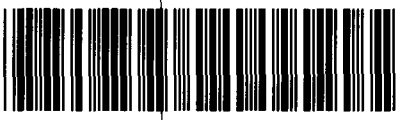

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APPLICATION OF DOUBLE DIAMOND UTILITY COMPANY, INC. FOR WATER AND SEWER RATE/TARIFF CHANGE	§ § § §	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

DOUBLE DIAMOND UTILITY COMPANY, INC.'S BRIEF REGARDING UTILITY ASSET TREATMENT IN WATER AND SEWER CASES

TO THE HONORABLE ADMINISTRATIVE LAW JUDGES:

COMES NOW, Double Diamond Utility Company, Inc. ("Double Diamond"), in the above styled and docketed water and wastewater rate proceeding and files the attached Brief Regarding Utility Asset Treatment in Water and Sewer Cases.

Respectfully submitted,

By: _____
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ATTORNEY FOR DOUBLE DIAMOND UTILITY COMPANY, INC.

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 2nd day of July, 2018.

_____
John Carlton

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INTRODUCTION

Double Diamond appreciates the opportunity to brief the Commission on the issues related to treatment of utility assets for rate base purposes in water and sewer utility rate matters. As a baseline, the Commission has an obligation to protect the financial integrity of water and sewer utilities when calculating "just and reasonable rates."[1] To protect that financial integrity, the Supreme Court has stated "[t]hat return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[2]

While regulatory schemes have evolved for utilities like telecommunications and electric, where prior notions of service delivery and infrastructure development have radically changed in the face of technological advance, the water and sewer utility industry has remained very much the same. Regardless of technological advances, water must still be obtained from nearby surface water or groundwater sources and be treated and delivered to end use customers through pipes and meters as it has been for hundreds of years. The same is true of wastewater, which must be collected from homes and businesses and delivered to regional or local centralized treatment locations for treatment before its release back in to the environment. Without these seemingly old-fashioned small and localized water and sewer systems, our modern communities simply would not exist.

The regulatory environment must incentivize, not discourage, development of water and utility systems to serve our growing population and promote economic development in the State. There are about 635 regulated investor owned water and sewer utilities currently active in Texas.[3] These water and sewer utilities are much smaller, more localized entities than either the regulated investor owned electric transmission and distribution utilities ("TDUs") or the non-ERCOT investor owned electric utilities that the Commission oversees. The largest water and sewer utility is Aqua Texas, and it serves approximately 61,000 connections across 375 public water systems and 44 wastewater treatment facilities,[4] which is less than one-fourth of the customers served by the now smallest regulated TDU in ERCOT and less than one-third of the customers served by the now smallest non-ERCOT investor owned electric utilities. The next largest water and sewer

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1 Texas Water Code (TWC) §§ 13.182(a) and 13.183(a).

2 *Fed. Power Com. v. Hope Nat. Gas Co.*, 320 U.S. 591, 603, 64 S. Ct. 281, 288 (1944).

3 Commission Water Utilities Database, List of Active Investor Owned Water and Sewer Utilities; available at https://www.puc.texas.gov/WaterSearch/

4 AquaAmerica, Texas; available at https://www.aquaamerica.com/our-states/texas.aspx.

utility in Texas is Southwest Water Company, which only has 50,000 customers spread across 32 counties.[5] There are fewer than 10 water and sewer investor owned utilities with more than 10,000 customers in Texas (less than 1.2% of all investor owned water and sewer utilities in Texas). While these "large" water and sewer companies are dwarfed in size compared to the TDUs and non-ERCOT investor owned electric utilities regulated by the Commission, the vast majority of the active investor owned water and sewer utilities in Texas as of 2018, including Double Diamond, are even smaller.[6]

As the Commission knows, there are only five TDUs within ERCOT in the State of Texas.[7] As a result of deregulation of electric power generation companies and retail electric providers ("REPs") within the ERCOT region by SB 7 in 2002,[8] the Commission only regulates the delivery rates charged by these TDUs and the end-user rates of investor owned electric utilities outside ERCOT. As shown in Table 1 below, these TDUs serve between approximately 250,000 and nearly 10,000,000 customers each.[9]

TABLE 1

	TDU	# of Customers
	Oncor	"nearly 10,000,000"[10]
	CenterPoint	2,500,000[11]
	AEP Texas • Texas Central • Texas North	"more than 1,000,000"[12]
	TNMP	249,632[13]

5 Southwest Water Company, Texas; available at http://www.swwc.com/texas/

6 There are approximately 640 water customers and 567 sewer customers in White Bluff, and there are approximately 287 water customers and 239 sewer customers in The Cliffs.

