



Control Number: 46245



Item Number: 669

Addendum StartPage: 0

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

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BEFORE THE STATE OFFICE
OF
ADMINISTRATIVE HEARINGS

**DOUBLE DIAMOND UTILITY COMPANY, INC.'S
RESPONSES TO 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 12th day of April, 2018.



John J. Carlton

669

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

**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**

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**DOUBLE DIAMOND UTILITY COMPANY, INC.'S
RESPONSES TO EXCEPTIONS TO THE PROPOSAL FOR DECISION**

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

SECTION 1. RESPONSE TO STAFF'S EXCEPTIONS

I. INTRODUCTION

DDU respectfully disagrees with Staff's positions, as set forth in its Exceptions, related to employee labor expense, allocated resort overhead, the treatment of expenses for grinder pumps as investment in utility plant, and return on equity (ROE), as well as Staff's other miscellaneous exceptions. Staff's Exceptions should be denied, except for those corrections to the PFD where DDU notes our agreement.

II. JURISDICTION, NOTICE, AND PROCEDURAL HISTORY

Staff filed no exceptions regarding this topic.

III. BACKGROUND

Staff filed no exceptions regarding this topic.

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 a correction to the PFD and corresponding schedules adding the \$3,600 for Nextlink revenues to White Bluff water's other revenues. DDU agrees.

2. Other Volume-Related Expenses

Staff filed no exceptions regarding this topic.

3. Employee Labor

Staff filed an Exception to the ALJ findings that DDU has shown at least some if not all of the salaries of Messrs. Whitworth and Keeton were “reasonably and necessarily incurred by DDU in providing water and sewer service during the test year.”¹ Staff asserts that DDU failed to meet its burden to show by a preponderance of the evidence that the \$43,680 in salaries paid to Whitworth and Keeton were reasonable and necessary.

DDU did provide a basic description of job duties as shown in Staff Exhibit 2A.² At the hearing and in post-hearing briefing, Commission Staff argued that these employees’ salaries were covered by tap fees even though they admitted that only 1% of the salaries for these men was covered by tap fees, leaving 99% of their time uncompensated through rates.³ The Commission Staff asserted that DDU failed to produce a “more robust description.”⁴ This is simply an incredible assertion.

As Mr. Gracy testified, DDU produced 859 pages of White Bluff system work orders in response to WBRG RFI 1-32 that “demonstrate that all employees work on every call, whether water or sewer, at different times.”⁵ Mr. Gracy goes on to testify about the work that these men do for the utility.⁶ Staff witness, Ms. Emily Sears, never acknowledged that the response to WBRG 1-32 was produced and claimed that Mr. Gracy’s testimony was inadequate. Staff continues to assert this claim. As is shown by her testimony on cross-examination, Ms. Sears took her position based upon a single discovery response, Staff 1-1, and determined that no other evidence would be sufficient to change her mind.⁷ In fact, the discovery responses provided by DDU and attached

¹ PFD at 8, Bates 000012.

² Staff Ex. 2A at ES Workpaper 6.

³ Staff Initial Brief at p. 9.

⁴ *Id.* at p. 10.

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

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

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

to Ms. Sears' testimony support Mr. Gracy's testimony and show that the employees of DDU worked 1,039 hours of overtime during the test year.⁸ While DDU is not seeking overtime compensation as part of its revenue requirement, the fact that there are 1,039 hours of overtime worked in White Bluff during the test year provides additional support for the need for all the employees and their salaries as requested by DDU. Furthermore, Ms. Sears' claims that she did not get enough information clearly reflects that she did not fully review the documentation produced by DDU in this case.

There is sufficient evidence in the records to support the ALJ's findings on this issue, and Staff's Exception should be denied.

4. Contract Work

Staff filed no exceptions regarding this topic.

5. Transportation Expense

DDU agrees with Staff's comments on this issue.

6. Other Plant Maintenance

Staff filed an Exception to the ALJ's recommendation to classify DDU's costs for purchasing grinder pumps as recurring expenses. Staff argues its Exception on the basis that the grinder pumps are capital investments as they have a useful life of ten years.⁹ Staff even claims this position is required by DDU's Capitalization Policy.¹⁰

In post-hearing briefing, Staff even asserted that because the costs exceed \$750, the repairs extend the life of the grinder pumps and, amazingly, there is "no evidence that these types of repairs are typical, recurring expenses."¹¹ DDU acknowledges that the costs of many of the grinder pump repairs exceed \$750, but this factor is simply one of three that DDU uses to determine whether to capitalize an asset. The other factors include the extension of the useful life of the asset

⁸ Staff Ex. 2A at ES Workpaper 7 and ES Workpaper 8, Bates 00008-00009, Responses to Staff RFIs 1-5, 1-6, 1-7 and 1-8.

