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SOAH DOCKET NO. 473-17-0119.WS

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PUBLIC UTILITY COMMISSION
CLERK

APPLICATION OF DOUBLE §
DIAMOND UTILITY COMPANY, INC. §
FOR WATER AND SEWER §
RATE/TARIFF CHANGE §

PUBLIC UTILITY COMMISSION
OF TEXAS

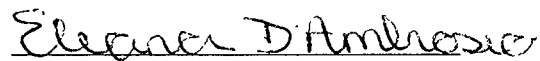
COMMISSION STAFF'S REPLIES TO
EXCEPTIONS TO THE PROPOSAL FOR DECISION

Respectfully submitted,

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APPLICATION OF DOUBLE	§	PUBLIC UTILITY COMMISSION
DIAMOND UTILITY COMPANY, INC.	§	
FOR WATER AND SEWER	§	OF TEXAS
RATE/TARIFF CHANGE	§	

**COMMISSION STAFF’S REPLIES TO EXCEPTIONS
TO THE PROPOSAL FOR DECISION**

COMES NOW the Staff (Staff) of the Public Utility Commission of Texas (Commission), representing the public interest, and files this Commission Staff’s Replies to Exceptions to the Proposal for Decision. On February 13, 2018, the State Office of Administrative Hearings (SOAH) Administrative Law Judge (ALJ) issued a Proposal for Decision (PFD)¹ in this proceeding. All parties timely filed exceptions to the PFD on March 28, 2018. The deadline for filing replies to exceptions is April 12, 2018; therefore, this pleading is timely filed. In support of its Replies to Exceptions, Staff shows the following:

I. INTRODUCTION

Staff respectfully replies to Double Diamond Utility Company, Inc.’s (DDU) exceptions to the PFD. In particular, Staff asserts that the PFD’s recommendations regarding insurance expenses, cash working capital, and accumulated deferred federal income tax (ADFIT) should be adopted along with the recommendation to exclude a small stock risk premium adjustment from DDU’s return on equity.

II. JURISDICTION, NOTICE, AND PROCEDURAL HISTORY

No reply.

III. BACKGROUND

No reply.

¹ Proposal for Decision (Feb. 13, 2018) (PFD).

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

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

1. Other Revenues

Staff recommended adding the \$3,600 for monthly revenues received from Nextlink to the other revenues for White Bluff Water.² Although section IV(A)(1) of the PFD, entitled “Other Revenues,” states that it adopted Staff’s recommendation, it mistakenly concludes that the \$3,600 should be *added* to the *operations and maintenance expenses* for White Bluff water.³ This phrasing would add the \$3,600 to DDU’s cost of service rather than deducting it from the revenue requirement. However, the number running memoranda correctly adjusted the other revenues for White Bluff water to incorporate the \$3,600.⁴

DDU agreed with Staff’s recommendation regarding the Nextlink revenues,⁵ yet in its exceptions it states it agrees with the PFD’s recommendation.⁶ To clear up any confusion, Staff continues to recommend a correction to the current wording of the PFD to correctly reflect that the addition of the \$3,600 for Nextlink revenues should be included in the other revenues for White Bluff water.

2. Other Volume-Related Expenses

No reply.

3. Employee Labor

No reply.

4. Contract Work

No reply.

5. Transportation Expense

No reply.

² Direct Testimony of Emily Sears, Staff Ex. 2 at 8-9.

³ PFD at 5.

⁴ Number Running Memoranda and Workpapers, White Bluff Water – Schedule I (Revenue Requirement).

⁵ Tr. at 513:5-10 (Joyce Supplemental Rebuttal) (Oct. 26, 2017).

⁶ Double Diamond Utility Company, Inc.’s Exceptions to the Proposal for Decision at 6 of 39 (Mar. 28, 2018) (DDU’s Exceptions).

6. Other Plant Maintenance

No reply.

7. Professional Services

Staff agrees with DDU that the amount of the surcharge for professional services related to the CCN amendment for the Cliffs should be excluded from the calculation to determine the 51% threshold for rate case expenses.⁷

8. Insurance Expenses

The PFD correctly recommended disallowing the entire cost of DDU's umbrella insurance policy.⁸ DDU's Corporate Umbrella Policy covers multiple underlying base policies, including Corporate Business Auto, Corporate Crime, and Spa Errors and Omissions.⁹ While Staff agrees that an expense for insurance coverage related to items like auto or crime is an expense related to the provision of water and sewer service, it is not possible to separate out the portion of the umbrella policy related to each individual underlying policy.¹⁰ Moreover, DDU did not dispute the assertion that coverage related to spa errors and omissions is unrelated to serving its customers. Therefore the PFD's recommendation to remove \$3,371 from White Bluff water, and \$1,127 from White Bluff sewer for the umbrella policy premium should be adopted.¹¹

In addition, Staff disagrees with DDU's continued insistence that the \$3,100 premium for the Spa Omissions and Errors Policy bears a direct proportional relationship to the \$100,797 premium for the Corporate Umbrella Policy. While it is correct that there is a relationship between the underlying base policies and the cost of the umbrella policy,¹² DDU did not produce any evidence confirming that there is a proportional relationship. However, the calculation offered by DDU's witness Jay Joyce assumes proportionality asserting that the expense claimed for the umbrella policy should be reduced by 2.98% because the spa policy premium is 2.98% of the total premium for both the umbrella and spa policies ($3100 / (3100 + 100797) = 2.98$).¹³

⁷ DDU's Exceptions at 6-7 of 39.