7 2017 Report to the 85th Legislature: Scope of Competition in Electric Markets in Texas, by the Public Utility Commission of Texas, p. 3, Table 1.

8 Senate Bill 7, Acts 1999, 76th R.S.,Ch. 405, General and Special Laws of Texas (effective September 1, 1999).

9 Sharyland Utilities (including Sharyland – McAllen) was the smallest investor owned utility in ERCOT; however, its retail customers were transferred to Oncor as of November 9, 2017. Sharyland Utilities, Oncor Transition; available at http://www.sharyland.com/oncor.aspx (as of November 9, 2017, all former Sharyland customers are now served by Oncor).

10 Oncor, Who is Oncor; available at http://www.oncor.com/EN/Pages/Who-is-Oncor.aspx.

11 CenterPoint Energy, Electric Services; available at https://www.centerpointenergy.com/en-us/business/services/electric-utility.

12 AEP Texas, Facts; available at https://www.aeptexas.com/info/facts/Facts.aspx.

13 PNM Resources, Our Businesses; available at http://www.pnmresources.com/about-us/our-businesses.aspx.

There are only four regulated non-ERCOT investor-owned electric utilities, which are shown in Table 2 below.

TABLE 2

Non-ERCOT Electric IOUs	# of Customers
Entergy Texas, Inc.	448,000[14]
El Paso Electric	417,000[15]
Southwestern Public Service	390,000[16]
SWEPCo Texas	185,000[17]

These nine companies comprised most of the Commission's regulated rate work before it was given jurisdiction over water and sewer utilities again by the Texas Legislature in 2015. The regulation of investor-owned water and sewer utilities is a very different undertaking from what the Commission was tasked with prior to 2015.

While some issues may be similar to those addressed by the Commission in the electric rate cases under Chapter 36 of the Texas Utilities Code, the issues in water and sewer cases are not the same because water and sewer utilities are not the same types of entities as the much larger regulated electric utilities that the Commission regulates. These differences are significant and directly impact the way the different utility types are regulated. The Texas Legislature has adopted various provisions of Chapter 13 of the Texas Water Code ("TWC") to take these differences into account, including the provisions that govern the treatment of water and sewer utility assets in rate proceedings.

The difference in size between the electric utilities and the water and sewer utilities has resulted in the rate regulatory program bouncing back and forth from the Commission to the Texas Commission on Environmental Quality and it predecessors since the Commission was created by the Texas Legislature in 1975.[18] In 1985, the Texas Legislature transferred water and sewer utility rate-making jurisdiction from the Commission to the Texas Water Commission and adopted the

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[14] Entergy Texas, Inc, About Us; available at https://www.swepco.com/info/facts/Facts.aspx

[15] El Paso Electric, About El Paso Electric; available at https://www.epelectric.com/about-el-paso-electric

[16] Xcel Energy, Who We Are, Southwestern Public Services; available at https://www.xcelenergy.com/company/corporate_responsibility_report/who_we_are

[17] Southwestern Electric Power Company, SWEPCo Facts; available at https://www.swepco.com/info/facts/Facts.aspx

[18] Act of June 2, 1975, 64th R.S.,ch. 721 (HB 819), General and Special Laws of Texas, 2327 (effective September 1, 1975)(Tex.Rev.Civ.Stat.Ann. art. 1446c).

initial versions of Sections 13.183 and 13.185 of the Texas Water Code.[19] The provisions of SB 249 generally mirrored those of PURA at the time.[20] But those provisions have been altered over time to reflect the differences of water and sewer utilities and respond to decisions by the Texas courts. The following analysis of the legislative history and the relevant cases reveals that Double Diamond's position on the treatment of its assets is correct.

1. What is a developer contribution as that term is used in TWC § 13.183(j)?[21] What is a customer contribution in aid of construction as that term is used in TWC §§ 13.183(b), 13.185(b), and 13.185(j)?