⁹ Staff Ex. 2 at 18; Tr. at 344:3-4 (Sears Cross) (Oct. 25, 2017).

¹⁰ Staff Ex. 6 at DDU16-015961; Staff Exceptions at p. 8.

¹¹ Staff's Initial Brief at p. 14.

and, importantly, “whether the repair is a typical recurring expense.”¹² DDU’s engineering expert, Dr. Victoria Harkins – a registered professional engineer in Texas with 20 years of experience in the utility industry¹³ – was the sole witness in the proceeding with any experience in the operation and maintenance of grinder pumps.¹⁴ In fact, Dr. Harkins was the only witness with any experience at all in designing and operating utility systems.¹⁵ No other witnesses challenged her expert testimony on this topic. Dr. Harkins explained at length the challenges of maintaining grinder pumps in a wastewater system.¹⁶ Based upon her review of 10 years of grinder pump invoices, Dr. Harkins testified that the grinder pump costs are recurring costs every year and that those cost should be expensed not capitalized.¹⁷ She also provided testimony about how the costs should be treated if the Commission Staff decides to require recurring grinder pump repair costs to be capitalized.¹⁸

DDU has filed several rate applications and has always treated the grinder pumps and grinder pump repairs as recurring expenses.¹⁹ Staff also states that presumably DDU’s prior year costs have already been recovered in rates²⁰—but there is no evidence that these costs have been recovered. The prior rates were based on a settlement, and DDU filed this rate application because they were not recovering their costs as shown in the application document themselves.²¹ In fact, Staff recommended denying DDU’s net operating loss argument for taxes because there is no evidence of prior years’ net operating losses.²² There has been no change in treatment of these costs by DDU that would dictate a change in the recovery of these costs. They have been treated

¹² Staff Ex. 6 at DDU16-015961.

¹³ Ex. DDU-5, Pre-filed Direct Testimony of Victoria Harkins (Attachment DDU-5A), page 12 of 52 through page 23 of 52.

¹⁴ Tr. at 484:6-7 (Harkins Redirect) (Oct. 26, 2017).

¹⁵ Tr. at 343:16 through 344:10 (Sears Cross) (Oct. 25, 2017); Tr. at 304:23 through 306:3 (Mathis Cross) (Oct. 25, 2017).

¹⁶ Tr. at 484:12 through 485:12 (Harkins Direct) (Oct. 26, 2017).

¹⁷ Tr. at 488:20-25, 490:19-491:18, 493:12-494:10 (Harkins Cross) (Oct. 26, 2017).

¹⁸ Ex. DDU-9, page 4 of 527 through page 5 of 527.

¹⁹ Tr. at 473:5-16 (Gracy Cross) (Oct. 26, 2017).

²⁰ Staff’s Exceptions at p. 8-9.

²¹ Ex. DDU-1 and DDU-2.

²² Staff’s Reply Brief, p. 18

and continue to be appropriately treated as annual expenses. The chart below summarizes the recurring grinder pump expenses established by DDU Exhibit 9C:

Chart 1

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

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

There is sufficient evidence in the records to support the ALJ's findings on this issue, and Staff's Exception should be denied.

7. Professional Services

Staff filed no exceptions regarding this topic.

8. Insurance Expenses

Staff filed no exceptions regarding this topic.

9. Salaries

Staff filed no exceptions regarding this topic.

10. Regulatory Fees

Staff filed no exceptions regarding this topic.

11. Miscellaneous Expenses

Staff filed an Exception to the ALJ'S recommendation to include expenses for resort overhead and G&A in DDU's cost of service, citing the rule that a utility may only include expenses that are reasonable and necessary to provide service to the ratepayers in its cost of service.²³ Staff claims that the evidence in this case has "clearly shown that the amount of resort overhead allocated to White Bluff and the Cliffs includes the cost of items like uniforms and commissions/bonuses for resort employees; items that are unrelated to the provision of utility service."²⁴

