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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
EXCEPTIONS TO THE PROPOSAL FOR DECISION**

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have served or will serve a true and correct copy of the foregoing document via hand delivery, facsimile, electronic mail, overnight mail, U.S. mail and/or Certified Mail Return Receipt Requested to all parties on this the 28th day of March, 2018.



John J. Carlton

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COMES NOW, Double Diamond Utility Company, Inc., and files this, its Exceptions to the Proposal for Decision and proposed Order. In support thereof, DDU respectfully shows the following:

I. INTRODUCTION

Double Diamond Utility Company, Inc. (“DDU”), filed Applications (“Applications”) with the Public Utility Commission of Texas (“Commission”) for a rate/tariff change under Certificate of Convenience and Necessity Nos. 12087 and 20705 for water and sewer utility service to The Cliffs and White Bluff resort/residential developments in Palo Pinto County and Hill County, respectively. Pursuant to Texas Water Code § 13.1872(c)(2), DDU opted to file the Applications as a Class B utility.

DDU’s test year revenue requirements (costs of service) for White Bluff were \$465,237 for water service and \$412,543 for sewer service, and for The Cliffs, were \$368,356 for water service and \$215,111 for sewer service. DDU proposes to increase its revenue requirements, based on test year cost data and adjustments for known and measurable changes, to \$568,368 for White Bluff water; \$572,068 for White Bluff sewer; \$421,488 for The Cliffs water; and \$313,686 for The Cliffs sewer.

The Administrative Law Judge (“ALJ”) issued a proposal for decision recommending a \$139,963 reduction in DDU’s revenue requirement for the White Bluff water and sewer systems and a \$134,423 increase in DDU’s revenue requirement for The Cliffs water and sewer systems. See **Attachments A and B** for summary tables of the proposed adjustments for White Bluff and The Cliffs.

As one can see from the summary tables, DDU's primary disagreements with the recommendations in the PFD relate to: (1) payroll and payroll taxes; (2) umbrella insurance; (3) inclusion of trending study asset values and depreciation; (4) return on equity and ADFIT adjustments; and (5) exclusion of assets related to Developer Contributions.

II. JURISDICTION, NOTICE, AND PROCEDURAL HISTORY

A. Jurisdiction and Notice.

DDU agrees with the ALJ's proposal for decision ("PFD") as it relates to jurisdiction and notice.

B. Procedural History.

DDU agrees with the ALJ's PFD as it relates to procedural history.

III. BACKGROUND

DDU is an investor-owned water utility company servicing several communities in North Texas, including White Bluff and The Cliffs. DDU has approximately 640 water customers and 567 sewer customers in White Bluff, and approximately 287 water customers and 239 sewer customers in The Cliffs.¹ The White Bluff water and sewer systems contain assets that were installed as early as 1990-1991, over 25 years ago.² The Cliff's water and sewer systems also contain assets that were installed as early as 1996, over 22 years ago.³

Ratemaking for retail water and sewer utilities is governed by Chapter 13, Subchapter F of the Texas Water Code.⁴ In this proceeding, because DDU seeks a change of rates, DDU bears the burden of proving that its proposed changes are just and reasonable,⁵ and the Commission is

¹ Ex. DDU-2, p. 55 of 151; Ex. DDU-2, p. 103 of 151; Ex. DDU-1, p. 55 of 151; Ex. DDU-1, p. 103 of 151.

² DDU Ex. 5-B, Asset Table for White Bluff Water; DDU Ex. 5-F, Asset Table for White Bluff Sewer.

³ DDU Ex. 5-C, Asset Table for The Cliffs Water; DDU Ex. 5-G, Asset Table for The Cliffs Sewer.

⁴ Tex. Water Code § 13.181.

⁵ Tex. Water Code § 13.184(c).

obligated to “ensure that every rate made, demanded, or received by any utility ... shall be just and reasonable.”⁶

IV. REVENUE REQUIREMENT [PO Issues 3, 5, 6, 34]

DDU agrees with the PFD general statements regarding Revenue Requirement.

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

1. Other Revenues

DDU agrees with the PFD recommendation regarding Other Revenues.

2. Other Volume-Related Expenses

DDU agrees with the PFD recommendation regarding Other Volume-Related Expenses.

3. Employee Labor

DDU agrees with the PFD recommendation regarding Employee Labor, but DDU excepts to the exclusion of known and measurable changes for salaries as discussed in Section A.9., below.

4. Contract Work

DDU agrees with the PFD recommendation regarding Contract Work.

5. Transportation Expense

DDU agrees with the PFD recommendation regarding Transportation Expense.

6. Other Plant Maintenance

DDU agrees with the PFD recommendation regarding Other Plant Maintenance.

7. Professional Services

DDU agrees with the PFD recommendation regarding Professional Services related to the CCN for The Cliffs. In addition, this surcharge and the related expense should not be included in

⁶ Tex. Water Code § 13.182(a).

the calculation of the 51% threshold for recovery of rate case expenses similar to the treatment of the Prairieland Groundwater Conservation District fees discussed in Section 10 of the PFD.

8. Insurance Expenses

DDU excepts to the PFD recommendation regarding Insurance Expense as discussed below.⁷

The ALJ agreed with Commission staff witness Emily Sears' recommended removal of \$3,371 in water costs and \$1,127 in sewer costs from the DDU insurance for the umbrella-spa & ski liability insurance premiums because Ms. Sears claimed she was unable to separate out the spa & ski portion of the insurance that she wants to exclude from the umbrella liability insurance that she wants to include.⁸ Notably, Ms. Sears acknowledges that the umbrella policy is based upon the underlying policies⁹ and does not assert that an umbrella policy is not appropriate for a utility.¹⁰ However, as Mr. Joyce testified and contrary to the ALJ's conclusions and Ms. Sears assertion, it is possible to remove the spa & ski portion of the umbrella policy using the documents included in Ms. Sears' work papers.¹¹ By applying the proportionate amount of the spa & ski premium of \$3,100 to the total umbrella policy premium as recommended by Mr. Joyce, the resulting reductions in insurance costs are \$100 for water and \$34 for sewer.¹² In addition, as Mr. Gracy testified, it would be difficult to get the same coverage of insurance for less than the \$18,000 being requested by DDU for White Bluff.¹³ Allowing a reasonable total amount of insurance expense to adequately insure the systems is appropriate. The PFD and Commission staff reductions should be adjusted to the levels recommend by Mr. Joyce.

⁷ PFD, p. 19-21; Proposed Findings of Fact Nos. 48-51.

⁸ Ex. Staff-2 (Sears Direct), p. 20, lines 10-16.

⁹ Tr. 325:12-13 (Testimony of Emily Sears) (Oct. 25, 2017).

¹⁰ Tr. 323:8-10 (Testimony of Emily Sears) (Oct. 25, 2017).

¹¹ Ex. Staff-2A (Sears Workpapers), p. 84-95.

¹² Ex. DDU-11, p. 8 of 106, line 20 through p. 9 of 106, line 8.

¹³ Tr. 461:12-13 (Testimony of Randy Gracy)(Oct. 26, 2017).

9. Salaries

DDU excepts to the PFD recommendation regarding Salaries.¹⁴

The ALJ agrees with WBRG's assertions 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.¹⁵ Mr. Joyce testified that the reason for the amount listed in the known and measurable column on Table I-1 in the application¹⁶ 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.¹⁷ Mr. Gracy confirmed this during his testimony.¹⁸ Mr. Joyce explained that the total employee labor cost set forth in the revenue requirement summary in the White Bluff Application is the same as the total yearly salaries of the seven employees listed in the Application. The ALJ asserts that Mr. Joyce "testified that the amount that was actually paid in salaries was less than the total salaries of the seven employees because not all seven employees worked the entire test year and therefore did not earn their total yearly salaries."¹⁹ However, this mischaracterizes Mr. Joyce's testimony. Mr. Joyce actually testified that "I understand there were some vacancies during the year, so that's -- that explains why there's a difference between the actual test year numbers and the numbers adjusted for known and measurable changes because we're assuming that the system is fully staffed."²⁰ The known and measurable change to salary costs is a direct result of the utility system being not fully staffed during the test year.

The ALJ relies upon many of Mr. Gracy's statements to conclude that the known and measurable changes should be denied. However, Mr. Gracy's testimony regarding the current

¹⁴ PFD, p. 21-22; Proposed Findings of Fact Nos. 52-55.

¹⁵ Staff Exhibit 2A, Workpaper 5.

¹⁶ Ex. DDU-2, White Bluff – Water and Sewer Rate Increase Applications, including Verifications (Totals, Water and Sewer), page 6 of 151 (Table I-1).