§§ 13.183 and 13.185

The first step to determining developer contributions and customer contributions is determining the original costs of the utility's assets because those contributions are only relevant to the extent that they relate to utility assets used and useful in rendering service. TWC § 13.183 and § 13.185 are the relevant sections of the TWC. Under TWC § 13.183(a), the Commission is required to:

> (a) ...fix [a utility's] overall revenues at a level that will:
>
> (1) permit the utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses; ***and***
>
> (2) preserve the financial integrity of the utility. (***emphasis added***)[22]

TWC § 13.183(a)(2) was added in 1987 as part of a "clean up" bill that required the regulatory agency to "preserve the financial integrity of the utility" in setting a water or sewer utility's

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[19] Act of May 26, 1985, 69th R.S., ch. 795 (SB 249), General and Special Laws of Texas, § 3.005, secs. 13.183 and 13.185, 2796.

[20] Public Utility Regulatory Act, Tex.Rev.Civ.Stat.Ann. art. 1446c (As Amended through the 1983 Regular and First Called Sessions of the 68th Legislature); available at https://www.sll.texas.gov/assets/pdf/historical-statutes/1984-CO/1984-corporation-laws-wests-texas-statutes-and-codes.pdf.

[21] There is no 13.183(j) in the Texas Water Code. Double Diamond presumes that the Commission intended to reference 13.185(j) in this question and will answer it using that assumption.

[22] Texas Water Code §13.183(a) (TWC).

revenues.[23] This was a departure from the mandate to the Commission for setting electric utility rates in Chapter 36 of the Utilities Code, which only addresses considering "financial integrity" in two specific circumstances when authorizing unusual rate relief.[24]

TWC § 13.185(b) states that "[u]tility rates shall be based on the original cost of property used by and useful to the utility in providing service..." The original cost of property is defined as "the actual money cost or the actual money value of any consideration paid, other than money, of the property at the time it shall have been dedicated to public use, whether by the utility that is the present owner or by a predecessor, less depreciation."[25] TWC § 13.185(b) clarifies that "[u]tility property funded by explicit customer agreements or customer contributions in aid of construction such as surcharges may not be included in invested capital."[26] In addition, TWC § 13.185(j) states that "[d]epreciation expense included in the cost of service includes depreciation on all currently used, depreciable utility property owned by the utility except for property provided by explicit customer agreements or funded by customer contributions in aid of construction."[27] However, TWC § 13.185(j) also states that "[d]epreciation on all currently used and useful developer or governmental entity contributed property shall be allowed in the cost of service."[28]

Customer Contributions

The references to customer contributions in TWC § 13.183 and § 13.185 were added in 1989, when TWC § 13.183 was amended by adding § 13.183(b) to allow the regulatory authority to authorize collection of revenues from customers to provide funding for capital improvements through customer surcharges.[29] The same amendment required that the improvements funded by these customer surcharges be considered customer contributed capital or contributions in aid of construction that may not be included in invested capital nor recovered in depreciation expense.

There is no definition within the TWC or elsewhere, but "customer contributed capital or contributions in aid of construction" as used in these provisions relates to either improvements constructed by specific agreements between the utility and a customer, such as line extensions or

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23 Act of June 1, 1987, 70th R.S., ch. 539 (HB 1459), General and Special Laws of Texas, §§9 and 10, secs. 13.183 and 13.185, 2163 (subsection (i) was also added at this time).

24 Only considered when authorizing Construction Work in Progress in the rate base (§36.054(a)) or mark-ups for costs of purchasing capacity and energy (§§36.206 and 36.207).

25 Texas Water Code Sec 13.185(b).

26 *Id.*

27 Texas Water Code §13.185(j).

28 *Id.*

29 Act of May 29, 1989, 71st R.S.,ch. 567 (HB 1808), General and Special Laws of Texas, §§17 and 18, secs. 13.183 and 13.185(b) and (j), 1891.

other facility expansions, or to surcharges approved by the regulatory authority to fund specific utility improvements, such as tap fees. Customer contributed capital or contributions in aid of construction can only exist if there is an agreement in place or a surcharge or fee approved by the regulatory authority.