Staff's claims are wrong. The amounts Staff proposed for removal from resort overhead for White Bluff are \$7,410 for water, and \$5,366 for sewer. The amounts Staff proposed for removal for allocated G&A expenses are \$970 for water and \$702 for sewer.²⁵ Staff asserts that the 3% allocation is fundamentally flawed and results in costs unrelated to utility service being paid by customers²⁶, but Mr. Gracy explained that the 3% allocation was a weighted average with some costs appropriately allocated to the utility being more than 3% and some being less.²⁷ Mr. Gracy also provided rebuttal testimony, stating that the overhead allocation is not already being recovered as also alleged by Staff and "is for portions of the general manager's salary, receptionist's salary, the human resources person, accounts payable person, office space, and copiers ..."²⁸ Mr. Gracy explained that it would cost more than the \$12,000 allocated to DDU-White Bluff in order to rent space, hire people and provide the other services, and he noted that the cost for these resources is \$1,000/month, which is 3% of the allocation department total costs.²⁹

²³ 16 Tex. Admin. Code (TAC) § 24.31(b).

²⁴ Staff Exceptions at p. 9.

²⁵ Ex. Staff-2, p. 23, lines 3-5.

²⁶ Staff Exceptions at p. 9.

²⁷ Tr. 476:23 through 477:2 (Gracy Cross) (Oct. 26, 2017).

²⁸ Ex. DDU-8, p. 8, lines 12-14.

²⁹ Ex. DDU-8, p. 8, lines 14-19.

Mr. Gracy also explained these allocated expenses in greater detail in live rebuttal, including an explanation that these portions of the overall overhead are related to utility service.³⁰ The allocated overhead expenses are reasonable and required for the local operation of the White Bluff utility systems. They should be included in the expenses recovered by DDU through rates. Mr. Gracy further testified at length about how the allocations were developed based upon historical costs.³¹ The overall impact is that allocation of 3% of resort overhead, or \$12,000/year, is reasonable for the services that the utility receives from the resort as described by Mr. Gracy.

There is sufficient evidence in the records to support the ALJ's findings on this issue, and Staff's Exception should be denied.

B. Depreciation [PO Issues 12, 27]

Other than citing to the grinder pump issue discussed above, Staff filed no exceptions regarding this topic. This seems particularly strange since Staff's expert witness on this topic, Ms. Mathis, who has worked on utility asset and depreciation issues for at least 24 years³², "developed depreciation schedules for the water and sewer systems for The Cliffs and White Bluff according to the Commission's rules and Texas Water Code from capital assets which were used and useful in providing water service."³³ And those schedules conflict with the ALJ's proposed recommendation.

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

Staff filed no exceptions regarding this topic.

2. Error in Trending Study

Staff filed no exceptions regarding this topic.

3. Fully Depreciated Assets

Staff filed no exceptions regarding this topic.

³⁰ Tr. 464:21-467-5 and 478:3-21 and 479:16-21 (Testimony of Randy Gracy)(Oct. 26, 2017).

³¹ Tr. 474:4 through 477:2 (Gracy Cross) (Oct. 26, 2017).

³² Staff Ex. 4, p. 2, line 9, p. 2, line 16, through p. 3, line 1.

³³ *Id.* at p. 4, line 20 through p. 5, line 2.

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

1. Federal Income Tax Expense [PO Issue 30]

DDU agrees with Staff that the Commission should consider the effects of the federal income tax reforms enacted by the Tax Cuts and Jobs Act of 2017 (TCJA).³⁴ DDU recommends that the effects be addressed in the number runs and that DDU file a compliance tariff with the approved rates. The reforms enacted by the TCJA are complex and the impact of those reforms on DDU is not a simple calculation.

As a related issue, any adjustments to DDU's rates related to the impact of the TCJA should not be included in the evaluation of the 51% threshold for recovering rate case expenses because that impact wasn't known or foreseeable at the time of DDU's filing.

2. Other Assessments and Taxes [PO Issue 29]

DDU agrees with Staff that flow through adjustments to payroll taxes must be made, but those adjustments should reflect the full staffing requested by DDU in its Exceptions.³⁵

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

1. Original Cost of Plant in Service

As discussed in section IV(A)(6), DDU opposes Staff's Exception related to capitalizing grinder pump costs.

2. Accumulated Depreciation

As discussed in section IV(A)(6), DDU opposes Staff's Exception related to capitalizing grinder pump costs, and therefore inclusion of accumulated depreciation for those costs.

3. Cash Working Capital

Staff filed no exceptions regarding this topic.

4. Developer Contribution

Staff filed no exceptions regarding this topic.

³⁴ *Proceeding to Investigate and Address the Effects of the Tax Cuts and Jobs Act of 2017 on the Rates of Texas Investor-Owned Utility Companies*, Project No. 47945 (Jan. 12, 2018).