¹⁷ Tr. at 206:15-21 (Joyce Cross) (Oct. 24, 2017).

¹⁸ Tr. at 104:14-17 (Gracy Cross) (Oct. 24, 2017).

¹⁹ Tr. at 206 (Joyce Cross) (Oct. 24, 2017).

²⁰ *Id.*

number of employees is irrelevant to this issue. Throughout his testimony he explains that he relied upon his staff and his consultants to provide the correct information for the application.²¹ In fact, he testifies that while he is generally familiar with the employees, he would have to look at the payroll records to confirm how many there are and how much they are paid.²² He also could not confirm who the current employees were or how many there were at the time of the hearing.²³ More importantly, Mr. Joyce testifies that:

There's a high turnover in this type of job, and these are \$20,000-a-year positions, so it's not uncommon to have vacancies in and out. And you've got a training experience coming along for each new employee that you hire. So the fact that in any one point in time there may have been a few less employees really has no bearing upon what an adjusted test year amount should be.²⁴

The vacancies and turnover in these utility positions make the analysis confusing, but DDU demonstrated its actual test year cost for salaries and its known and measurable changes for the following year. DDU's requested salary costs of \$171,960 are reasonable and should be included in the revenue requirement.

10. Regulatory Fees

DDU agrees with the PFD recommendation regarding Regulatory Fees, including the treatment of those fees in the calculation of the 51% threshold for purposes of rate case expense recovery.

11. Miscellaneous Expenses

DDU agrees with the PFD recommendation regarding Miscellaneous Expenses.

B. Depreciation (PO Issues 12, 27)

DDU excepts to the PFD recommendations regarding Depreciation.²⁵

²¹ Tr. 103:15-18 (Gracy Cross)(Oct. 24, 2017).

²² Tr. 101:4-10 (Gracy Cross)(Oct. 24, 2017).

²³ Tr. 104:23-25 (Gracy Cross)(Oct. 24, 2017).

²⁴ Tr. 208:22-209:5 (Joyce Cross)(Oct. 24, 2017).

²⁵ PFD, p. 26-31; Proposed Findings of Fact Nos. 68-74.

As a relatively minor matter, the ALJ misunderstood the Staff's \$80 adjustment related to the "Truck Bed Mat."²⁶ Staff did not recommend that the \$80 be excluded in its entirety, just that the \$80 related to the "Truck Bed Mat" be included as an expense rather than an asset that is depreciated.

More significantly, DDU disagrees with the PFD recommendations regarding exclusion of Dr. Harkins trended asset values from depreciation as discussed in Section B.1., below.

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

DDU excepts to the PFD recommendation regarding Improper Known and Measurable Adjustment/Inappropriate Use of Trended Original Cost Study, in particular the exclusion of the trended value of certain utility assets for which there were no records of costs.²⁷

The Commission rules states that "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*, may receive an adjustment to rate base and/or an adjustment to the rate of return on equity."²⁸ The Commission has adopted the position that "[a]ccounting does not determine the appropriate ratemaking treatment. The statutory framework determines regulatory treatment."²⁹

The issue is essentially whether the Commission will conclude that a current balance sheet entry with a line item entry for a group of assets constitutes "historical records for verification purposes" as contemplated by Rule 24.31(c)(2)(B)(i). DDU asserts that a lump-sum entry on a current balance sheet is not a historical record and would be insufficient for this purpose, instead a utility must look to historical records of actual costs, such as invoices.

²⁶ PFD, p. 26-27; Proposed Findings of Fact No. 68.

²⁷ PFD, p. 27-29; Proposed Findings of Fact Nos. 69-74.

²⁸ 16 Tex. Admin. Code § 24.31(c)(2)(B)(i) (emphasis added)

²⁹ Proposal for Decision in Docket No. 44649, Application of Southwestern Electric Power Company for Authority to Change Rates, p 94, adopted by Commission Order on Rehearing issued March 19, 2018.

The ALJ states, “It is not entirely clear whether historical records exist (or existed at the time the Applications were prepared) showing the original construction costs for the collection and distribution lines at White Bluff and The Cliffs.”³⁰ The ALJ also states that he “interprets 16 Texas Administrative Code § 24.31(c)(2)(B)(i) to put the burden on DDU to show that its account balances do not reflect the original costs of the line work assets before estimating those costs by a trending study for purposes of determining rate base.”³¹ But that is not what the rule provides. The ALJ seems to conclude this because “Dr. Harkins did not review DDU’s balance sheets to determine if those asset costs were recorded there.”³² Setting aside the fact that balance sheets are not historical in and of themselves, Mr. Grout testified that the detail in the balance sheets is “one-line, lump-sum numbers.”³³ The ALJ comments that “DDU relies solely on this statement by Mr. Grout as support for the ‘idea’ that the original costs of the line work cannot be determined from the balance sheets.”³⁴ The ALJ’s assertion is not correct. In fact, the consolidated balance sheet for Double Diamond, Inc. and Subsidiaries does list a single line item for “property and equipment, net”; in addition, the notes to the balance sheet related to that property and equipment line item include a single line item for the assets for the “water/wastewater systems.”³⁵ The details of the utility assets are lumped into a single line item as testified to by Mr. Grout. But these balance sheet values are not “historical records”. They are current records relating to the book value of the entity’s current assets.

The record contains a preponderance of evidence to support that there are “no historical records for verification purposes” related to the trended assets, which were installed over a period of time 25 years ago. Dr. Harkins testified that

Based on review of the footage of linework for both The Cliffs and White Bluff Water and Wastewater Systems and a comparison to the trended original costs, invoices were not available to account for the linework in its entirety. Therefore, I took the trended original cost and subtracted the value

³⁰ PFD, p. 28.

³¹ PFD, p. 29.

³² PFD, p. 28.

³³ Tr. at 157: 15-17 (Grout Cross)(Oct. 24, 2017).

³⁴ PFD, p. 28, citing DDU Reply Brief at 19.

³⁵ WBRG Ex. 8 at DDU003571 and DDU0003584.

of the invoices in receipt and depreciated the remainder. The costs subtracted are shown in duplicate at the bottom of each trended data summary for completeness.³⁶

She also clarified on cross-examination that she reviewed DDU's records and could not locate records related to the trended assets.³⁷ She further testified that she created the asset lists supporting the Application from invoices.³⁸ The asset lists are a comprehensive listing of every single asset that Dr. Harkins found in her review and include 556 asset entries, not including the trended assets.³⁹ Based upon this review, and as she testified in her pre-filed direct testimony quoted above, she concluded that the entirety of the linework in the utility systems was not accounted for in the historical records of the utility. Consequently, she completed a trending study as contemplated by the Commission rules.

WBRG's arguments on this issue are confusing at best and appear to have had this effect on the ALJ's decision. Generally accepted accounting principles do not match the requirements of regulatory accounting requirements. Asset lives are treated differently, and costs may be booked differently.⁴⁰ Yes, there are assets on the consolidated balance sheets for DDU's parent company, but as the Commission knows, those balance sheet entries are not determinative of the value of DDU's original cost of plant and equipment because of these different accounting regimes. This important difference in accounting methods is further highlighted in the discussions related to developer contributions, below.

On the other hand, Staff understands these regulatory accounting issues. Staff's recommended original cost, annual depreciation and net book value all include Dr. Harkins' trended asset values. Apparently, Staff did not find the issue significant because their witness did

³⁶ Exhibit DDU-5, p. 6, lines 10-16.

³⁷ Tr. 186:8-15 and 16-21; Tr. 187:22-188:1; Tr. 187:16-17 (Harkins Cross)(Oct. 24, 2017).

³⁸ See Exhibits DDU-5B, DDU-5C, DDU-5F and DDU-5G, and Tr. 187:22-188:1; Tr. 188:21-189:1 (Harkins Cross)(Oct. 24, 2017).

³⁹ *Id.*

⁴⁰ For example, DDU's parent company tax accelerated depreciation for tax purposes (Tr. 537:16 (Joyce Cross)(Oct. 26, 2017)), but is prohibited from doing so for regulatory purposes under 16 Tex. Admin. Code § 24.31(c)(2)(B)(2).

not address it at all and simply recommends a rate base and depreciation that includes Dr. Harkins' trended asset values.⁴¹

The Commission should accept DDU's trending study because it is consistent with the Commission's rules.

