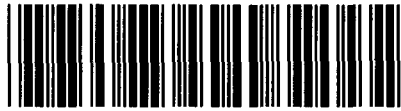




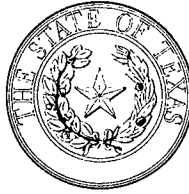
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Lesli G. Ginn
Chief Administrative Law Judge

May 2, 2018

TO: Stephen Journey, Director
Commission Advising and Docket Management
William B. Travis State Office Building
1701 N. Congress, 7th Floor
Austin, Texas 78701

VIA EMAIL

RE: SOAH Docket No. 473-17-0119.WS
PUC Docket No. 46245

*Application of Double Diamond Utility Company, Inc. For Water And Sewer
Rate/Tariff Change*

Dear Mr. Journey,

On February 13, 2018, I issued the Proposal for Decision (PFD) in this case. After the deadlines for filing exceptions were extended by agreement among all parties, Double Diamond Utility Company, Inc. (DDU), White Bluff Ratepayers Group (WBRG), The Cliffs Utility Committee (TCUC), and Commission Staff timely filed exceptions on March 28, 2018. DDU, WBRG, and Staff then filed timely replies to exceptions on April 12, 2018.

Most of the exceptions repeat arguments raised by the parties at the hearing and in post-hearing briefing and which were fully considered and discussed in the PFD, or express disagreement with how I have weighed the evidence. Therefore, the exceptions have not persuaded me to change my recommendations on any of the issues, other than in the limited instances set forth below. The matters addressed in this letter are discussed in the order in which the issues are discussed in the PFD.

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IV. REVENUE REQUIREMENT

A. Operations and Maintenance/General and Administrative Expenses

1. Other Revenues

Both DDU and Staff except to the PFD's adoption of Staff's recommendation concerning the addition of \$3,600 in monthly revenues received from Nextlink to the operations and maintenance (O&M) expense account of the White Bluff water system. Staff and DDU are correct that this expense should have been added to the White Bluff water system's other revenues and not its O&M account. Therefore, I recommend that Finding of Fact 18 be amended to read as follows:

Finding of Fact 18: DDU received \$3,600 in revenue from Nextlink that should be added to White Bluff water's other revenues.

2. Transportation

Staff clarifies in its exceptions that the amount of the tool box expense it recommended be removed from White Bluff's transportation expenses and added to its depreciation schedule was \$850, not \$580. DDU concurs with this exception. The ALJ agrees that the correct dollar amount for this expense is \$850. Therefore, I recommend that Finding of Fact 35 be amended to read as follows:

Finding of Fact 35: A vehicle lease expense (\$2,912 for both water and sewer) and a tool box expense for White Bluff of \$850 should be removed from transportation expenses and added to the depreciation schedule.

3. Miscellaneous Expenses

WBRG takes issue with the ALJ's interpretation of Texas Water Code § 13.085(e) as it pertains to resort overhead and administrative and general expenses allocated to the DDU water and sewer utilities at White Bluff and The Cliffs. According to WBRG, the allocations must be considered payments by DDU under the statute to avoid "creat[ing] bad policy . . ." ¹ However, the preponderance of the evidence shows that DDU shares various costs at White Bluff and The Cliffs with the developer and other companies, including office space rental, utilities for that office, office equipment, a receptionist, a human resources department, and a billing department. ² As stated in the PFD, WBRG does not point to any evidence that DDU pays any other Double Diamond company for these shared costs. Whether bad policy or not, I conclude that by the terms of the statute, such cost sharing between related companies is not subject to the

¹ WBRG Exceptions at 3.

² Tr. at 465-466.

same scrutiny as payments made from one company to the other. I recommend no changes to the PFD based on this exception by WBRG.

B. Depreciation

DDU excepts to removal of an \$80 truck bed mat expense from the White Bluff sewer depreciation schedule. The ALJ adopted Staff's recommendation in this regard, which indicated that DDU's errata for the depreciation schedule showed an addition of \$930.04 for "TK Crossbed Toolbox," while the corresponding deduction from its expenses for that item was only \$850. Staff attributed the \$80 difference to the cost of the truck bed mat that was on the same invoice for the toolbox, and argued that the \$80 should be removed from the depreciation schedule since it is included as an expense in White Bluff's cost of service. DDU appears to have misunderstood the PFD to recommend complete exclusion of this \$80 expense; in fact, I only recommend adoption of Staff's position, which is that the \$80 truck bed mat expense should not be included on the sewer depreciation schedule.

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

DDU also excepts to the PFD's determination that it failed to show that its account balances do not reflect original costs of the distribution and collection lines at White Bluff and The Cliffs such that estimating those costs through a trending study was allowable. DDU frames the issue as whether a line item entry for a group of assets on a current balance sheet constitutes "historical records for verification purposes" as contemplated by the rule. The evidence is clear, and DDU does not dispute, that its White Bluff application includes a test-year depreciation cost based on its account balances, which is increased by approximately \$46,000 in known and measurable changes in depreciation costs based on the estimated values from Dr. Harkins' trending study.³ Therefore, I find that WBRG frames the issue more accurately when it questions how DDU could have included a test-year depreciation amount without book values, and why a trending study would be appropriate to increase that depreciation amount without evidence that the test-year depreciation amount was based on inaccurate or faulty book values. DDU witness Mr. Grout clearly testified that the costs of the initial utility infrastructure would have been recorded in DDU's books based on invoices, and that he had no reason to doubt those book values. I stand by my finding that DDU failed to meet its burden of proof to justify the use of a trending study to estimate original cost for purposes of determining its depreciation expense.