³⁵ DDU Exceptions at p. 8-9.

5. Property Not Belonging to DDU

Staff filed no exceptions regarding this topic.

6. Improper Use of Trending Study

Staff filed no exceptions regarding this topic.

7. Used and Useful/Prudence

Staff filed no exceptions regarding this topic.

8. Accumulated Deferred Federal Income Tax (ADFIT)

Staff filed no exceptions regarding this topic.

V. RATE OF RETURN

A. Return on Equity [PO Issue 8]

Staff filed an Exception to the ALJ'S recommendation to adopt a 9.84% return on equity (ROE). Staff cites the only contested case to be considered by the Commission for a water utility rate application as precedent.³⁶ As staff well knows, the utility in that case did not present evidence about a recommended return on equity but presented evidence about the impact of Staff's low return on equity on the value of the company. Staff makes generalized statements about Staff's position falling "squarely within the requirements established by the Texas Water Code and Commission rules."³⁷ Staff goes on to complain that, because DDU's witness, Mr. Greg Scheig, testified on these matters in rebuttal, his testimony should be given little deference.³⁸ Of course, Staff does not acknowledge that Staff was afforded the opportunity to supplement its direct testimony in response to DDU's pre-filed rebuttal testimony, which it did.³⁹

³⁶ *Application of Rio Concho Aviation, Inc. for a Rate/Tariff Change*, Docket No. 45720, Order (Jun. 29, 2017).

³⁷ Staff Exceptions at p. 12, *citing* TWC § 13.184; 16 TAC § 24.31(c)(1).

³⁸ Staff Exceptions at p. 13.

³⁹ Staff Ex. 2, *Direct Testimony of Emily Sears, including Errata*, filed on October 23, 2017, p. 14, lines 2-3, p. 15, lines 13-14, Staff references DDU's rebuttal testimony as the basis for its adjustments contained in the Errata.

DDU's expert on rate of return, Mr. Scheig, has been providing expert analysis of return on equity for over 25 years.⁴⁰ He is a Certified Public Accountant and holds a Master of Business Administration, Finance and Accounting, along with numerous other relevant certifications.⁴¹

Mr. Scheig points out that Ms. Sears' analyses have mathematical errors and do not adequately account for the risk of an illiquid common stock equity investment in a small private company such as DDU.⁴² Ms. Sears' reliance on only two limited analyses, excluding other recognized financial models, results in a return on equity that does not adequately compensate DDU's equity investors for the risk of an illiquid common stock equity investment in a small private company such as DDU.⁴³

As Mr. Scheig noted, the Constant Growth DCF model relied upon by Ms. Sears is based upon very simplistic assumptions which limit its reliability. Those assumptions are (1) a single, constant growth rate into perpetuity and (2) investors depend on dividends as their sole source of returns.⁴⁴ But, as Mr. Scheig testified, many growth companies never pay dividends, reflecting the expectation that equity capital will earn a higher rate of return for investors by reinvesting it in the business, rather than by paying a dividend.⁴⁵ In addition, Mr. Scheig notes that Ms. Sears "mechanically" averaged disparate growth rates for each comparable company, in her barometer group in her DCF analyses. She did this without using informed judgment, resulting in an unsupportable conclusion. For example, San Jose Water, Ms. Sears' table shows two estimates of 14.0% and 3.0% for the same company into perpetuity, which she averages to a single estimate of 8.50%.⁴⁶ Simply averaging two growth rates, without any additional analyses, does not automatically result in a reliable conclusion.⁴⁷

Mr. Scheig also noted significant problems in Ms. Sears' CAPM analyses. Ms. Sears' CAPM analyses should not be considered reliable based on her assumptions of risk-free rate inputs,

⁴⁰ Ex. DDU-10, Pre-filed Rebuttal Testimony of Greg Scheig, page 3-page 4 of 123.

⁴¹ Ex. DDU-10 (Attachment DDU-10A), page 39 of 123 through page 50 of 123.

⁴² Ex. DDU-10, page 6 of 123, lines 2-4.

⁴³ *Id.* at 7 of 123, lines 6-9.

⁴⁴ *Id.* at 7, line 12 through 9, line 5.

⁴⁵ *Id.* at 8.

⁴⁶ Staff Exhibit 2, Attachment ES-9 (Emily Sears Direct).

