resort expenses should be disallowed.

B. Depreciation [PO Issues 12, 27]

No exceptions.

C. Taxes [PO Issues 28, 29, 30, 31]

No exceptions.

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

1. Original Cost of Plant in Service

WBRG's overriding goal in this proceeding was to get a rate base established that properly recognized DDU's investment in the utility separate from the investment made by DDU's affiliated development entities. This was also WBRG's goal in the last three rate cases filed at TCEQ. WBRG hopes that it has finally achieved that goal. Based on prior practice, however, WBRG is concerned that DDU will use any ambiguity in the order to force the ratepayers to once again litigate DDU's rate base in a future rate proceeding.

Based on the ALJ's findings, as set out in II.D.4 of the PFD, the original cost of DDU's plant in service for White Bluff water is $71,367.48 and White Bluff sewer is $25,624.64.[5] These amounts should be expressly referenced in the PFD and in the Commission's final order so that DDU will not attempt to re-litigate the historic rate base in any future rate case.

2. Accumulated Depreciation

As with WBRG's position on Original Cost of Plant in Service, WBRG asserts that based on the ALJ's findings, the PFD and the final order need to expressly recognize the Accumulated Depreciation associated with the plant in service. For White Bluff, these amounts are the difference between Original Cost and Net Book Value in the "DDU Funded" rows and Tables

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[5] PFD at 50 ("the record does show that certain utility assets . . . were paid for DDU, and the net book value of these assets should remain in DDU's rate base"). The record citation is to Table NDH-1 and NDH-2 in WBRG Ex. 1. The amounts shown as Net Plant in the Schedules contained in Attachment A to the PFD correspond to the amounts in Tables NDH-1 and NDH-2. It follows that the ALJ agreed with the Original Cost amounts also shown in Tables NDH-1 and NDH-2.

NDH-1 and NDH-2.[6] Accumulated depreciation for White Bluff water is $3,012 and for White Bluff sewer is $1,595.

3. Cash Working Capital

No exceptions.

4. Developer Contributions

WBRG reads the PFD to hold that DDU failed to meet its burden of separating developer contributions from the utility's invested capital, and therefore, the ALJ limited DDU's rate base to plant that DDU directly paid for.[7] If a specific amount of developer contributions is required for the final order[8], that amount should be the invested capital amount shown in DDU's application (adjusted to remove the inflated values associated with the trending study) less the amount of original cost found by the ALJ.

While the PFD appears to limit this finding to the White Bluff system, there do not appear to be any findings regarding how this finding should be implemented for The Cliffs. Moreover, if the PFD is holding that the 80%/20% split is appropriate for The Cliffs, the rate calculations in the Attachment do not appear to correct developer contributions for the initial wastewater plant at The Cliffs that was shown as 100% utility in the application, but for which the testimony at the hearing supported a finding of 80% developer/20% utility.[9]

5. Property Not Belonging to DDU

No exceptions.

6. Improper Use of Trending Study

WBRG agrees with the ALJ's finding on this issue – DDU failed to justify its use of a trending study. While the PFD properly addresses the effect of this conclusion with regard to **depreciation**, the schedules attached to the PFD fail to adjust the **rate base values** for either White Bluff or The Cliffs to set the values equal to the values recorded in DDU's books. In other words, the PFD does not correct rate base values to remove the inflated values associated

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[6] Ex. WBRG-1 at WBRG000022-WBRG000023.

[7] PFD at 50.

[8] The PFD appears to treat this plant as developer contributions because DDU is allowed to recover depreciation of the assets but not allowed a return.

[9] PFD at 45. The amount for The Cliffs wastewater is shown on Ex. DDU-6D page 70 of 89. The original cost of the asset, identified as Total Pipe Installed (1/1/96) is $703,723.37.

with the trending study. The final order should reflect the book value for these assets and not the trended value.

7. Used and Useful/Prudence

WBRG agrees with the ALJ that the issue of used and useful/prudence is moot based on the ALJ's findings on rate base. Nevertheless, WBRG disagrees with the ALJ's conclusions on this issue if the issue is not moot. The system at White Bluff was built to serve 6,314 lots and the system at The Cliffs was built to serve 2,518 lots, yet the vast majority of these lots (approximately 90%) have never been connected to the system and have never contributed to the cost of the water and sewer systems built to serve the lots. The questions that need to be asked are whether a prudent utility operator would build such a large system to serve only a few customers, and whether, given the nature of these systems (developer-constructed), each lot that has access to the systems should be required to contribute to the cost of the systems, particularly if those lots are owned by an affiliate of the utility.