³ DDU Ex. 2 (White Bluff Application) at 6; Tr. at 205.

C. Taxes

1. Federal Income Tax Expense

Based on the Tax Cuts and Jobs Act of 2017 (TCJA) and the Commission's accounting order in Docket No. 47945, Staff argues that the rates recommended by the PFD should be reduced to reflect the savings DDU may realize under the TCJA. Specifically, Staff recommends the Commission order DDU to (a) adjust the income tax rates used in the number running process and file a compliance tariff reflecting the approved rates, and (b) record the excess accumulated deferred federal income tax in a regulatory liability account to be returned to customers in its next base rate case. TCUC also recommends that the tax rates set forth in the TJCA be used to determine the rates in this proceeding. DDU appears to agree with Staff's recommendations in this regard, although it notes that the TCJA reforms are complex and that their impact cannot be determined through "a simple calculation." I recommend the Commission adopt Staff's recommendations.

D. Return on Invested Capital

1. Developer Contributions

The primary issue pertaining to rate base that was raised in exceptions by all parties (except Staff) deals with developer contributions in aid of construction, which all parties agree must be excluded from DDU's invested capital upon which it can earn a reasonable return. However, most of the arguments presented were covered in post-hearing briefing and thoroughly analyzed in the PFD, so I will not repeat that analysis here. However, I will address arguments raised by TCUC in its exceptions that were not fully explained in the PFD.

WBRG placed a major focus in its direct testimony, its hearing presentation and cross-examination, and its post-hearing briefing on the developer contribution issue, setting forth several arguments as to why only the assets that DDU actually paid for should be included in the rate base for White Bluff. In its exceptions, TCUC contends that all of these arguments apply equally to the rate base claimed for The Cliffs. Alternatively, TCUC maintains that if the Commission adopts DDU's management decision to split the cost of certain assets 80% developer and 20% DDU, the cost of the initial sewer pipes at The Cliffs should be so allocated, instead of 100% to DDU as reflected in the schedules attached to the PFD. TCUC also claims that the PFD's determination that DDU failed to meet its burden to prove to show how much of the original cost of the utility assets were contributed by the developer should also apply to The Cliffs systems. In response, DDU argues that TCUC offered no evidence with respect to the issue of developer contributions at The Cliffs.

With respect to the issue of developer contributions, TCUC argued in its post-hearing briefing that the evidence was conflicting as it related to developer invested capital and utility invested capital. TCUC's brief identified the issue as "whether Double Diamond's invested

capital should be ‘adjusted’ to reflect the fact that it paid less than the various estimates of original cost.” TCUC argued that it was impossible to discern from the evidence the appropriate amount of rate base because DDU did not “accurately account[ed] for which capital investments are developer and which are utility capital . . .”⁴ However, unlike WBRG, TCUC did not offer any evidence to rebut DDU’s testimony and asset lists that showed which of The Cliffs water and sewer system assets were partially developer-contributed and what assets were funded solely by DDU.

In the PFD, the analysis of the developer contribution issue centered on the arguments and evidence presented by WBRG, which was much more extensive than the arguments raised by TCUC. For example, WBRG asked DDU in discovery for documentation pertaining to which of the Double Diamond companies funded utility infrastructure for the White Bluff systems. WBRG witness Nelisa Heddin then reviewed the documents produced as well as the lists of assets claimed by DDU as part of its rate base at White Bluff and provided in-depth analysis of which of the various Double Diamond companies paid for which White Bluff assets. Ms. Heddin also offered explanations regarding inconsistencies between the White Bluff asset lists in the application and DDU’s tax depreciation schedules. TCUC did not undergo any type of analysis of the asset lists and depreciation schedules provided by DDU for The Cliffs water and sewer systems, much less an in-depth review of the history of the acquisition of the assets of those systems like Ms. Heddin performed for the White Bluff systems.