⁴⁷ Ex. DDU-10, page 10 of 123, lines 7-14.

equity risk premia, and failure to consider a small stock risk premium.⁴⁸ With regard to her risk-free rate inputs, Ms. Sears used a 10-year US Treasury bond yield, as opposed to the standard 30-year bond yield.⁴⁹ This is problematic because the 30-year bond yield is consistent with the longer-term asset lives of utility systems and a 10-year Treasury bond yield with a lower yield to maturity does not adequately compensate DDU investors for the risk of an equity investment.⁵⁰ Had Ms. Sears' used 2018-2022 Blue Chip forecast rate of 3.80% from her own testimony, this would have increased her concluded ROE by approximately 100 basis points to 9.68%.⁵¹ With regard to her equity risk premia, Ms. Sears used a historical ERP of 5.82% in her CAPM analyses. However, in her Attachments ES-13 and ES-14, she calculated an expected return for the market of 11.06% equates to a forward-looking ERP of 8.25% (11.06% from ES-13 less the 2.81% risk-free rate from ES-14).⁵² An 8.25% forward-looking ERP is a more reasonable input for the CAPM analysis because the CAPM is a forward-looking model.⁵³

Ms. Sears' application of the CAPM is more appropriate for larger public utilities given her beta inputs are from large public companies, and small private companies like DDU, require an adjustment for small stock risk and lack of liquidity.⁵⁴ To adjust for this difference, a small stock risk premium (SSRP) must be utilized.⁵⁵ Mr. Scheig explains that the SSRP increases inversely to entity size, and is in addition to the required systematic (i.e., market) risk.⁵⁶

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

⁴⁸ *Id.* at 11, lines 9-10.

⁴⁹ *Id.* at 12, lines 3-9.

⁵⁰ *Id.*

⁵¹ *Id.* at lines 10-15.

⁵² *Id.* at lines 18-23.

⁵³ *Id.* at 13, lines 1-2.

⁵⁴ *Id.* at lines 11-14.

⁵⁵ *Id.* at 21, lines 13-15.

⁵⁶ *Id.* at 29, lines 4-6.

There is sufficient evidence in the records to support the ALJ's findings on this issue with the adjustment to include a small stock risk premium as noted in DDU's Exception⁵⁷, and Staff's Exception should be denied.

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

Staff filed no exceptions regarding this topic.

C. Capital Structure [PO Issue 7]

Staff filed no exceptions regarding this topic.

D. Overall Rate of Return [PO Issue 8]

For the reasons discussed in section V(A), DDU opposes Staff's exception related to return on equity. As noted in DDU's Exception on this issue, DDU's recommended ROE results in an overall return of 8.39%.⁵⁸

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

Staff filed no exceptions regarding this topic.

VII. RATE-CASE EXPENSES [PO ISSUE 38]

Staff filed no exceptions regarding this topic.

VIII. INTERIM RATES AND EFFECTIVE DATE

[PO Issue 29, 40, 41]

Staff filed no exceptions regarding this topic.

IX. CONCLUSION

DDU opposes Staff's request to revise any final order in this proceeding to be consistent with Staff's exceptions for the reasons set forth above.

⁵⁷ DDU Exceptions at p. 20-25.

⁵⁸ DDU Exceptions at p. 25 and p. 35.

X. FINDINGS OF FACT

DDU opposes Staff's request to revise to the Findings of Fact consistent with Staff's exceptions for the reasons set forth above.

XI. CONCLUSIONS OF LAW

DDU opposes Staff's exception to Conclusion of Law No. 10 as discussed in section V(A).

XII. ORDERING PARAGRAPHS

Staff filed no exceptions regarding this topic.

SECTION 2. RESPONSE TO WBRG'S EXCEPTIONS

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

WBRG begins its exceptions by claiming that the "PFD omits some of the procedural background that provides necessary context regarding DDU's approach to this filing." The ALJ appropriately excluded WBRG's argument from his recommendations in the PFD because they are irrelevant to the case. DDU amended its application and the effective date of its rate increase has been suspended for the entire pendency of this case.

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

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

Miscellaneous Expenses

WBRG filed an Exception to the ALJ'S recommendation to allow approximately \$12,000 of resort overhead and general & administrative expenses in the revenue requirement. WBRG argues that these costs should be excluded because they are affiliated transactions. As noted by WBRG, the allocated costs include portions of the salaries of the resort's general manager, receptionist, HR employee, and other costs. And based upon the testimony of Mr. Gracy, it would cost more than \$12,000 for DDU "to hire those persons and rent space solely for DDU's use."⁵⁹

⁵⁹ PFD at 24, Bates 000028.