Developer Contributions

The term "developer contribution" is not used within the TWC. However, TWC § 13.185(j) does specify that depreciation must be allowed on "developer... contributed capital," although the term is not defined. Under the Texas Business Organizations Code, a "contribution" is defined as:

> a tangible or intangible benefit that a person transfers to an entity in consideration for an ownership interest in the entity or otherwise in the person's capacity as an owner or a member. The benefit includes cash, services rendered, a contract for services to be performed, a promissory note or other obligation of a person to pay cash or transfer property to the entity, or securities or other interests in or obligations of an entity, but does not include cash or property received by the entity: (A) with respect to a promissory note or other obligation to the extent that the agreed value of the note or obligation has previously been included as a contribution; or (B) that the person intends to be a loan to the entity.[30]

Developer contributed capital under 13.185(j) would be capital, such as facilities or money, contributed by a developer to the water or sewer utility. Those contributions could be for an ownership interest in the entity or simply a donation to the entity. In either case, TWC requires that depreciation be allowed on such contributions.[31]

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[30] Texas Business Organizations Code, § 1.002(9).
[31] TWC § 13.185(b).

a. What factors should be evaluated to determine whether an investment qualifies as developer contributed or customer contributed?

Developer contributed capital factors

The TWC does not address the treatment of developer contributed capital for purposes of rate base and return except to require that:

> Utility rates shall be based on the original cost of property used by and useful to the utility in providing service... Original cost is the actual money cost or the actual money value of any consideration paid, other than money, of the property at the time it shall have been dedicated to public use, whether by the utility that is the present owner or by a predecessor, less depreciation.[32]

Nowhere does the TWC require exclusion of developer contributed capital from the rate base like it does customer contributed capital.

There is also very little guidance in the caselaw regarding treatment of developer contributed capital, but much has been made by the intervenors of *Sunbelt Utilities v. Public Utility Commission*, 589 S.W.2d 392 (1979), which is one of very few cases on the topic. However, *Sunbelt* does not require the exclusion of all developer contributed assets, only the exclusion of those that have been fully written off by the developer. Double Diamond has not written off all the costs of constructing its White Bluff and The Cliffs utility systems claimed as rate base, as the developer did in the *Sunbelt* case. The facts are easily distinguishable.

Sunbelt Utilities was a partnership composed of five corporations that were owned and controlled by one individual and his immediate family. The associated companies had common ownership. Each of the related companies was a partner of Sunbelt and profits or losses of Sunbelt were to be shared in proportion to the number of connections in each subdivision.[33] The development company division of Sunbelt installed the utilities, streets, sidewalks and curbs in each subdivision, to make the property marketable, and the lots transferred to the building corporation. The developer then wrote off the entire cost of the utility system in one year.[34]

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[32] Texas Water Code Sec 13.185(b).
[33] *Sunbelt Utilities v. Public Utility Commission*, 589 S.W.2d 392 (1979).
[34] *Id.*

Sunbelt subsequently filed an application and statement of intent to raise rates with the Commission. The Commission excluded nearly $800,000 from the asserted rate base of $2,374,262 because the sums had been written off by the development companies prior to transferring ownership to the related utility corporations for each subdivision.[35] The Commission concluded that since the entire cost of the utility system was expensed by the development companies against the amount realized by the sale of the lots, the rate payers had already paid for the utility system and the costs should be excluded from the rate base, and the Supreme Court agreed.[36]

In the specific facts of *Sunbelt*, the developer constructed the utility system and then took advantage of the federal income tax laws and wrote off the entire cost of the utility system.[37] Double Diamond's utility assets are still on its parent company's books as depreciable property,[38] which means that the assets have not been written off for tax purposes against the cost of lot sales. Consequently, *Sunbelt* does not require that all the assets be removed from Double Diamond's rate base.

The assets that have not been written off are investor supplied capital, which is distinguishable from developer contribution. Double Diamond has requested that 80% of the value of certain assets be removed from rate base because only 20% of the value of those assets was intended to remain as investor supplied capital in the utility to reduce costs to the customers.[39]

This potential outcome was recognized years after the *Sunbelt* case in *Tex. Water Comm'n v. Lakeshore Util. Co.*, 877 S.W.2d 814 (Tex. App.—Austin 1994). In *Lakeshore*, the Third Court of Appeals noted that:

> there conceivably could be situations in which a utility's facilities are wholly owned by a separate entity, and yet the utility meets its burden of demonstrating that it is entitled to a rate of return on the facilities.[10] Section 13.183(a)(1) of the Water Code requires only that a utility's invested capital be "used and useful in rendering

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35 *Id.*
36 *Id.*
37 *Id.*
38 Exhibit WBRG-8 CONFIDENTIAL at Bates No. DDU003584, and Exhibit WBRG-8 CONFIDENTIAL at Bates No. DDU16-015470 – DDU16-015475.
39 Exhibit DDU-3, p. 8 of 27, lines 3-5 (Testimony of Randy Gracy), admitted into the record on October 24, 2017.

service to the public" for the utility to earn a reasonable rate of return on the invested capital.

> [10] This court has recognized that "much of the utility industry consists of holding company arrangements in which the utility operating company is the subsidiary of a parent corporation."[40]

The court went on to say that:

> Lakeshore's application lacks the information required by section 13.185(a) of the Water Code; the application does not contain (1) a breakdown by item of the cost of the facilities when installed; (2) the date of installation of each item; or (3) a depreciation value for each item. Because Lakeshore did not introduce into the record the evidence necessary for the Commission to evaluate the facilities as invested capital, Lakeshore cannot complain that the Commission did not grant it a reasonable rate of return on the Sentry-owned facilities as invested capital.[41]

Given the statutes and the case law, the factors that should be used to evaluate investor supplied capital, including developer contributed capital, are:

1. Determination of all assets that are used by and useful to the utility in providing service;
2. Determination of the original cost of each such asset, or the actual money cost or the actual money value of any consideration paid, other than money, for the asset at the time it was dedicated to public use, whether by the utility that is the present owner or by a predecessor;
3. Determination of the accumulated depreciation for each such asset;
4. Determine whether such asset was written off, in whole or in part, as a developer expense and the value of the asset, if any, that was not written off as such an expense; and

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[40] *Tex. Water Comm'n v. Lakeshore Util. Co.*, 877 S.W.2d 814, 821 and n. 10 (Tex. App.—Austin 1994), citing *General Tel. Co. v. Public Util. Comm'n*, 628 S.W.2d 832, 837 (Tex. App.—Austin 1982, writ ref'd n.r.e.) in footnote 10.

[41] *Id.* at 822.

5. Determine whether such asset was customer contributed capital, as discussed further below.

Customer contributed capital factors

As discussed above, there is no definition within the TWC or elsewhere of "customer contributed capital or contributions in aid of construction." The TWC only speaks of this type of capital where there are agreements between the utility and a customer or surcharges approved by the regulatory authority to fund specific utility improvements. Customer contributed capital or contributions in aid of construction can only exist if there is an explicit customer agreement in place or a surcharge or fee approved by the regulatory authority. So, the factors to consider when evaluating customer contributed capital are:

1. Is there an explicit agreement between the customer and the utility for the customer to fund the construction of an asset or group of assets; or
2. Has the regulatory authority approved a surcharge or fee to allow the utility to recover the costs of a certain asset or assets from the utility's customers that the utility has used to construct that asset?

2. How should the fact that Double Diamond, Inc. was both the developer and the utility at White Bluff through 1996 be considered in this analysis?

The fact that Double Diamond, Inc. was both the developer and the utility at White Bluff through 1996 is not relevant to this analysis. As discussed above, "Section 13.183(a)(1) of the Water Code requires only that a utility's invested capital be 'used and useful in rendering service to the public' for the utility to earn a reasonable rate of return on the invested capital."[42]

Double Diamond's Exhibits DDU-5B and DDU-5F list the assets that are used and useful in rendering service to its customers, the original price of those assets and their depreciable lives.[43] Double Diamond's Exhibit DDU-6C lists the assets from Exhibits DDU-5B and DDU-5F and deducts the value of the developer contributed assets that were written off and the amount of accumulated depreciation.[44]

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42 *Lakeshore* at 821.
43 Exhibits DDU-5B and DDU-5F, admitted into the record on October 24, 2017.
44 Exhibit DDU-6C, admitted into the record on October 24, 2017.

In addition, Double Diamond's evidence supported its proposed rate base by reconciling the original cost of the assets comprising the rate base requested in the application to the original costs of the assets shown on the company's financial statements and tax returns as shown on **Attachment 1**.