8. Accumulated Deferred Federal Income Tax (ADFIT)

No exceptions.

III. RATE OF RETURN

A. Return on Equity [PO Issue 8]

No exceptions.

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

No exceptions.

C. Capital Structure [PO Issue 7]

The record clearly shows that DDD (the only shareholder in DDU) removed all of its equity in DDU through a transfer of $3,000,000 from DDU to DDD. The capital structure needs to reflect the utility's actual capital structure – 100% debt.

The evidence in the record shows that DDU took out a loan for $3,000,000 on March 7, 2013.[10] This loan had a maturity date of March 7, 2015, which was extended to August 28, 2018, and is secured by the utility assets at White Bluff.[11] The proceeds of the loan do not appear to have been used for utility purposes. After receiving the proceeds, DDU installed

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[10] Ex. WBRG-1 at WBRG000027-WBRG000028.

[11] *Id.*; Ex. WBRG-6.

infrastructure investment of only $263,404.[12] DDU admitted that the loan was taken out to provide capital to its corporate parent, DDD, for "whatever . . . the parent company chose to do with the monies."[13] DDU's president testified that he did not know if any of the funds were used by DDU[14] and that he did not know whether there was an agreement for DDD to repay the loan.[15] The facts are clear that DDD took $3,000,000 from DDU to use for DDD's own purposes – not for utility purposes. Unless, and until, DDD returns that capital to DDU by repaying the debt (or completely transferring the debt to DDD and removing the lien on DDU's assets), DDD (DDU's only shareholder) should not be viewed as having any equity in DDU.

The ALJ takes the position that the payment of the loan proceeds to DDD was not a dividend payment because DDD is the guarantor of the note and the bank would look to DDD for payment.[16] The record, however, contains no evidence as to DDD's obligations as "guarantor." Presumably, DDD's obligations only kick in after foreclosure on the security posted by DDU -- the White Bluff utility system. In that case, the transfer of funds to DDD is still a dividend because DDD will not be obligated to repay so long as the debt is covered by the value of the White Bluff system, which was pledged as security.

DDD could have taken out the loan itself and pledged its shares in DDU as collateral. That would not have affected DDU's capital structure. That is not what happened here. Instead, DDU took out a loan secured by utility property, and then gave those funds to its shareholder. This action can only be described as a dividend, as acknowledged by DDD's expert at the hearing.[17]

Even if the Commission rules against WBRG on the issue of DDU's capital structure, WBRG asserts that there is something fundamentally "fishy" about this loan, and DDD's use of the proceeds and is something that the Commission should address, either in this rate case or in a separate enforcement docket. DDU took out a short-term, balloon note for an amount well in excess of its invested capital, and well beyond its ability to repay out of rate revenue; secured that note with utility property; gave the proceeds of the loan to its corporate parent, without any

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[12] Ex. WBRG-1 at WBRG00027.
[13] Tr. at 91:22–92:1 (Gracy Cross) (Oct. 24, 2017).
[14] Tr. at 92:7 (Gracy Cross) (Oct. 24, 2017).
[15] Tr. at 97:8 (Gracy Cross) (Oct. 24, 2017).
[16] PFD at 71-72.
[17] Tr. at 424:20–425:21 (Scheig Cross) (Oct. 24, 2017).

understanding of when or how the money would be repaid. The Commission should not condone the speculative use of utility property for non-utility purposes.

While WBRG believes that the Commission can address this loan in this proceeding, there are other avenues available to the Commission to protect the ratepayers from this behavior. For example, the transaction looks like a loan of money by DDU to DDD, a person owning or holding stock in DDU. DDU did not give notice of this loan to the Commission, as required by Texas Water Code §13.303. This provision should give the Commission to take action to provide the ratepayers with protection against the possible adverse consequences of this loan.

1. Overall Rate of Return [PO Issue 8]

No exceptions.

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

No exceptions.

V. RATE CASE EXPENSES [PO ISSUE 38]

The Commission's 51% rule provides:

> A utility may not recover any rate-case expenses if the increase in revenue generated by the just and reasonable rate determined by the commission after a contested case hearing is less than 51% of the increase in revenues that would have been generated by ***a utility's proposed rate***.[18]

WBRG disagrees with the ALJ's recommendation that the Commission use the amended proposed rate, rather than the originally submitted proposed rate, for purposes of the 51% rule. DDU's initially submitted application included significant misrepresentations of rate base from the previous rate case as well as developer contributions. These rates were not suspended and went into effect. DDU's customers in White Bluff and The Cliffs were forced to pay rates based on the misrepresented facts. Yes, DDU later revised the application to make some corrections identified by WBRG, but DDU only made these revisions to keep its application from being dismissed. 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%,** without any of the disallowances recommended by WBRG.[19]

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[18] 16 Tex. Admin. Code § 24.33(b) (emphasis added).
[19] Ex. WBRG-1 at WBRG000055.