The ALJ goes on to recommend that even if the Commission decides to accept the trending study "DDU's rate base should be lowered to account for the trending study."⁴² The ALJ claims that "DDU offered no evidence or argument to explain why it has no records of the original cost of the assets Dr. Harkins trended in her study."⁴³ The facts are simple and in the record. The records for the assets in the trending study are over 20 years old and while some of the invoices for these types of assets were located, not all of them could be found.⁴⁴ DDU requests that the Commission allow the trending study to be included in its Original Cost and used for determination of annual depreciation and rate base.

2. Error in Trending Study

DDU agrees with the PFD recommendation regarding WBRG's alleged Error in Trending Study.

3. Fully Depreciated Assets

DDU agrees with the PFD recommendation regarding the treatment of assets listed in the Application schedules that are fully depreciated in those schedules.

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

1. Federal Income Tax Expense [PO Issue 30]

DDU agrees with the PFD recommendation regarding Federal Income Tax Expense.

⁴¹ Exhibit Staff 4, p. 6 (Direct Testimony of Jolie Mathis).

⁴² PFD, p. 29.

⁴³ *Id.*

⁴⁴ See Exhibits DDU-5B, DDU-5C, DDU-5F and DDU-5G; Exhibit DDU-5, p. 8 of 52, lines 10-15.

2. Other Assessments and Taxes [PO Issue 29]

DDU agrees with the PFD recommendation regarding Other Assessments and Taxes.

D. Return On Invested Capital [PO Issues 9, 10, 15, 16, 18, 19, 28, 31]

DDU excepts to the PFD recommendation regarding Return on Invested Capital as they relate to developer contributions and discussed below in Section D.4. and the application of a small stock risk premium for return on equity discussed below in Section V.A.⁴⁵

1. Original Cost of Plant in Service

a. Staff's Recommended Adjustments and ALJ's Recommendations

DDU agrees with the PFD recommendation regarding Staff's Recommended Adjustments to Plant in Service Costs in this Section of the PFD.

b. TCUC's Argument, DDU's Response, and ALJ's Analysis

DDU agrees with the PFD recommendation regarding TCUC's Argument related to Original Cost of Plant in Service in this Section of the PFD.

2. Accumulated Depreciation

DDU agrees with the PFD recommendation regarding Accumulated Depreciation.

3. Cash Working Capital

DDU excepts to the PFD recommendation regarding Cash Working Capital as it relates to The Cliffs.⁴⁶

The ALJ agrees with Staff's assertion that White Bluff and The Cliffs should both have cash working capital calculated at 1/12 of operating expenses.⁴⁷ DDU disagrees. 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.

⁴⁵ PFD, p. 33.

⁴⁶ PFD, p. 36-37; Proposed Findings of Fact Nos. 84-86.

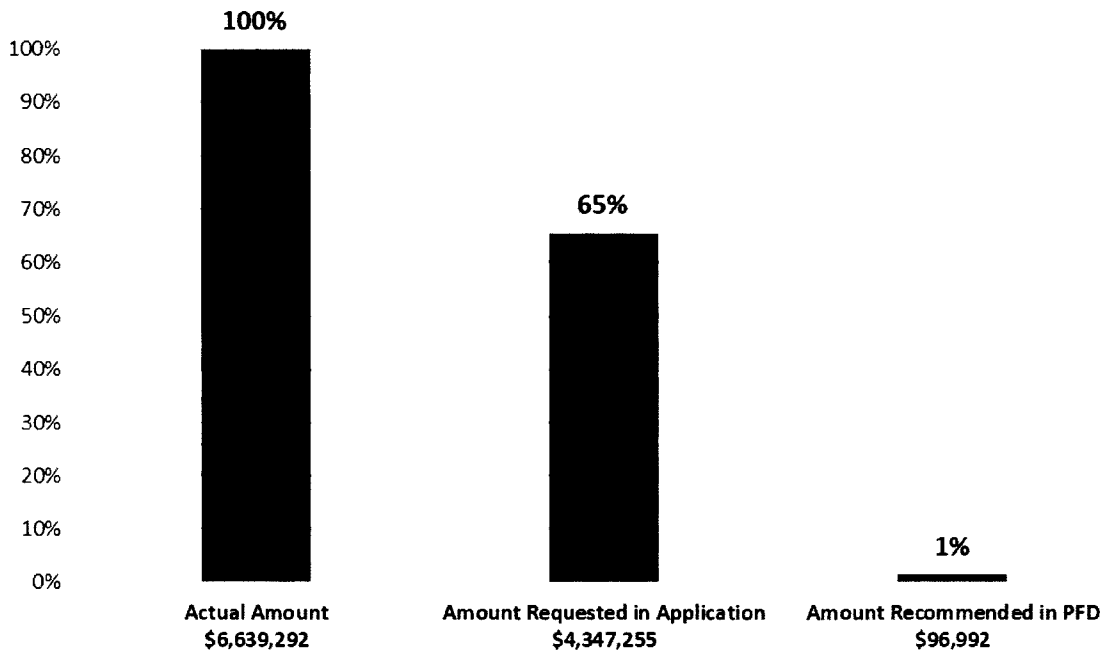
⁴⁷ *Id.*

4. Developer Contributions

DDU excepts to the PFD recommendation regarding Developer Contributions.⁴⁸ This issue is the largest single impact to DDU's applications related to the White Bluff systems, and reverses decades of regulatory accounting practice regarding the treatment of DDU's assets. The ALJ's recommendation is based primarily upon his assertion that, because DDU could produce no historical bookkeeping records showing the 80% developer contributions and 20% allocation to the utility for transactions that occurred over 20 years ago, nearly the entire balance of DDU's assets should be excluded from rate base for purposes of calculating a reasonable return on investment. The ALJ proposes wiping out 99% of DDU's original cost of plant in service as shown in the charts below.

⁴⁸ PFD, p. 37-50; Proposed Findings of Fact Nos. 87-100.

WHITE BLUFF ORIGINAL COST OF PLANT IN SERVICE



White Bluff Utility Plant In Service				
Line No.	Original Cost	Total	Percent	
1	Actual Amount	\$ 6,639,292	100%	
2	Amount Requested in Application	\$ 4,347,225	65%	
3	Amount Recommended in PFD	\$ 96,992	1%	
Sources: Line 1: Exh. DDU-2, Schedules III-3, Col. D.1 Line 2: Line 1 less Exh DDU-2, Schedules III-8(b), Col. C Line 3: Exh. WBRG-1, Tables NDH-1 and NDH-2				

Essentially, the ALJ ignores Mr. Gracy’s historical testimony about DDU and its assets and the testimony of DDU’s consultants that corroborates Mr. Gracy’s testimony. Mr. Gracy has been president of DDU since its inception in 1996,⁴⁹ and prior to that worked for DDU’s related companies since 1983.⁵⁰ His testimony is an accurate account of the treatment of the utility assets over the prior 30 years.⁵¹ He testified that the decision of how the costs of the utility assets were

⁴⁹ Exhibit DDU-3, Gracy Direct at 3:5-7.

⁵⁰ Tr. at 83:25 (Gracy Cross)(Oct. 24, 2017).

⁵¹ Exhibit DDU-3, Gracy Direct at 7:13-8:14 (White Bluff water), 8:21-9:19 (The Cliffs water), 10:10-11:8 (White Bluff sewer), and 11:15-12:10 (The Cliffs sewer).

split, either 80% to the developer and 20% to the utility or 100% to the utility, was initially made in 1990 and 1991, although he stated that could not find any documentation reflecting this decision of 30 years ago.⁵² To determine the original cost of DDU's assets, DDU retained Dr. Harkins to develop an asset study to determine the original cost and accumulated depreciation for DDU's assets.⁵³ Dr. Harkins prepared her study by inspecting the records of the DDU systems and reviewing historical invoices for DDU's assets.⁵⁴ She completed a small trending study for any existing assets for which there were no historical records.⁵⁵ Mr. Gracy reviewed the asset lists prepared by Dr. Harkins and identified the assets that were to be treated as 80% developer contributions based upon the historical treatment of those assets by the DDU and its predecessors.⁵⁶ Mr. Gracy's identification of assets to be treated as developer contributions reduced the net plant value figures by 45% from the full original cost.⁵⁷

As a result of cross-examination by WBRG on this issue, Mr. Joyce reviewed the test year tax return depreciation schedules of DDU and its related entities⁵⁸ and DDU's depreciation schedule⁵⁹ and determined that the 80/20 split asserted by Mr. Gracy could generally be reconciled with the costs requested by DDU.⁶⁰ Ms. Heddin failed to reconcile these figures,⁶¹ but Staff witness Debi Loockerman was also able to reconcile the DDU depreciation schedule with the tax return depreciation schedule.⁶² Any differences in exact dollar amounts can be attributed to the different treatment of asset lives and accumulated depreciation for regulatory accounting purposes and tax accounting purposes. This is exactly why Ms. Loockerman reconciled the documents for

⁵² Tr. at 67:10-20 (Gracy Cross)(Oct. 24, 2017).