⁸ PFD at 21.

⁹ Workpapers of Emily Sears, Staff Ex. 2A at 84-88.

¹⁰ Tr. at 325:6-21 (Sears Cross) (Oct. 25, 2017).

¹¹ PFD at 21.

¹² Tr. at 325:6-21 (Sears Cross) (Oct. 25, 2017).

¹³ Rebuttal Testimony of Jay Joyce, Ex. DDU-11 at 9 of 106.

Furthermore, Mr. Joyce did not provide any rationale for his illogical decision to add the spa policy premium to the umbrella policy premium to calculate this percentage.

9. Salaries

No reply.

10. Regulatory Fees

No reply.

11. Miscellaneous Expenses

No reply.

B. Depreciation [PO Issues 12, 27]

Staff agrees that the \$80 for the “Truck Bed Mat” should be left in White Bluff’s cost of service as an expense and should not be capitalized as part of the original cost for the “TK Crossbed Toolbox.”¹⁴

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

The PFD correctly recommended disallowing DDU’s request for a known and measurable change to the depreciation for both White Bluff and the Cliffs. It is undisputed that a trending study may only be used to determine the original cost of a capital asset if historical records are not available for verification purposes.¹⁵ DDU argues that a current balance sheet does not constitute a historical record.¹⁶ However, historical information about a company’s assets is typically carried forward onto its current balance sheet, and DDU did not provide any evidence explaining how or why the asset values shown on its books are unreliable.

Furthermore, the Commission should not give weight to DDU’s argument regarding Staff witness Jolie Mathis’ inclusion of the trended asset values developed by DDU’s witness Dr. Victoria Harkins in her depreciation schedule.¹⁷ DDU’s conclusion that “Staff did not find the

¹⁴ Commission Staff’s Initial Brief at 23 of 41 (Nov. 22, 2017).

¹⁵ 16 Tex. Admin. Code (TAC) § 24.31(c)(2)(B)(i).

¹⁶ DDU’s Exceptions at 10 of 39.

¹⁷ *Id.* at 12-13 of 39.

issue significant”¹⁸ is speculative as DDU did not cross-examine Ms. Mathis on this issue. Further, Staff’s decisions about what issues to offer testimony on in a rate case are based on a number of factors, and the decision not to address a particular issue is not necessarily indicative of Staff’s position on the arguments presented by the parties that did address the issue. Finally, it would be imprudent to set a precedent that could be construed to suggest that Staff’s silence on an issue equates to approval.

2. Error in Trending Study

No reply.

3. Fully Depreciated Assets

No reply.

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

1. Federal Income Tax Expense [PO Issue 30]

DDU’s exceptions did not address how it would be impacted by the reforms enacted by the Tax Cuts and Jobs Act of 2017. Accordingly, Staff continues to recommend that any savings DDU will realize as a result of the changes to federal income tax laws should be reflected in the rates set.

2. Other Assessments and Taxes [PO Issue 29]

No reply.

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

1. Original Cost of Plant in Service

No reply.

2. Accumulated Depreciation

No reply.

¹⁸ *Id.* at 12 of 39.

3. Cash Working Capital

The PFD's recommendation that the cash working capital allowance for both White Bluff and the Cliffs should be 1/12th of operations and maintenance expenses should be adopted.¹⁹ Cash working capital is the money a utility uses to bridge the gap between the time it pays for an expense and the time it recovers that expense through the receipt of revenues. Commission rules consider 1/12th of operations and maintenance expenses a reasonable allowance for cash working capital for a Class B utility, and DDU is a Class B utility.²⁰ Because the Cliffs is a part of DDU, it has access to all of its capital; thus, the 1/12th ratio applicable to DDU should apply to the Cliffs.

DDU argues that the cash working capital allowance for the Cliffs should be calculated using the 1/8th ratio applicable to a Class C utility because Staff treated White Bluff and the Cliffs as separate utilities to calculate the federal income tax expense.²¹ Staff did not except to the PFD's recommendation to reject Staff's treatment of White Bluff and the Cliffs as separate entities for tax purposes.²² Therefore, if the PFD's recommendation regarding income taxes is adopted, then its recommendation regarding cash working capital should also be adopted. Such an outcome would treat White Bluff and the Cliffs as a combined utility for both federal income tax expense and cash working capital allowance.