The ALJ's approach is contrary to the 51% rule and the policy behind the 51% rule, which is intended to provide a check on outrageous and wholly unsupported requests made by water and sewer utilities. If a utility asks for an increase that it cannot support, and the ratepayers spend their time and money to prove the rates should be reduced, the ratepayers have earned the right to be relieved of the obligation to pay the utility's costs of preparing and litigating rates, which were far too high to begin with.

Under the ALJ's approach, utilities will be incented to file applications seeking unsupported rates with the hope that no ratepayers intervene. This is particularly true for rate applications filed by Class B utilities such as DDU, where the Commission typically does not even bother to review an application unless 10% of the ratepayers petition the Commission.[20] Under the ALJ's approach, utilities will be motivated to ask for more than they can support, knowing that they can reduce the amount sought to a more realistic level later and still recover their rate case expenses. The Commission should encourage utilities to properly complete their rate change applications initially.

One flaw with the ALJ's approach is that the ALJ provides no guidance as to the latest date that a utility could amend its application and still be able to assert that the amended proposed rates be used for the purposes of the 51% rule. This demonstrates the unworkable nature of the ALJ's recommendation. For instance, would the ALJ allow DDU to amend its application today and reduce its proposed rate to level that would meet the 51% rule based on the ALJ's recommended rate? If today would be too late, then what cutoff date would control? If the Commission agrees with the ALJ that the amended application prevails, then WBRG recommends that Commission clearly state that the cut off date for eligible amendments be set as either the effective date or the date that matter is referred to SOAH. The Commission should also address whether costs incurred prior to the amendment will be recoverable as rate case expenses.

The ALJ also does not provide any guidance as to whether DDU's eligibility to recover rate case expenses will be determined based on all of the rates set by this matter collectively or individually. The ALJ is recommending rate decreases for the White Bluff water and sewer systems but rate increases for The Cliff's systems. If analyzed individually, will DDU be allowed to recover all of its rate case expenses if the approved rates for one of the four systems exceed the 51% threshold, even if the other three rates, or all four rates collectively, do not

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[20] Tex. Water Code §13.1871(i).

exceed the 51% threshold? WBRG recommends that the Commission deny all rate case expenses because collectively the rates recommended by the PFD do not exceed the 51% threshold.

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

No exceptions.

VI. 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, and 33 are not applicable to this proceeding, and are therefore not addressed.

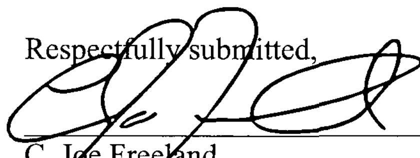
VII. CONCLUSION

With the exceptions set out herein, WBRG supports the PFD. For the White Bluff systems, the Commission must finally set a rate base so that both the ratepayers and the utility can stop litigating these issues in every rate case. The issues were thoroughly vetted in this docket, and the PFD properly adjudicates the issues. The Commission needs to correct the ALJ's findings and conclusions regarding affiliate transactions. The Commission also needs to determine whether it was proper for DDU to take out a loan secured by utility assets for an amount far in excess of the utility's ability to repay from rates and transfer the proceeds of that loan to DDU's only shareholder.

For the reasons discussed herein, White Bluff Ratepayers Group respectfully requests that the Commission amend the PFD and the final order as recommended in these exceptions.

Dated: March 28, 2018

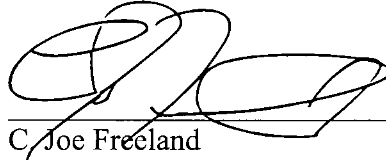
Respectfully submitted,



C. Joe Freeland
State Bar No. 07417500
Mathews & Freeland, LLP
8140 N. MoPac Expy, Suite 2-260
Austin, Texas 78759
(512) 404-7800
jfreeland@mandf.com
ATTORNEYS FOR
WHITE BLUFFS RATEPAYER GROUP

CERTIFICATE OF SERVICE

I certify that a copy of the foregoing pleading was served on all parties of record in this proceeding on March 28, 2018, by hand-delivery, facsimile, electronic mail, and/or First Class Mail.



C. Joe Freeland