The ALJ properly found that these costs were reasonable. The ALJ recognizes that “DDU is saving money by allocating these resort costs...”⁶⁰ WBRG’s arguments fail to recognize that DDU did prove that the allocated costs were less than the costs that would have been incurred by the utility. The ALJ accepted Mr. Gracy’s testimony that it would cost more than the \$12,000 allocated to DDU-White Bluff in order to rent space, hire people and provide the other services, and that the cost for these resources is \$1,000/month, which is 3% of the allocation department total costs.⁶¹

The affiliate transaction rule is in place to prevent overcharging of costs to customers through affiliate transactions. The record shows, and the ALJ properly concludes, that is not the case for these allocations. There is sufficient evidence in the record to support the ALJ’s findings related to the reasonableness of these transactions and the fact that they actually save money for the customers.

B. Depreciation [PO Issues 12, 27]

WBRG filed no exceptions regarding this topic.

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

WBRG filed no exceptions regarding this topic.

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

1. Original Cost of Plant in Service

WBRG appears to except to the absence of a specific finding regarding rate base within the PFD. DDU filed exceptions to the ALJ’s recommendations on treatment of developer contributions in relation to the original cost of plant in service.⁶² Based upon those exceptions, the Commission should revise the findings in the PFD to establish an original cost of plant in service that recognizes the rate base proposed by DDU in its exceptions.

⁶⁰ PFD at 25, Bates 000029.

⁶¹ Ex. DDU-8, p. 8, lines 14-19.

⁶² DDU Exceptions at p. 14-18.

2. Accumulated Depreciation

WBRG appears to except to the absence of a specific finding regarding depreciation within the PFD. DDU also filed exceptions to the ALJ's recommendations on depreciation of plant in service. Based upon those exceptions, the Commission should revise the findings in the PFD to establish accumulated depreciation that recognizes the depreciation proposed by DDU in its exceptions.

3. Cash Working Capital

WBRG filed no exceptions regarding this topic.

4. Developer Contributions

WBRG appears to except to the absence of a specific finding regarding developer contributions for The Cliffs. There was no evidence presented related to this issue for The Cliffs systems. But DDU would file the same exceptions for the The Cliffs systems as those set forth for the White Bluff systems in its Exceptions.⁶³

5. Property Not Belonging to DDU

WBRG filed no exceptions regarding this topic.

6. Improper Use of Trending Study

As stated in the arguments in its Exceptions, DDU opposes the changes proposed by WBRG to the rate base values.⁶⁴

7. Used and Useful/Prudence

WBRG filed an exception to the ALJ's recommendation regarding Use and Useful/Prudence. WBRG claims that questions remain unanswered about the used and usefulness of DDU's assets. But contrary to WBRG's assertions, Dr. Harkins, DDU's expert, provided uncontroverted testimony that she made a used and useful determination for each of the utility assets in all four DDU systems based upon her review of the systems.⁶⁵ The maps attached to Mr.

⁶³ DDU Exceptions at p. 15-18.

⁶⁴ *Id.* at p. 16-18.

⁶⁵ Ex. DDU-5, page 7 of 52, lines 17-20 and page 10 of 52, lines 10-11; Tr. 197:9 through 198:2 (Harkins Cross) (Oct. 24, 2017).

Gracy's testimony also show water and wastewater systems at The Cliffs and White Bluff that are fully interconnected and looped.⁶⁶ The interconnection of these distribution and collection systems is one of the reasons cited by Dr. Harkins for treating all of the facilities as used and useful.⁶⁷ Her testimony actually stated that the lines were looped and provide water further along the system, those lines are used and useful.⁶⁸ In addition, Dr. Harkins was unwilling to testify that the lines on a single street on a map were not used and useful.⁶⁹ WBRG simply chooses to ignore Dr. Harkins' testimony. All of the DDU assets included in DDU's proposed rate base are used and useful.

With regard to WBRG's assertion related to prudence of construction, the Courts have concluded that prudence is

The exercise of that judgment and the choosing of one of that select range of options which a reasonable utility manager would exercise or choose in the same or similar circumstances given the information or alternatives available at that point in time such judgment is exercised or option is chosen.⁷⁰

As the record reflects, 85 to 90 percent of the lots in White Bluff are sold.⁷¹ Any of those lot owners could request utility service from DDU at any time and choose to build a house. DDU must be prepared to provide that service in accordance with its CCN. Having the system built and in place, and ready to extend service, is a reasonable option for the utility, particularly when considering that much of the DDU infrastructure has been treated as developer contributed capital.