TCUC makes arguments in its exceptions regarding invested capital and developer contribution based on documents that are not in the record that purport to show how much Double Diamond Inc. paid for The Cliffs utility systems.⁵ However, the only evidence in the record regarding the amount of developer contributions at The Cliffs comes from DDU’s testimony and asset lists. Although TCUC maintains generally that there are inconsistencies and conflicts within DDU’s own evidence on the issue, it only identifies one specific example, which pertains to a “Total Pipe Installed” asset on DDU’s asset list for The Cliffs sewer system submitted with the direct testimony of Jay Joyce (DDU Exhibit 6D at 70). The list indicates that the cost of that asset, listed as \$703,723.37, was funded 100% by DDU. TCUC notes that DDU witness Mr. Gracy testified at the hearing that he “believed” an asset with the same name on the asset list for White Bluff sewer (DDU Exhibit 6C at 49) was “intended to be” split 80% developer/20% utility. However, Mr. Gracy did not definitively state that the Total Pipe Installed asset on the White Bluff sewer list was 80% developer-contributed/20% DDU-contributed; instead, he deferred to DDU witnesses Dr. Harkins and Mr. Joyce, and it does not appear that they were questioned on that particular point. With respect to the Total Pipe Installed asset on The Cliffs sewer system list, neither Mr. Gracy nor any other witness was questioned about the source of the investment for this asset. Mr. Gracy testified on direct that 80% of the cost of the collection system necessary to serve The Cliffs Phase I was “treated” as developer contributions to DDU. However, there is no evidence in the record as to

⁴ TCUC Initial Brief at 8-9.

⁵ The evidence shows that Double Diamond Inc., a separate company from DDU, purchased The Cliffs in 1993 out of a bankruptcy proceeding. DDU Ex. 3, (Direct Testimony of Randy Gracy) at 8; Tr. at 56.

whether (or if so, how much) of the cost of “Total Pipe Installed” on The Cliffs sewer asset list correlates with the “cost of the collection system necessary to serve The Cliffs Phase I” referred to by Mr. Gracy. Mr. Gracy also testified on direct that he reviewed DDU Exhibit 6D created by Mr. Joyce, and that it accurately reflects the treatment of The Cliffs sewer assets.⁶

Considering the record evidence as a whole, the preponderance of the evidence does not support a finding that DDU’s requested rate base inappropriately includes contributions in aid of construction from the developer at The Cliffs. Therefore, I recommend no changes to the PFD in response to TCUC’s exception on this issue.

2. Improper Use of Trending Study

Both WBRG and TCUC except to the PFD’s proposed rates not having been adjusted to reflect the book values of the assets that were the subject of Dr. Harkins’ trending study as opposed to the estimates reached by that study. With respect to the rates for WBRG, the original cost of the assets that make up the PFD’s recommended rate base for White Bluff was based on actual invoices produced by DDU, not Dr. Harkins’ study, so WBRG’s exception has no basis. However, I agree that the trended values for the original utility assets at The Cliffs that were included in the rate base for The Cliffs should be adjusted to the book values that were used to calculate the test-year depreciation amount for The Cliffs application.

V. RATE OF RETURN

A. Return on Equity

Staff excepts to the PFD’s reliance on the rebuttal testimony of DDU witness Gregory Scheig in developing the recommended return on equity. Staff repeats several arguments made in its post-hearing briefing, but further contends that I gave undue weight to Mr. Scheig’s testimony, given that Staff was unable to propound discovery and respond via its own rebuttal testimony. However, I found that Mr. Scheig’s testimony was appropriate rebuttal testimony that responded to the analysis and proposed return on equity set forth in the direct testimony of Staff witness Emily Sears. Mr. Scheig’s testimony directly addresses Ms. Sears’ testimony regarding the proper methodology to calculate return on equity. Further, Staff offered supplemental direct testimony from Ms. Sears, through errata, in response to other portions of DDU’s rebuttal case, and could also have done so in response to Mr. Scheig’s testimony regarding return on equity. Staff did not request expedited relief to propound discovery regarding Mr. Scheig’s testimony. I also found compelling DDU’s position that it had initially chosen to use the instructions in the application form for calculating return on equity in an effort to keep costs down, and that it only sought Mr. Scheig’s testimony after it received Ms. Sears’ direct testimony which criticized DDU’s use of the Commission’s form instructions and set out

⁶ Mr. Gracy actually refers to DDU Exhibit 6B, which is a list of utility projects Mr. Joyce has worked on, but I inferred from the context of Mr. Gracy’s testimony and my review of the exhibits attached to Mr. Joyce’s direct testimony that Mr. Gracy meant to refer to DDU Exhibit 6D, which is an asset list for The Cliffs sewer system.

her opinion as to how the return should be calculated. While Mr. Scheig did his own independent analysis of a fair return on equity, it was done in the context of countering Ms. Sears' analysis. Therefore, I recommend no changes to the PFD's findings regarding return on equity based on Staff's exceptions.

DDU excepts to the exclusion of the small stock risk premium (SSRP) adjustment in the PFD's recommended return on equity. DDU offers a lengthy narrative with respect to several schedules attached to Mr. Scheig's testimony in an attempt to rebut my finding that the bases for Mr. Scheig's determination that DDU is a small company and that the SSRP should be included were unclear. However, I agree with Staff that an explanation of Mr. Scheig's schedules that was not provided by Mr. Scheig himself does not clarify Mr. Scheig's reasoning on those issues. I recommend no change to the PFD in response to this exception.

With the changes recommended in this letter, the PFD is ready for your consideration.

Sincerely,

A handwritten signature in black ink, appearing to read 'Casey A. Bell', with a long horizontal line extending to the right.

Casey A. Bell
Administrative Law Judge

xc: All Parties of Record