Double Diamond's asset values and accumulated depreciation for ratemaking purposes, financial reporting purposes, and income tax purposes as of December 31, 2015 (the end of the test year) are shown in:

- **The Rate Application** (Exhibit DDU-2, p. 79 of 151 for Water Plant-In-Service and Exhibit DDU-2, p. 127 of 151 for Sewer Plant-In Service; Exhibit DDU-2, p. 85 of 151 for Water Developer Contributions-In-Aid of Construction and Exhibit DDU-2 p. 133 for Sewer Developer Contributions-In-Aid of Construction; plant-in-service and developer contribution detail shown on Exhibit DDU-6C)
- **Audited Financial Statements** (Exhibit WBRG-8 CONFIDENTIAL at Bates No. DDU003584; detail shown on Exhibit DDU-12, White Bluff Water (Dept. 9090) and White Bluff Sewer (Dept. 9091) segregated)
- **Federal Income Tax Return** (Exhibit WBRG-8 CONFIDENTIAL at Bates No. DDU16-015470 – DDU16-015475; White Bluff portion of assets detailed in CONFIDENTIAL Attachment 3 to DDU's Initial Brief)

The calculations shown on **Attachment 1** are the result of reconciling these three records using the following process. To reconcile these three documents, you must begin with the known values from each:

- **The Rate Application:** All of the components are known:
  - Original Cost, Accumulated Depreciation and Net Asset Value for Investor-Supplied Assets also known as Net Plant-In-Service
  - Original Cost, Accumulated Depreciation and Net Asset Value for Developer-Supplied Assets
  - Original Cost, Accumulated Depreciation and Net Asset Value for all Assets also known as Gross Plant-In-Service
- **Audited Financial Statements:** The asset listing identifies the system associated with each asset allowing the Original Cost, Accumulated Depreciation and Net Asset Value of

White Bluff assets to be accurately identified. These assets are specifically Double Diamond assets, and the listing contains contra accounts to remove assets written off for the development from Double Diamond's White Bluff asset value.

- **Federal Income Tax Return - Depreciation schedule:** The system in which each asset is located is identified for many assets, and the Original Cost and Accumulated Depreciation for each of these can be directly assigned to the White Bluff systems. The remainder of the assets (those without a system identifier) can reasonably be allocated to the White Bluff systems based on the total of White Bluff's directly assigned assets as a percentage of total directly-assigned assets applied to the assets without identifier. The result is an estimate of the Original Cost and Accumulated Depreciation on the Tax Return Asset Depreciation Schedule related specifically to the White Bluff systems.

The next step is to reconcile the Rate Application amounts to the Financial Audit numbers and the Tax Schedule numbers. The primary differences among the three documents is that depreciable lives are different and some of the fully-depreciated assets on the Financial Audit schedule and the Tax Schedule have been fully written off and removed from those schedules. To compare these documents, the full asset listing from the Rate Application must be adjusted to reflect the depreciable lives of the other two documents:

- Virtually all the White Bluff assets on the Financial Schedule have a 10-year life versus the 50-year life used for most assets in the Rate Application. The Original Cost of all the Rate Application assets is assumed to be the starting point of the Financial Audit schedule, so the 10-year lives are applied to the original cost of the assets to determine the accumulated depreciation on parity footing for the two documents.
- The White Bluff assets on the Tax Return depreciation schedule have a maximum life of 25 years versus the 50-year life used for most assets in the Rate Application. The Original Cost of all the Rate Application assets is assumed to be the starting point of the Tax Return schedule, so the average depreciable life is applied to the original cost of the assets to determine the estimated accumulated depreciation on parity footing for the two documents.
- Assets or portions of assets that the developer has chosen to expense are referred to as "Developer Contributions." Those assets are assumed to have the same original cost for

all three documents based on the Rate Application. Different depreciation rates are applied to this Original Cost to determine Net Asset Values for Developer Contributions.

- Once all these data points have been filled-in, the remaining differences can be explained by the writing-off of fully-depreciated assets on the Financial Audit schedules and the Tax Return Schedules.[45]

Applying the criteria set forth in *Lakeshore*,[46] Double Diamond met its burden of proof in establishing the value of the facilities as invested supplied capital pursuant to the TWC. Double Diamond has shown the original cost of the facilities, the date of installation and the amount of depreciation, both annually and accumulated, the amount of any assets that have been expensed by the developer (as required by *Sunbelt*), and the amount of any assets paid for through customer surcharges and fees (through the removal of tap fees from rate base).

b. How should the Commission consider the fact that Double Diamond, Inc. contractually obligated itself through deeds to provide and complete the central water system and central sewer system at White Bluff, while the utility company was listed as the party responsible for maintaining the systems?