8. Accumulated Deferred Federal Income Tax (ADFIT)

WBRG filed no exceptions regarding this topic.

⁶⁶ Ex. DDU-3, Attachments 3B, 3C and -3D.

⁶⁷ Tr. 197:9-16 (Harkins Cross) (Oct. 24, 2017).

⁶⁸ Tr. 197:9-162 (Harkins Cross) (Oct. 24, 2017).

⁶⁹ *Id.*

⁷⁰ *Gulf States Utilities Company v. Public Utility Commission of Texas*, 841 S.W.2d 459, 476 (Tex. App—Austin 1992, writ denied).

⁷¹ Tr. 63:2-3 (Gracy Cross) (Oct. 24, 2017).

III. RATE OF RETURN

A. Return on Equity [PO Issue 8]

WBRG filed no exceptions regarding this topic.

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

WBRG filed no exceptions regarding this topic.

C. Capital Structure [PO Issue 7]

WBRG filed an exception to the ALJ's recommendation regarding capital structure, arguing that the proper structure should be 100% debt and 0% equity. To reach this conclusion, WBRG twists the testimony of DDU's witness, Mr. Greg Scheig. Mr. Scheig did not testify that DDU has taken a loan out and distributed the funds to its shareholders. He did testify that a hypothetical utility could do that, but it would damage the equity of the utility and that does not typically happen.⁷² DDU's capital structure should not be restructured for many reasons, not the least of which is that DDU did not do what WBRG argues must be done to support its 0% equity assertion.

D. Overall Rate of Return

WBRG filed no exceptions regarding this topic.

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

WBRG filed no exceptions regarding this topic.

V. RATE CASE EXPENSES [PO Issue 38]

WBRG filed an exception to the ALJ's recommendation regarding rate case expenses. WBRG's exception and argument are misguided. The Commission rules provide that:

A utility may recover rate-case expenses, including attorney fees, incurred as a result of filing a rate-change application pursuant to TWC §13.187 or TWC §13.1871, only if the expenses are just, reasonable, necessary, and in the public interest.⁷³

⁷² Tr. 425:15-21 (Scheig Cross) (Oct. 25, 2017).

⁷³ 16 TAC § 24.33(a).

And that:

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 revenue that would have been generated by a utility's proposed rate.⁷⁴

The chart below⁷⁵ shows DDU's revenue generated from rates during the test year, DDU's requested revenue from proposed rates, and the proposed amount of revenue increase. In order to make a valid comparison, the White Bluff revenues exclude the revenues generated by the pass-through of the Prairielands Groundwater Conservation District production fee, and the White Bluff expenses exclude the associated Prairielands Groundwater Conservation District production fee expense.

	Current Revenue Generated from Rates	Requested Revenue Requirement	Propose Increase in Revenue
White Bluff	\$877,780	\$1,118,390	\$210,609
The Cliffs	\$583,467	\$735,174	\$151,707
Total	\$1,461,247	\$1,853,564	\$392,317

If the Commission establishes rates in its final order in this case that generate an increase in revenue that equals or exceeds 51% of the increase in revenues that would have been generated by the proposed revenues, then DDU is entitled to recover its just, reasonable and necessary rate-case expenses.⁷⁶ In addition, as noted by Mr. Joyce, the impact of the treatment of the Prairielands Groundwater Conservation District production fee as a pass-through rather than part of the revenue requirement should not be allowed to adversely impact DDU's ability to meet the 51% threshold. Similarly, DDU's compliance with the Commission's instructions for calculating a rate of return at the time it filed its application should not be allowed to adversely impact DDU's ability to meet the 51% threshold.

In addition, any adjustments related to the impact of the TCJA should not be included in the evaluation of meeting the 51% threshold because that impact wasn't known or foreseeable at time of filing.

⁷⁴ 16 TAC § 24.33(b).

⁷⁵ From Exhibit DDU-11, p.13 of 106, lines 7-8.

⁷⁶ 16 TAC § 24.33(B).

WBRG argues that the rate proposed in the initial application should be the basis for the calculation of the 51% threshold. Unfortunately for WBRG, those rates are no longer the proposed rates and have no relevance to the evaluation. WBRG justifies its argument by stating that there were significant adjustments to the revenue requirements in the revised application. While this is true, it is also true that the application was revised well before the bulk of discovery commenced and before the preparation and filing of any testimony.