⁵³ Exhibit DDU-3, Gracy Direct at 5:18-20.

⁵⁴ Exhibit DDU-5, Harkins Direct at p. 7 of 52.

⁵⁵ Tr. at 186:2-3 (Harkins Cross)(Oct. 24, 2017).

⁵⁶ Exhibit DDU-6, Joyce Direct at 6:2-3.

⁵⁷ See Table 1, above.

⁵⁸ Exhibit DDU-8 at DDU16-015470 – DDU16-015475.

⁵⁹ Exhibit DDU-12.

⁶⁰ Tr. at 517:3-14 (Joyce Cross)(Oct. 26, 2017).

⁶¹ Tr. at 258:2-4 (Heddin Cross)(Oct. 25, 2017).

⁶² Tr. at 262:21 – 263:3 (Loockerman Cross)(Oct. 25, 2017); See also Exhibit Staff 1, Attachment DL-7 (Loockerman Confidential Workpapers).

her ADFIT analysis.⁶³ The tax depreciation schedule in DL-7 demonstrate that there are utility assets remaining on the books for depreciation purposes and that those assets have not been written-off as costs against lot sales. In addition, because the amounts are so close, the reconciliation corroborates Mr. Gracy's testimony regarding the 80/20 developer/utility allocations.

Additionally, DDU notes that the ALJ appears to confuse the issues of customer contributions in aid of construction (CIAC) with developer contributions.⁶⁴ As the Commission is well aware, these are two separate concepts. Depreciation is not allowed under Commission rules for property provided by explicit customer agreements or construction funded by CIAC.⁶⁵ CIAC are not an issue in this case. The records contain no evidence of explicit customer agreements or construction that has been funded by customer contributions.

If the Commission accepts the ALJ recommendation regarding developer contributions, DDU will not be able to remain financially sound and "properly discharge its public duties" as required by the Commission rules.⁶⁶ DDU urges the Commission to reject the ALJ's recommendation on this point and allow it to earn return off of its invested capital as proposed.

5. Property Not Belonging to DDU

DDU excepts to the PFD recommendation regarding Property Not Belonging to DDU.⁶⁷

The ALJ agrees with WBRG's assertion that the property identified as WB4 TR2 is not owned by DDU.⁶⁸ However, WBRG's own exhibit shows otherwise.⁶⁹ 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 when the current tax records show DDU as the owner. Dr. Harkins testified that she completed a comprehensive review of DDU's prior rate base

⁶³ Exhibit Staff 1 at 0000004: 19-21.

⁶⁴ PFD at 46.

⁶⁵ 16 Tex. Admin. Code § 24.31(b)(1)(B).

⁶⁶ 16 Tex. Admin. Code § 24.31(c)(1).

⁶⁷ PFD, p. 50-51; Proposed Findings of Fact Nos. 101-102.

⁶⁸ WBRG Initial Brief at 10.

⁶⁹ Exhibit WBRG 1M at WBRG000137, DDU's response to WBRG RFI 3-10.

files and all new items invoiced and included them in rate base.⁷⁰ 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.

6. Improper Use of Trending Study

DDU excepts to the PFD recommendation regarding Improper Use of Trending Study.⁷¹

For the reasons stated in Section IV.A.1., above, DDU's rate base should not be adjusted to remove the known and measurable change to depreciation, which was included based on Dr. Harkins' trending study.

7. Used and Useful/Prudence

DDU agrees with the PFD recommendation regarding Used and Useful/Prudence.

8. Accumulated Deferred Federal Income Tax (ADFIT)

DDU excepts to the PFD recommendation regarding ADFIT.⁷²

The ALJ agreed with Staff's assertion 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 the recommendations in the PFD or Staff's calculations. In addition, DDU disagrees with the PFD's conclusion and Staff's assertion that normalization rules do not apply. In fact, Staff's assertion is simply not supported by any testimony or evidence in the record, which is why there is none cited.⁷³ The Commission's rules state that federal income taxes are allowable on a normalized basis.⁷⁴

Staff witness Debi Loockerman provided testimony regarding ADFIT. While DDU generally agrees with the concept of ADFIT, Ms. Loockerman's calculations contain significant errors, as explained in detail by Mr. Joyce in his rebuttal testimony.⁷⁵ "First, she erroneously

⁷⁰ Ex. DDU- 5, page 7 of 52, lines 4-10.

⁷¹ PFD, p. 51.

⁷² PFD, p. 54-58; Proposed Findings of Fact Nos. 108-109.

⁷³ Staff Initial Brief at 30-31.

⁷⁴ 16 Tex. Admin. Code § 24.31(b)(1)(D).

⁷⁵ Ex. DDU-11, Joyce Rebuttal, p. 15 of 106, lines 14-21.

includes depreciation on assets that the Company identifies as ‘Developer Contributed.’ These assets are not included in rate base and therefore generate no taxable income with which to allow any timing differences to flow to the Company. In other words, there is no income to offset any depreciation timing differences. Second, Ms. Loockerman makes multiple substantive mathematical errors that must be corrected. Third, Ms. Loockerman violates normalization rules by failing to use net operating loss (‘NOL’) carryforwards to offset the ADFIT.”⁷⁶ The PFD’s and 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”.⁷⁷

The result of these errors is that the PFD’s reductions to rate base resulting from ADFIT should be cut in half,⁷⁸ the adjustments are shown in the corrected staff schedules attached to Mr. Joyce’s rebuttal testimony.

V. RATE OF RETURN

A. Return on Equity [PO Issue 8]

DDU excepts to the PFD recommendation regarding Return on Equity to the extent that it excludes a small stock risk premium adjustment from the calculations.⁷⁹

The Commission must apply the following regulatory principles in determining a fair rate of return:

... The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties....

(B) The commission may, in addition, consider inflation, deflation, the growth rate of the service area, and the need for the utility to

⁷⁶ *Id.*

⁷⁷ Application of Lone Star Transmission, LLC, for Authority to Establish Interim and Final Rates and Tariff, Docket No. 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.

⁷⁸ Ex. DDU-11, Joyce Rebuttal, p. 19 of 106, lines 27-28.

⁷⁹ PFD, p. 58-69; Proposed Findings of Fact Nos. 110-119.

attract new capital. In each case, the commission shall consider the utility's cost of capital, which is the composite of the cost of the various classes of capital used by the utility.⁸⁰

Additionally, there are two United States Supreme Court rulings that are oft-cited as establishing the legal criteria for determining a fair rate of return for regulated industries such as utilities: *Bluefield Water Works and Improvement Co. v. Public Service Comm'n of West Virginia*⁸¹ and *Federal Power Comm'n v. Hope Natural Gas Co.*⁸² In *Bluefield*, the United States Supreme Court stated that:

A public utility is entitled to such rates as will permit it to earn a return on the value of property which it employs for the convenience of the public equal to that general being made ... on investments in other business undertakings which are attended by corresponding risks and uncertainties.⁸³ (emphasis added)

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

From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks.⁸⁴ (emphasis added)

The ALJ recommends that the Commission approve a 9.84% return on equity (“ROE”).⁸⁵ This recommended ROE excludes an adjustment for a “small stock risk premium” (“SSRP”) and violates the principles of the *Hope* and *Bluefield* cases. The ALJ states that “[i]t is unclear from Mr. Scheig’s testimony how he determined that the ROE for DDU should include a small stock risk premium.”⁸⁶ However, the basis for Mr. Scheig’s determination is clear in his pre-filed

⁸⁰ 16 Tex. Admin. Code § 24.31(c)(1)

⁸¹ *Bluefield Water Works and Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 679 (1923).