DDI did not obligate itself through a deed. The document offered into evidence by the Intervenors is not a deed. It is not even an executed contract. The Commission should not consider the document as evidence supporting a claim that the customers have paid for utility assets. The document is merely a proposed contract for sale. At best, it is parole evidence of a future agreement, and as a matter of substantive law is meaningless on its own. Under the merger doctrine, the deed itself is the only relevant instrument in the purchase of property. "After delivery and acceptance, deeds are regarded as the final expression of the agreement of the parties and the sole repository of the terms on which they have agreed."[47] There is no evidence showing the obligations or commitments of DDI regarding the purchase of property in White Bluff by others.

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45 Tr. at 170: 7-16 (Grout Cross)(October 24, 2017)(CONFIDENTIAL)

46 *Lakeshore*, at 821.

47 *Smith v. Harrison Cty.*, 824 S.W.2d 788, 793 (Tex. App.—Texarkana 1992, no writ), citing *Sunderman v. Roberts*, 213 S.W.2d 705 (Tex. Civ. App.-San Antonio 1948, no writ).

But even if the purchase contract obligations had not merged into a subsequent deed and the contract was executed, the language of the contract does not commit DDI to "provide and complete the central water system and central sewer system at White Bluff" at ***no cost*** to the other party to the contract. Nothing within the "four corners" of the document states or implies this interpretation.

CONCLUSION

Double Diamond is a small water and sewer utility. The White Bluff and The Cliffs water systems have a combined 927 customers, and the combined sewer systems have 726 customers. With a customer base that is less than 3% of the largest water and sewer utility in the State, less than 1% of the smallest regulated electric entity, and less than 0.02% of the largest regulated electric entity, the Commission's obligation to protect the financial integrity of water and sewer utilities like Double Diamond is increased exponentially. In order to protect Double Diamond's financial integrity, the Commission must ensure that Double Diamond can maintain its credit and attract capital.

Double Diamond has provided significant investor supplied capital for its utility systems, which also promoted economic development in the State. Double Diamond already chose to deduct from rate base 80% of the value of many utility system assets to save money for its customers. Double Diamond's rate base should be determined using the factors outlined above, and Double Diamond is entitled to earn a reasonable return on the remaining asset value as requested in its application with the changes it agreed to on the record.

If the Commission excludes Double Diamond's investor supplied capital from its rate base, it will jeopardize Double Diamond's financial integrity. Without the ability to maintain its credit and attract capital for investment in its systems, Double Diamond will not be able to continue to serve its customers, nor will any other entity be interested in acquiring a system for which there is no ability to earn even a modest return on investment. Without the ability to earn a return on its investments, a utility like Double Diamond would struggle to make any investment in its utility systems. If the current case is illustrative of the policy of the Commission and the State, then the financial integrity of all the water and sewer utilities is at severe risk. With little to no rate base upon which to earn return, these utilities will not have access to capital because no one will want

to invest in them, and they will slowly die, leaving their customers without access to reliable, good quality water and sewer services.

PRAYER

WHEREFORE, PREMISES CONSIDERED, Double Diamond Utility Company, Inc., respectfully requests that the Commission issue a final order recognizing Double Diamond's rate base as requested in its application with the changes it agreed to on the record and reversing the relevant recommendations of the Administrative Law Judge.

Respectfully submitted,

By: _____

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ATTORNEY FOR DOUBLE DIAMOND UTILITY COMPANY, INC.