4. Developer Contribution

No reply.

5. Property Not Belonging to DDU

No reply.

6. Improper Use of Trending Study

No reply.

7. Used and Useful/Prudence

No reply.

¹⁹ PFD at 37.

²⁰ 16 TAC § 24.31(c)(2)(C)(iii)(III); Direct Testimony of Randy Gracy, Ex. DDU-3 at 6 of 27.

²¹ DDU's Exceptions at 14 of 39.

²² See Commission Staff's Exceptions to the Proposal for Decision at 10-11 of 15 (Mar. 28, 2018).

8. Accumulated Deferred Federal Income Tax (ADFIT)

The PFD's recommendation to adopt Staff's deductions from rate base for ADFIT should stand because DDU's exceptions on this issue are not supported by evidence in the record. Commission rules state that accumulated reserve for deferred federal income taxes will be deducted from rate base.²³ Accordingly, the only issue in this case is the amount of ADFIT to be deducted.

Despite having the opportunity to present its own ADFIT calculation in Schedule III-9(a) of the rate change application and in response to a discovery request, DDU did not.²⁴ Consequently, Staff's recommended deduction for ADFIT was based on calculations performed by its own witness, Debi Loockerman.²⁵ On rebuttal, DDU's witness Jay Joyce simply divided Staff's calculations in half to support the smaller ADFIT deduction he recommended.²⁶

DDU's exceptions recycle the three main assertions DDU made in its initial brief regarding Ms. Loockerman's ADFIT calculations—two of which are completely unsupported by evidence in the record. To avoid filing unnecessarily duplicative argument, Staff would refer to its Reply Brief where it has already addressed all three assertions.²⁷

V. RATE OF RETURN

A. Return on Equity [PO Issue 8]

Staff supports the PFD's rejection of DDU's proposed small stock risk premium (SSRP),²⁸ but continues to recommend that its ultimate return on equity (ROE) recommendation of 9.84% be reduced to 8.79%. The arguments presented in DDU's exceptions as to why a SSRP should be added to its ROE are not supported by the evidence and should be rejected. In response to the PFD's conclusions 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," and "Mr. Scheig

²³ 16 TAC § 24.31(c)(3)(A).

²⁴ See Tr. at 537:3-12 (Joyce Cross) (Oct. 26, 2017); Direct Testimony of Debi Loockerman, CPA, Staff Ex. 1, Attachment DL-8.

²⁵ Staff Ex. 1, Attachments DL-3 through DL-6.

²⁶ Ex. DDU-11 at 19 of 106.

²⁷ Commission Staff's Reply Brief at 17-18 of 26 (Dec. 15, 2017).

²⁸ PFD at 67.

could not articulate how he determined DDU's market capitalization for purposes of deciding that DDU is a small company..." DDU offers a narrative explanation of the information contained in Schedule G.2 of witness Gregory Scheig's rebuttal testimony.²⁹ However, this narrative is not provided anywhere in his written testimony as demonstrated by the lack of citations to any source but the schedule itself. In Docket No. 44649, the Commission adopted the PFD's recommendation declining to approve a change to the utility's rate design on the grounds that "the ALJs do not believe that references to schedules and workpapers are sufficient to explain to the decision-maker why a recommendation should be approved."³⁰ DDU has failed to carry its burden of proof because its explanations of Mr. Scheig's basis for applying a SSRP and method for determining DDU's market capitalization only contains references to Schedule G.2.

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

No reply.

C. Capital Structure [PO Issue 7]

No reply.

D. Overall Rate of Return [PO Issue 8]

For the reasons discussed in section V(A), Staff disagrees with an overall rate of return derived from a ROE that includes a SSRP.

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

No reply.

VII. RATE-CASE EXPENSES [PO ISSUE 38]

No reply.

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

No reply.

²⁹ DDU's Exceptions at 21-23 of 39.

³⁰ *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 46449, Order at Finding of Fact No. 321A (Jan. 11, 2018);

IX. CONCLUSION

For the foregoing reasons, Staff respectfully requests that any final order in this proceeding be revised consistent with Staff's exceptions.

X. FINDINGS OF FACT

Staff disagrees with any Finding of Fact proposed by DDU that addresses an issue to which DDU excepted and Staff replied, including but not limited to, DDU's proposed Finding of Fact Nos. 50, 51, 82, 95, 96, 97, 98, 99, and 101. As explained above in section B, Staff agrees with DDU's proposed Finding of Fact No. 67

XI. CONCLUSIONS OF LAW

Staff disagrees with DDU's proposed Conclusion of Law No. 10 consistent with Staff's reply to DDU's exceptions set forth in section V(A).

XII. ORDERING PARAGRAPHS

No reply.

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CERTIFICATE OF SERVICE

I certify that a copy of this document was served on all parties of record on April 12, 2018, in accordance with 16 TAC § 22.74.


Eleanor D'Ambrosio