⁸² *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

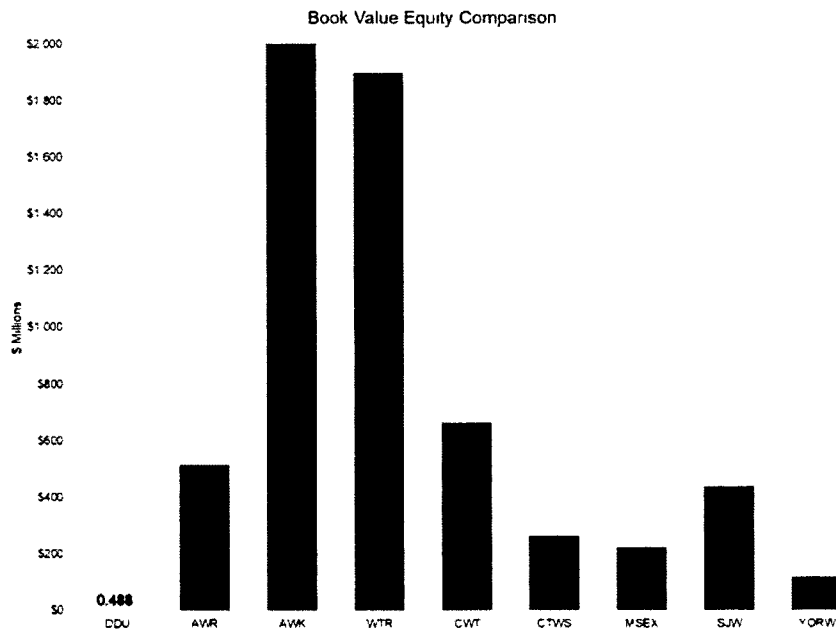
⁸³ *Bluefield* at 692.

⁸⁴ *Hope* at 603.

⁸⁵ PFD, p. 66.

⁸⁶ PFD, p. 67.

testimony. Mr. Scheig reviewed the book values and market values⁸⁷ shown in his schedules for each of the guideline public utilities used in his analyses. As shown below, most of the utilities have book values in excess of \$200 million, with two of the public companies having book values of equity in the billions.⁸⁸ In contrast, the recommended equity component of rate base in the PFD is less than \$500 thousand and the equity component of rate base requested by DDU is approximately \$5.19 million dollars.⁸⁹ These range from 0.25% to 2.6% of the value of the smallest guideline public utilities.



Mr. Scheig also reviewed the market values of equity⁹⁰ for each of the guideline public utilities used in his analyses. As shown below, most of the utilities have book values in excess of \$1 billion. In contrast, applying an assumed 3.0 market to book multiple⁹¹ for DDU (the average multiple from the guideline public utilities) to the recommended equity component of rate base in the PFD results in an estimated market cap for DDU of less than \$1.5 million and to the requested

⁸⁷ DDU Ex. 10B, Scheig rebuttal at 118, Schedule G.2.

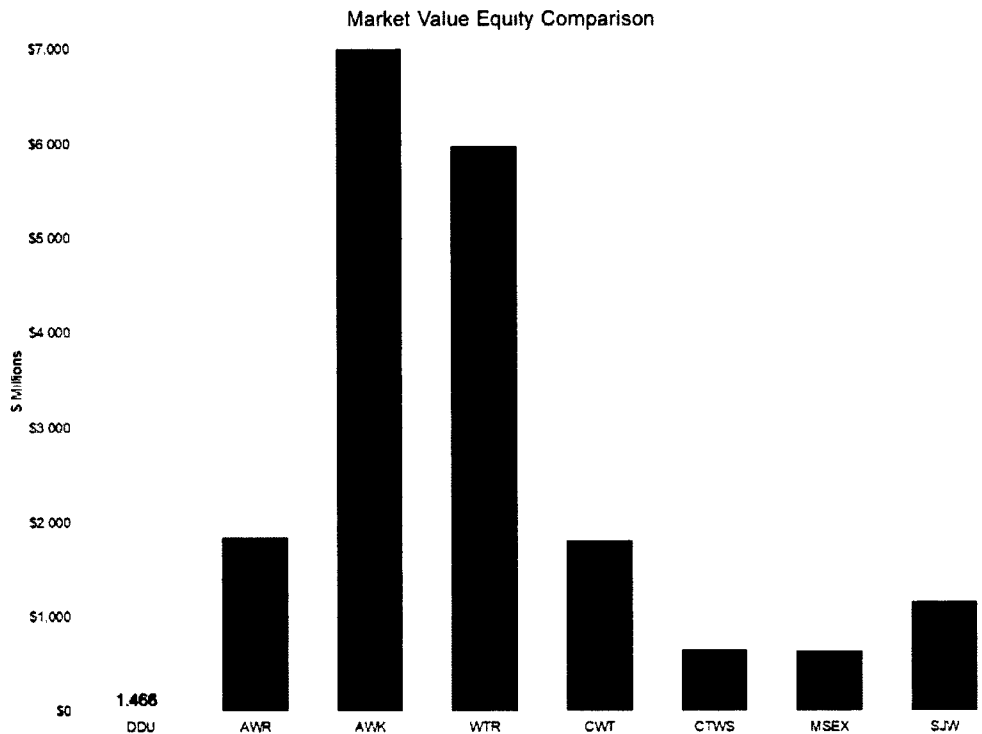
⁸⁸ See DDU Ex. 10B, Scheig rebuttal at 118, Schedule G.2.

⁸⁹ Exhibit Staff 4 at 6 (Testimony of Jolie Mathis).

⁹⁰ DDU Ex. 10B, Scheig rebuttal at 53, Schedule A.2; DDU Ex. 10B, Scheig rebuttal at 118, Schedule G.2.

⁹¹ DDU Ex. 10B, Scheig rebuttal at 118, Schedule G.2.

equity component of rate base results in an estimated market cap for DDU of approximately \$15.57 million dollars.



Based on this review and analyses, Mr. Scheig concluded that DDU was a small utility and would require a small stock premium as part of its overall return on equity.

The ALJ also asserts that Mr. Scheig “makes conclusory statements that it is a small privately-owned company with illiquid common stock investments.”⁹² He goes on to assert that “Mr. Scheig could not articulate how he determined DDU’s market capitalization for purposes of deciding that DDU is a small company...”⁹³ But Mr. Scheig shows in his testimony that he applied a 3.0x market to book ratio⁹⁴, which was the average market to book ratio for the group of guideline public utilities, to estimate a market value for DDU’s cost of equity. Applying this multiple to the recommended equity component of rate base in the PFD (\$488 thousand) results in an estimated

⁹² PFD, p. 67.

⁹³ *Id.*

⁹⁴ DDU Ex. 10B, Scheig rebuttal at 118, Schedule G.2, based on the average market to book ratio for the guideline public utilities.

market cap for DDU of \$1.466 million. And applying this multiple to the requested equity component of rate base (\$5.19 million) results in an estimated market cap for DDU of only \$15.57 million.

The ALJ asserts that Mr. Scheig “stated that he based his size premium on the capital balances found in DDU’s Applications, without considering that DDU is a wholly-owned subsidiary of Double Diamond-Delaware.” However, the capital balances in DDU’s rate application are appropriate for setting the cost of equity and evaluating its need for a size premium.⁹⁵ If DDU were sold by its parent to a larger, or smaller, company or group of individuals, the rate of return required by DDU would remain the same.

Finally, the ALJ asserted that “Mr. Scheig acknowledged that the regulated nature of the water utility industry in Texas reduces risk in DDU investment and should offset the SSRP, but he fails to reveal how he calculated what that offset should be, and why it would not offset the risk altogether, as indicated by Ms. Sears.”⁹⁶ But Mr. Scheig did testify that the regulated nature of the water utility would reduce the small stock risk, as compared to an unregulated company, but it would not eliminate that risk.⁹⁷ As shown in Duff and Phelps studies on Schedule G.1 of his testimony, DDU falls into the lowest decile grouping, requiring a SSRP of 5.59%, if it were not regulated.⁹⁸ In Schedule G.2 of his testimony, Mr. Scheig calculated that if DDU had been the size of the average public utility company in his guideline utility group, it would have received a 1.67% SSRP. This level of SSRP equates to approximate 30% of the 5.59% SSRP for an unregulated company. Therefore Mr. Scheig effectively reduces the SSRP from the Duff and Phelps’s tables by approximately 70% to account for it being regulated.

As shown by Mr. Scheig’s testimony, a SSRP is appropriate for calculating DDU’s ROE. Mr. Scheig’s comprehensive testimony demonstrates that DDU’s market capitalization is a

⁹⁵ Tr. at 419 (Scheig Cross)(Oct. 25, 2017).

⁹⁶ PFD, p. 67.

⁹⁷ DDU Ex. 10, Scheig rebuttal at pg. 29 of 123, line 14, through p. 30 of 123, line 2.

⁹⁸ DDU Ex. 10, Scheig rebuttal at pg. 29 of 123, lines 10-14.

fraction of the guideline public utilities and that DDU's ROE should be adjusted upward by a SSRP.

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

DDU agrees with the PFD recommendation regarding Cost of Debt.

C. Capital Structure [PO Issue 7]

DDU agrees with the PFD recommendation regarding Capital Structure.