Attachment 1

RECONCILIATION OF WHITE BLUFF INVESTOR-SUPPLIED CAPITAL AND DEVELOPER-SUPPLIED CAPITAL

Line No.		Section 1				Section 2				Section 3			
		White Bluff Rate Application				Audited Financial Statements - White Bluff portion only				Federal Income Tax Return - White Bluff portion only			
			Depreciable Assets				Depreciable Assets				Depreciable Assets		
		Land	Original Cost	Accumulated Depreciation	Net Asset Value	Land	Original Cost	Accumulated Depreciation	Net Asset Value	Land	Original Cost	Accumulated Depreciation	Net Asset Value
		(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(m)
1	Test Year 2015 Ending Balance at 12/31/15 DDU	$ 27,627	$4,319,598	$ (1,840,426)	$ 2,479,172	$ 27,627	$3,777,915	$ (3,270,900)	$ 507,015		$2,251,521	$ (1,849,055)	$ 402,466
	Add Back:												
2	Developer Contributions	49,268	2,242,799	(968,383)	1,274,416	49,268	2,242,799	(2,242,799)	-		2,242,799	(1,841,892)	400,907
3	Calculation of Fully-depreciated Assets Removed from Books						541,683	(625,420)	(83,737)		2,068,077	(1,698,402)	369,675
4	Developer Assets using Depreciation Rates from Rate Application	$ 76,895	$6,562,397	$ (2,808,809)	$ 3,753,588	$ 76,895	$6,562,397	$ (6,139,119)	$ 423,278		$6,562,397	$ (5,389,349)	$ 1,173,048

Reconciled Original Cost

References:

	Line No.	Column(s)	
Section 1	1	(a) - (d)	Requested Net Plant-In-Service for White Bluff (Exh. DDU-2, p. 79 of 151 for Water Plant-In-Service and Exh. DDU-2, p. 127 of 151 for Sewer Plant-In Service)
Section 1	2	(a) - (d)	Developer Contribution excluded from White Bluff Net Plant-In-Service (Exh. DDU-2, p. 85 of 151 for Water Developer Contributions-In-Aid of Construction and Exh. DDU-2 p. 133 for Sewer Developer Contributions-In-Aid of Construction)
Section 1	4	(a) - (d)	Gross Plant-In-Service (from Total WB Asset Listings) from Rate Application (Plant-in-service and developer contribution detail shown on Exh. DDU-6C)
Section 2	1	(f)	Original Cost of DDU Assets for White Bluff (Dept. 9090 and 9091 only from Exh DDU-12) included in Financial Statements (Exh. WBRG-8 CONFIDENTIAL at Bates # DDU003584)
Section 2	1	(g)	Accumulated Depreciation of DDU Assets for White Bluff (Dept. 9090 and 9091 only from Exh. DDU-12) included in Financial Statements
Section 2	1	(h)	Sum of 1(f) + 1(g)
Section 2	2	(f) - (h)	Financial Audit depreciation rates applied to White Bluff Original Cost developer contributions from Rate Application results in zero Net Asset Value
Section 2	4	(f)	Gross Plant-In-Service (from Total WB Asset Listings) from Rate Application(Plant-in-service and developer contribution detail shown on Exh. DDU-6C)
Section 2	4	(g)	Accumulated Depreciation calculated by applying Financial Statement depreciation rates (5-10 year lives) to Original Cost of Assets from Rate Application (Exh. DDU-6C)
Section 2	4	(h)	Sum of 4(f) + 4(g)
Section 3	1	(j)	Original Cost of DDU Assets for White Bluff on Federal Income Tax Depreciation Schedule from Exh WBRG-8 CONFIDENTIAL at Bates # DDU16-015470 - DDU16-015475 (Allocation to WB is detailed on CONFIDENTIAL Attachment 3 to DDU's Initial Brief)
Section 3	1	(k)	Accumulated Depreciation of DDU Assets for White Bluff on Federal Income Tax Depreciation Schedule from Exh WBRG-8 CONFIDENTIAL (Allocation to WB is detailed on CONFIDENTIAL Attachment 3 to DDU's Initial Brief)
Section 3	2	(j),(k),(m)	Estimated Tax Schedule Depreciation rates applied to White Bluff Original Cost developer contributions from Rate Application
Section 3	4	(j)	Gross Plant-In-Service (from Total WB Asset Listings) from Rate Application(Plant-in-service and developer contribution detail shown on Exh. DDU-6C)
Section 3	4	(k)	Accumulated Depreciation estimated by applying estimated Federal Income Tax Return depreciation rates (5-25 year lives) to Original Cost of Assets from Rate Application (Exh. DDU-6C)
Section 3	4	(m)	Sum of 4(j) + 4(k)