WBRG argues that allowing utilities to revise applications will encourage the utilities to seek rates in the hopes that no ratepayers intervene. Utilities certainly do not hope for a contested case in any application but allowing amendments to applications actually encourages utilities to make adjustments to requested revenues before incurring the expenses of a contested hearing, thus avoiding the litigation of agreed issues.

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

WBRG filed no exceptions regarding this topic.

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

WBRG filed no exceptions regarding this topic.

SECTION 3. RESPONSE TO TCUC'S EXCEPTIONS

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

TCUC filed no exceptions regarding this topic.

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]

For the first time in this proceeding, TCUC asserts that DDU's labor costs related to The Cliffs should be excluded. DDU filed its application, responded to discovery and presented its case. Staff reviewed DDU's documentation and did not recommend any changes to DDU's labor costs for The Cliffs systems.⁷⁷ TCUC mischaracterizes Mr. Gracy's testimony in its exception.

⁷⁷ Staff Exhibit 3, Attachments JR-2 and JR-3 (Jonathan Ramirez Direct).

Mr. Gracy simply testified that there were only five employees at The Cliffs systems at the time of his testimony.⁷⁸ DDU's labor costs at The Cliffs are based upon its historical costs for the test year as adjusted by the now historical known and measurable changes that it presented in its application and testimony and that Staff agreed with. TCUC's exception on this issue should be denied.

B. Depreciation (PO Issues 12, 27)

TCUC filed no exceptions regarding this topic.

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

As stated in response to Staff's exception on this issue, DDU agrees with Staff that the Commission should consider the effects of the federal income tax reforms enacted by the Tax Cuts and Jobs Act of 2017 (TCJA).⁷⁹ DDU recommends that the effects be addressed in the number runs and that DDU file a compliance tariff with the approved rates. The reforms enacted by the TCJA are complex and the impact of those reforms on DDU is not a simple calculation.

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

Rate Base

TCUC adopts WBRG's arguments about rate base in its exception on this issue. This issue was 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. It would have the same impact within The Cliffs' systems. 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. If the ALJ's proposal for White Bluff were similarly implemented for The Cliffs, it would result in wiping out nearly 99% of DDU's original cost of plant in service.

⁷⁸ Ex. DDU-3 at 15.

⁷⁹ *Proceeding to Investigate and Address the Effects of the Tax Cuts and Jobs Act of 2017 on the Rates of Texas Investor-Owned Utility Companies*, Project No. 47945 (Jan. 12, 2018).

TCUC does not accurately recount Mr. Gracy's testimony on the acquisition of The Cliffs because there is no evidence or testimony that the price was a "bargain price". TCUC also reference a deed in its exception that is not evidence within the record. Its arguments related to this deed and the dollars associated with the purchase are not based upon facts in evidence, cite no evidence or record documents, and should be wholly disregarded. DDU strongly objects to this attempt to insert evidence into the record through argument.

Improper Use of Trending Study

TCUC also adopts WBRG's arguments regarding use of the trending studies completed by Dr. Harkins. As stated in DDU's Exceptions, the use of the trending studies is appropriate.⁸⁰

III. RATE OF RETURN

A. Return on Equity [PO Issue 8]

TCUC also filed an exception to the ALJ's recommendation regarding Return on Equity. TCUC claims that DDU's return on equity should be reduced because of DDU's water loss. Once again, TCUC tries to rely upon documents that were never offered into evidence or admitted into the record.⁸¹ TCUC's argument on this issue should be disregarded as a result and the documents excluded from the record. The ALJ's analysis and recommendations regarding TCUC's claims on this issue are reasonable, supported by the evidence in the record, and should be adopted.

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

TCUC filed no exceptions regarding this topic.

C. Capital Structure [PO Issue 7]

TCUC filed no exceptions regarding this topic.

D. Overall Rate of Return

TCUC filed no exceptions regarding this topic.

⁸⁰ DDU Exceptions at p. 16-18.

⁸¹ TCUC Exhibits 17 and 18.

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

TCUC filed no exceptions regarding this topic.

V. RATE CASE EXPENSES [PO Issue 38]

TCUC appears to except to the ALJ's recommendations regarding rate case expenses. DDU believes that it has carried its burden of proof in this case and that the 51% threshold for rate case expenses will be met for all systems. However, if the Commission does not agree with DDU's position, DDU is entitled to recover rate case expenses for any systems for which it does satisfy the 51% threshold. The appropriate amount of that recovery would be determined in a subsequent proceeding focused specifically on rate case expenses.

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

TCUC filed no exceptions regarding this topic.

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

TCUC filed no exceptions regarding this topic.