D. Overall Rate of Return

DDU excepts to the PFD recommendation regarding Overall Rate of Return to the extent it excludes the small stock risk premium adjustment.⁹⁹

VI. RATE DESIGN [PO Issues 1, 2, 4, 35, 36, 37]

DDU agrees with the PFD recommendation regarding Rate Design.

VII. RATE CASE EXPENSES [PO Issue 38]

The ALJ severed all issues related to expenses incurred in this rate case into a separate Commission and SOAH docket. DDU reserves its rights regarding the level of recovery of rate case expenses for the severed docket. However, DDU agrees with the 51% threshold figures recommended in the PFD provided that they are adjusted for the treatment of the CCN expense described in Section A.7. above.¹⁰⁰

VIII. INTERIM RATES AND EFFECTIVE DATE [PO Issues 29, 40 41]

DDU agrees with the PFD recommendation regarding Interim Rates and Effective Date.

IX. CONCLUSION

DDU excepts to the PFD recommendation as discussed above. In support of its exceptions, DDU proposes the following the findings of fact and conclusions of law.

⁹⁹ PFD, p. 72; Proposed Findings of Fact No. 126.

¹⁰⁰ PFD, p. 73-77.

X. FINDINGS OF FACT

General and Procedural Findings

1. Double Diamond Utility Company, Inc. (DDU) is an investor-owned water utility company that provides water and sewer utility service to several communities in North Texas.
2. DDU provides water and sewer utility service to The Cliffs development in Palo Pinto County and White Bluff development in Hill County under water Certificate of Convenience and Necessity (CCN) No. 12087 and sewer CCN No. 20705.
3. DDU has approximately 640 water customers and 567 sewer customers in White Bluff and approximately 287 water customers and 239 sewer customers in The Cliffs.
4. White Bluff is a resort/residential development with amenities such as a golf course, marina, hotel, restaurant, conference center, spa, and swimming pools.
5. The White Bluff water system obtains its water supply from four wells in the Trinity aquifer, which is regulated by the Prairielands Groundwater Conservation District.
6. The Cliffs is a resort/residential development with amenities similar to those at White Bluff. The Cliffs water system obtains its water supply from Lake Possum Kingdom.
7. DDU is a wholly-owned subsidiary of Double Diamond–Delaware, Inc. (Double Diamond–Delaware).
8. On August 1, 2016, DDU filed Applications (Applications) with the Public Utility Commission of Texas (Commission) for Class B rate/tariff changes for water and sewer utility service at White Bluff and The Cliffs.
9. The Applications use a test year of January 1, 2015, through December 31, 2015.
10. DDU mailed notice of the proposed rate change to all of its customers in White Bluff and The Cliffs on or about August 10, 2016.
11. Between August 10, 2016, and September 1, 2016, over 220 of DDU's 927 ratepayers in White Bluff and The Cliffs (more than 10 percent of such ratepayers) filed timely protests to the rate/tariff changes proposed by the Applications.
12. The Applications were found to be administratively complete on September 7, 2016.
13. On September 8, 2016, the Commission referred this docket to the State Office of Administrative Hearings (SOAH) for a contested case hearing.
14. On October 7, 2016, the Commission issued its Preliminary Order identifying 41 issues to be addressed in this proceeding.
15. On October 18, 2016, a SOAH Administrative Law Judge (ALJ) convened a prehearing conference in Austin, Texas. The following appeared and were admitted as the parties in

this case: DDU; White Bluff Ratepayers Group (WBRG); The Cliffs Utility Committee (TCUC) and Commission staff (Staff).

16. By agreement between the parties, a SOAH order set the effective date for the proposed rate/tariff changes as April 1, 2018, and set February 21, 2018, as the “relate-back” date for purposes of determining refunds or surcharges.
17. The hearing on the merits convened on October 24, 2017 and concluded on October 26, 2017. The parties filed initial briefs on November 22, 2017, and reply briefs on December 15, 2017, which is when the record closed.

Revenue Requirement

Operation and Maintenance (O&M) Expenses

Other Revenues

18. DDU received \$3,600 in revenue from Nextlink that should be added to White Bluff water’s operation and maintenance expenses.

Other Volume-Related Expenses

19. DDU included \$830 of White Bluff water expenses in the other volume-related expense account that were actually fixed expenses belonging in the other plant maintenance account.
20. A \$1,148 expense for chlorine gas cylinders should be added to the other volume-related expense account for White Bluff water.
21. DDU included \$530 of White Bluff sewer expenses in the other volume-related expenses account that were actually fixed expenses belonging in the other plant maintenance account.

Employee Labor

22. All DDU employees at White Bluff are cross-trained on both the water and sewer utility systems.
23. DDU employees Jerry Whitworth and Danny Keeton performed water and sewer tap installations, performed other duties as needed, and answered service calls for both the White Bluff water and sewer systems during the test year.
24. DDU employees Clovis Wilhelm, Jody Bledsoe, and Dwayne Cota worked on both the water and sewer systems and responded to service calls on both systems during the test year.
25. Messrs. Wilhelm, Bledsoe, and Cota were not prohibited from performing work on systems for which they were not specifically licensed.

26. The salaries of Mr. Whitworth, Mr. Keeton, Clovis Wilhelm, Jody Bledsoe, and Dwayne Cota were reasonable and necessary for DDU to provide water and sewer services to its customers, and DDU appropriately apportioned those salaries between the two utility systems in the White Bluff Application.

Contract Work

27. Todd Dilworth, the White Bluff utility manager for DDU, is on call at all times to respond to service calls at the White Bluff water and sewer systems.
28. It is reasonable to have Mr. Dilworth on call at all times in case issues arise that affect service, and it is a reasonable expense to allow Mr. Dilworth to have a mobile phone with cell service so that there can be effective and efficient communication regarding any such issues.
29. DDU's phone allowance of \$900 for 12 months for Mr. Dilworth is a reasonable and necessary expense incurred to provide water and sewer services at White Bluff.
30. A total of \$890 for White Bluff water and \$790 for White Bluff sewer in general and administrative (G&A) expenses attributable to security at the White Bluff resort should be reallocated from miscellaneous expenses to contract work as intercompany labor transfers.

Transportation

31. Mr. Dilworth and another employee have DDU vehicles that they can use to respond at any time to a service call at White Bluff.
32. Mr. Dilworth drives one of the trucks to and from work daily, and the other truck is used by the DDU employee assigned to be on call to drive to and from work during such assignment.
33. Mr. Dilworth and the on-call DDU employee do not use the trucks for any personal reasons; although they use the trucks to drive to and from work, this use is reasonable and necessary so that they can respond to a service call from home if such a call is made.
34. The fuel costs incurred by DDU for Mr. Dilworth and the other employee driving to and from work in company trucks while on-call are not purely commuter miles and are reasonable and necessary expenses incurred by DDU in providing service at White Bluff.
35. A vehicle lease expense (\$2,912 for both water and sewer) and a tool box expense for White Bluff of \$580 should be removed from transportation expenses and added to the depreciation schedule.

Other Plant Maintenance

36. Grinder pumps are part of the White Bluff wastewater system and installed at each service location in the White Bluff system.

37. There is significant, typical, and recurring maintenance, repair, and replacement expenses associated with the grinder pumps in the White Bluff sewer system.
38. Approximately 20 to 30 grinder pumps are replaced and approximately half of the pumps are repaired every year in the White Bluff sewer system.
39. The grinder pump costs included in DDU's other plant maintenance account for White Bluff sewer are incurred on an annual basis by DDU in order to repair and replace the pumps, and therefore are more appropriately categorized as operation and maintenance expenses than as capital assets.
40. The \$709 included in the trial balance for the White Bluff water system reflects costs incurred in the operation and maintenance of the water system at White Bluff and is appropriately included as other plant maintenance expense.
41. It is standard in the water and sewer utility industry to classify ordinary maintenance and repair costs as expenses rather than capital costs.
42. The invoice from Industrial Electric Repair and Sales referencing "Rewind 3 Phase," "machine work on pump," and pump repair, and reflecting charges for bearings and a pump seal pertains to repairs, and the costs reflected in this invoice are appropriately designated as other plant maintenance expenses.
43. The invoice from Wallace Controls & Electric referring to a call regarding a well not running and reflecting a burned-out motor protector and service wire and a motor protector replacement pertains to repairs, and the costs reflected in this invoice are appropriately designated as other plant maintenance expenses.

Professional Services

44. The cost of renewing DDU's wastewater permit for White Bluff, which DDU has historically incurred approximately every three years, should be allowed to be recovered in equal parts in DDU's rates over three years.
45. The cost incurred by DDU to obtain a CCN amendment for The Cliffs during the test year was not a typical or recurring cost, and it is difficult if not impossible to determine when or how often such a cost will be incurred.
46. The cost of obtaining the CCN amendment for The Cliffs was reasonable and necessary to provide sewer service to customers at The Cliffs.
47. DDU did not incur any cost to obtain a CCN amendment for White Bluff during the test year, and the costs of such amendment reflected in the White Bluff professional services account should be removed.

Insurance

48. The premiums paid by DDU for worker's compensation insurance (\$1,444 for water and \$373 for sewer) are not recoverable insurance expenses.
49. Some portion of the premium paid by DDU for an umbrella insurance policy is attributable to insurance coverage that is incurred as part of providing service and maintaining plant.
50. The amount of the umbrella premium attributable to coverage for providing utility service and maintaining plant correlates to the base premium for such coverage.
51. The cost of the umbrella coverage that relates to DDU's provision of water and sewer utility service is a recoverable expense.

Salaries

52. There were seven salaried employees working for the White Bluff utility systems at some point during the test year; not all seven of these employees worked the entire test year.
53. The seven employees who worked for the White Bluff utility systems during the test year earned and were paid \$151,074 in salary during the test year; they earned and were paid their full yearly salaries for the five full time positions plus an additional position in 2016, which accounts for the known and measurable change.
54. Employee salaries totaling \$171,960 are reasonable and necessary expenses for DDU to provide services through the White Bluff systems.

Regulatory Fees

55. The Prairieland Groundwater District fees paid by DDU for White Bluff should not be included in DDU's revenue requirement but should be included as a pass-through provision in DDU's tariff.
56. DDU's expenses related to water tests that occur every three years should be normalized such that DDU recovers one-third of the expenses every year.

Miscellaneous Expenses

57. Equipment lease fees of \$19,728 for White Bluff water and \$20,148 for White Bluff sewer associated with automatic meter reading and the 50,000 gallon wastewater treatment plant should be removed from the miscellaneous expense accounts.
58. Sewer tap fee expenses of \$500 should be removed from the White Bluff sewer miscellaneous expense account.
59. The water and sewer plants are located within the resort properties at White Bluff and The Cliffs, and DDU uses some of the resort's resources and allocates for those resort resources used.

60. Resort expenses that DDU allocates to miscellaneous expenses include those related to the general manager and office manager, commissions and bonuses, employee compensation, payroll burden, electricity, water and sewer, uniforms, small tools, and the like.
61. Overhead expenses at White Bluff include portions of the salaries of the resort's general manager, receptionist, human resources employee, and accounts payable employee; rent for office space; and copier costs.
62. DDU's White Bluff office is located in the resort's administration building, and there is no direct charge to DDU for rent, computers, phones, the receptionist, or the copiers. DDU, along with other departments within the resort, shares the expenses related to the administration building.
63. The allocated costs shared with the resort for the expenses that DDU needs, including office space, office supplies, and certain employees, were lower than if DDU had rented its own space, set up its own office, and hired its own employees.
64. DDU's allocation of approximately 3% of the resorts' total overhead and G&A expenses to be reasonable, based on an average of DDU's portion of those costs, is reasonable.
65. The resorts incur and pay costs for overhead and G&A expenses, and 3% of those costs are then expensed to DDU.
66. The allocated overhead and G&A costs for White Bluff and The Cliffs are reasonable and necessary operational expenses incurred by DDU to provide service to its ratepayers.

Depreciation

67. The \$80 expense for a "Truck Bed Mat" should be removed from the White Bluff sewer depreciation schedule and included as an expense.

Use of Trending Study to Determine Original Cost

68. DDU retained Dr. Victoria Harkins to perform an analysis of the utility assets at White Bluff and The Cliffs and determine the original cost of such assets.
69. To perform her analysis, Dr. Harkins looked at historical invoices provided to her by DDU for the utility assets.
70. The invoices reviewed by Dr. Harkins for purposes of determining the original cost of utility assets did not reflect the entirety of the pipe work for the White Bluff and The Cliffs systems.
71. Dr. Harkins performed a trended original cost study to establish the original cost for certain of White Bluff's and The Cliffs's assets for which no invoice was available.
72. Historical records do not exist to show the original construction costs for some of the collection and distribution lines at White Bluff and The Cliffs.

73. Construction of the collection and distribution lines at the White Bluff development began in around 1990. Construction was ongoing through 2007 or 2008.
74. Dr. Harkins's use in her trending study of January 1, 1996, as an installation date for the pipe work was reasonable and appropriate.
75. Any gain in original cost from using 1996 as the installation date was corrected by installation performed up to ten years after that date and beyond, at which time the cost would have been even greater.

Fully Depreciated Assets

76. All assets that have fully depreciated should be removed from DDU's White Bluff depreciation schedules, as set forth in Tables NDH-14, NDH-15, NDH-16, and NDH-17 of the direct testimony of WBRG witness Nelisa Heddin.

Taxes

Federal Income Tax Expense

77. Treating White Bluff and The Cliffs as separate entities when calculating federal income tax expense is not appropriate.

Other Assessments and Taxes

78. The sales and title taxes for the 2014 Ford truck are included in the asset depreciation schedule and therefore should be removed from taxes.

Return on Invested Capital

Original Cost of Plant In Service

79. The correct original cost of a "75,000 gallon gst, field erect with pad" and "75,000 gallon gan, field erect mth pad" is \$16,565, and the water depreciation schedule for The Cliffs system should be revised accordingly.
80. The original cost of the "TK Crossbed Toolbox" set forth on the White Bluff sewer depreciation schedule should be revised to \$850 to remove an \$80 expense for a "Truck Bed Mat" that was also included in White Bluff's cost of service.

Cash Working Capital

81. A reasonable cash working capital allowance for the White Bluff utility system is 1/12 of the system's O&M expenses.
82. A reasonable cash working capital allowance for The Cliffs utility system is 1/8 of the system's O&M expenses.

Developer Contributions

83. In determining the original cost of used and useful utility plant, property, and equipment for purposes of calculating its rate base, DDU used an asset list prepared jointly by DDU's President Randy Gracy and DDU witness Dr. Harkins, which identifies certain assets that were considered 80% developer-contributed. That 80% portion of the cost of those assets was removed from DDU's rate base calculation.
84. DDU has consistently recognized the 80% developer contribution for its assets constructed before 2007 in filings before the state regulatory agencies.
85. There were contributions made by the White Bluff developer to the investment made in utility plant, property, and equipment used to service ratepayers of the White Bluff water and sewer utility systems.
86. DDU provided evidence necessary to differentiate between plant, equipment, and property contributed by the developer and that invested by DDU.
87. The net book value of the utility assets claimed as part of DDU's rate base as set forth in the application and adjusted as described above are properly included in DDU's invested capital.

Property Not Belonging to DDU

88. Tract 2 in White Bluff, as well as certain facilities included on such tract, including a water well, the water plant, and the water storage tank are owned by DDU.
89. DDU's request for net book value of Tract 2 and the facilities on Tract 2 of \$88,565 and annual depreciation of \$2,060 to be included in its rate base is appropriate.

Used and Useful/Prudence

90. The White Bluff systems "serve" 6,314 lots and that The Cliffs systems "serve" 2,518 lots.
91. There are approximately 65 miles of water lines and 60 miles of sewer lines at White Bluff, and 23 miles of water and sewer lines at The Cliffs.
92. Only approximately 10% of the lots at White Bluff and The Cliffs developments are actually receiving service from DDU.
93. Approximately 85 to 90 percent of the lots at White Bluff have been sold.
94. It was reasonable to build out the distribution and collection systems such that if any lot within either White Bluff or The Cliffs was sold and the new owner requested service, it could be provided.

Accumulated Deferred Federal Income Tax (ADFIT)

95. A net operating loss (NOL) must be considered when calculation ADFIT.

96. The estimate of the effect of the alleged NOL carryover on the ADFIT calculated by Staff witness Debi Loockerman was reasonable.

Rate of Return

Return on Equity

97. A reasonable return on equity (ROE) for DDU, based on a discounted cash flow (DCF) analysis employed with the Capital Asset Pricing Model (CAPM) and the Expected Earnings model and including a Risk Premium analysis, is 11.51%.
98. A ROE of 11.51% is reasonably sufficient to assure confidence in DDU's financial soundness and will be adequate to maintain and support its credit and allow it to raise necessary capital.
99. A ROE of 11.51% will not yield more than a fair return on DDU's invested capital.
100. The more thorough analysis employed by DDU witness Gregory Scheig, which used the DCF and Risk Premium analysis and employed the CAPM and Expected Earnings model and gave the most weight to the DCF and CAPM, was more accurate in determining a reasonable ROE for DDU than the analysis of Staff witness Ms. Sears, who used only the DCF analysis and compared it to the CAPM.
101. A small stock risk premium of 1.67% is warranted, resulting in a ROE of 11.51%.
102. Approximately 40% of the unaccounted for water noted in the Applications is water loss due to brine discharge after water from the lake goes through a reverse osmosis plant, and thousands of gallons a day used to backwash sand filters.
103. Additional water is used to regularly flush out the lines at White Bluff and The Cliffs and is therefore unaccounted for.
104. DDU employs various methods at The Cliffs to track down leaks, and DDU has responded to and repaired discovered and reported leaks in a reasonable manner.
105. The utility crew at The Cliffs is instructed to respond to reports of leaks as quickly as possible and make the necessary repairs. Some leaks can be fixed in a few hours, and most leaks are repaired the same day or the day after they are reported.
106. A reduction in ROE due to the quality and efficiency of service at White Bluff and The Cliffs is not warranted.

Cost of Debt

107. A 4.91% cost of debt, which is Double Diamond-Delaware's overall weighted average cost of debt as of December 31, 2015, is an appropriate cost of DDU's debt.

Capital Structure

108. DDU took out a \$3 million loan secured by White Bluff utility assets, the proceeds of which Double Diamond-Delaware used to make capital improvements and for other purposes. Double Diamond-Delaware guaranteed repayment of the debt.
109. It is unclear exactly how the \$3 million proceeds of the loan were accounted for.
110. Double Diamond, Inc. has been making the payments on the loan; if Double Diamond, Inc. did not make those payments and there was a default, the bank would look to Double Diamond-Delaware as guarantor, and not DDU, for payment.
111. The \$3 million loan is not related to DDU's debt financing and therefore cannot serve as the basis for the capital structure recommended by WBRG.
112. The appropriate capital structure for DDU is 47.27% debt and 52.73% equity, which is representative of the capital structure of other companies in the water utility industry and reflects an efficient use of capital.

Overall Rate of Return

113. DDU's overall rate of return should be set as follows:

Component	Ratio	Cost Rate	Weighted Cost Rate
Debt	47.27%	4.91%	2.32%
Equity	52.73%	11.51%	6.07%
Overall			8.39%

Rate Design

114. The rate structures set forth in Attachment C to this Proposal for Decision will recover DDU's revenue requirements for White Bluff water and White Bluff sewer.
115. The rate structures set forth in Attachment D to this Proposal for Decision will recover DDU's revenue requirement for The Cliffs water and The Cliffs sewer.

XI. CONCLUSIONS OF LAW

1. DDU is a retail public utility as defined in Texas Water Code § 13.002(19) and a utility as defined by Texas Water Code § 13.002(23).
2. The Commission has jurisdiction over the Applications pursuant to Texas Water Code §§ 13.041, 13.043(b), 13.181-.185, 13.1871, and 13.1872.
3. All required notices of the Applications and the contested case hearing were given as required by law. Tex. Water Code § 13.1871; Tex. Gov't Code §§ 2001.051, .052.

4. The ALJ conducted a contested case hearing and proposed a decision on the Applications under the authority of chapter 2003 of the Texas Government Code and chapter 13 of the Texas Water Code.
5. DDU bears the burden of proof that its proposed rates are just and reasonable. Tex. Water Code § 13.184(c).
6. The resort overhead and G&A expenses allocated to DDU's water and sewer utilities at White Bluff and The Cliffs are not payments to an affiliated interest. Texas Water Code §§ 13.002(2), .185(e).
7. DDU met its burden to show that its historical documents were not available for the original costs of certain assets and appropriately used a trending study to determining rate base and depreciation for those assets. 16 Tex. Admin. Code § 24.31(c)(2)(B)(i).
8. DDU demonstrated that 80% of the original cost of a portion of the utility assets included in its proposed rate base for White Bluff were contributed by the developer and that the remainder were appropriately utility costs. Tex. Water Code § 13.184(c).
9. In compliance with Texas Water Code § 13.183 and based on the findings of fact and conclusions of law, DDU's overall revenues approved in this case permit DDU a reasonable opportunity to earn a reasonable return on its invested capital used and useful in providing service to the public over and above its reasonable and necessary operating expenses.
10. Based on the findings of fact and conclusions of law, an overall rate of return of 8.39% will permit DDU a reasonable opportunity to earn a reasonable return on its invested capital. Tex. Water Code § 13.184.
11. Consistent with Texas Water Code § 13.185, the rates approved in this case are based on original cost, less depreciation, of property used and useful to DDU's provision of service.
12. The rates approved in this case are just and reasonable, comply with the ratemaking provisions in Texas Water Code chapter 13, and are not unreasonably discriminatory, preferential, or prejudicial.
13. The increase in revenue that would have been generated by DDU's proposed rates should be calculated using the proposed rates from the amended Applications, which were those upon which a contested hearing was held. 16 Tex. Admin. Code § 24.33(b).

XII. ORDERING PARAGRAPHS

1. As amended in this order, DDU's applications for a rate increase at White Bluff and The Cliffs are granted.
2. The Commission is setting just and reasonable rates consistent with the findings of fact and conclusions of law.

3. Within 10 days of the issuance of this Order, DDU shall file with the Commission's Docket Clerk a copy of its tariff with the approved rates.
4. All other motions, requests of entry of specific findings of fact and conclusions of law, and any other requests for general or specific relief, if not expressly granted, are denied.

White Bluff

	Current Revenues		
	Water	Sewer	Total
Total Revenues at Current Rates	\$ 496,047	\$ 417,117	\$ 913,164
Less:			
Miscellaneous Revenues	(8,763)	(4,574)	(13,337)
Prairieland GWD Pass-Thru	(22,047)		(22,047)
Rate Revenues at Present Rates	\$ 465,237	\$ 412,543	\$ 877,780

	Revenue Requirements		
	Water	Sewer	Total
Original DDU-Requested Revenue Rqmts	\$ 573,923	\$ 572,130	\$ 1,146,053
Less: DDU-Agreed Adjustments	(70,806)	(12,690)	(83,496)
Revised DDU-Requested Rev Rqmts	\$ 503,118	\$ 559,440	\$ 1,062,558
PFD Adjustments-Impact on Rev Rqmts:			
<u>Operation & Maintenance Expenses</u>			
Payroll & Payroll Taxes	6,043	(16,434)	(10,391)
Umbrella Liability Ins	(3,371)	(1,127)	(4,498)
 <u>Depreciation & Return</u>			
Trending Study Elimination	(30,988)	(15,246)	(46,234)
Additional impact from overall ROR Adjustment, ADFIT Adj.	(9,236)	(19,586)	(28,822)
Additional impact from 100% Devel Contrib, "DDU-Paid" Assets only	(70,965)	(150,493)	(221,458)
Revenue Requirements per PFD	\$ 394,601	\$ 356,554	\$ 751,155
Less:			
Miscellaneous Revenues	(8,763)	(4,574)	(13,337)
Rate Revenue Rqmts per PFD	\$ 385,838	\$ 351,980	\$ 737,818
Plus Prairieland GWD Pass-Thru	\$ 22,047		

The Cliffs

	Current Revenues		
	Water	Sewer	Total
Total Revenues at Current Rates	\$ 371,259	\$ 220,436	\$ 591,695
Less:			
Miscellaneous Revenues	(2,903)	(2,418)	(5,321)
CCN Rate Rider		(2,907)	(2,907)
Rate Revenues at Present Rates	\$ 368,356	\$ 215,111	\$ 583,467

	Revenue Requirements		
	Water	Sewer	Total
Original DDU-Requested Revenue Rqmts	\$ 429,015	\$ 319,775	\$ 748,790
Less: DDU-Agreed Adjustments	4,290	7,315	11,605
Revised DDU-Requested Rev Rqmts	\$ 433,305	\$ 327,090	\$ 760,395
PFD Adjustments-Impact on Rev Rqmts:			
<u>Depreciation & Return</u>			
Trending Study Elimination	(32,620)	8,887	(23,733)
Additional impact from overall ROR Adjustment, ADFIT Adj.	(6,784)	(6,667)	(13,451)
Revenue Requirements per PFD	\$ 393,901	\$ 329,310	\$ 723,211
Less:			
Miscellaneous Revenues	(2,903)	(2,418)	(5,321)
Rate Revenue Rqmts per PFD	\$ 390,998	\$ 326,892	\$ 717,890
Plus CCN Rider		\$ 2,907	