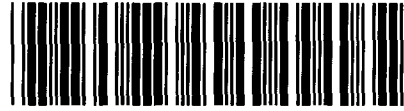


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PUC DOCKET NO. 46245
SOAH DOCKET NO. 473-17-0119.WS

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

ORDER

This Order addresses Double Diamond Utilities Company, Inc.'s application to increase rates for water and sewer service provided to two resort developments owned by its affiliates, The Cliffs in Palo Pinto County, and White Bluff in Hill County. Double Diamond Utilities filed two rate-filing packages, one for its White Bluff system and one for its system at The Cliffs; each package includes a rate increase for water and sewer tariffs. Double Diamond Utilities requested revenue requirements of \$568,368 for the White Bluff water system, \$572,068 for the White Bluff sewer system, \$421,488 for The Cliffs water system, and \$313,686 for The Cliffs sewer system, each based on a 2015 calendar year test year.

The State Office of Administrative Hearings (SOAH) administrative law judge (ALJ), after conducting a hearing, issued a proposal for decision recommending a revenue requirement of \$375,150 for the White Bluff water system, \$349,074 for the White Bluff sewer system, \$383,758 for The Cliffs water system, and \$319,791 for The Cliffs sewer system, based on adjustments to expenses, rate base, depreciation, and return on invested capital.

The Commission agrees with the majority of the ALJ's determinations in the proposal for decision. However, the Commission disagrees with and rejects the ALJ's conclusions regarding Double Diamond Utilities' employee labor expense, other plant maintenance expense, professional services expense, miscellaneous expense, and return on equity. The Commission's decisions result in a revenue requirement of \$384,197 for the White Bluff water system, \$270,916 for the White Bluff sewer system, \$358,088 for The Cliffs water system, and \$296,018 for The Cliffs sewer system.

Except as discussed in this Order, the Commission adopts the proposal for decision, including findings of fact and conclusions of law.

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I. Discussion

A. Allocation of Employee Salaries

Double Diamond Utilities requested a total of \$171,960 in employee labor expenses for its White Bluff water and sewer systems. This amount reflects the test-year salaries for seven employees. The salaries of two employees were challenged by Commission Staff and are discussed in subsection B. For the remaining employee salaries, Commission Staff challenged the allocation of employee salaries between the White Bluff water and sewer systems.

With one exception, the salaries of the employees are allocated evenly between water and sewer systems, which resulted in expense amounts of \$80,520 for water and \$91,440 for sewer. Double Diamond Utilities stated it allocated the employee salaries in this manner because all employees are cross-trained in both water and sewer operations and work seamlessly between the water and sewer systems.¹

The ALJ concluded that Double Diamond Utilities met its burden to show that the allocation of salaries is reasonable because employees are trained on both systems and work on both systems.²

The Commission disagrees with the ALJ's conclusion that Double Diamond Utilities met its burden to show that its allocation of employee salaries is reasonable. Double Diamond Utilities did not provide any evidence on the amount of time each employee spends working on each system or even which system the employee worked on. The fact that all employees are cross-trained to work on both utilities does not mean that each employee worked on both utilities, or if they did, that their time was split evenly between the two systems. Given the absence of actual time records for the employees, the better approach in this proceeding is to allocate the employee salaries based on the type of license held by each employee. However, this approach is not the Commission's preferred approach when tasked with determining the appropriate allocation of employee salaries between systems. Rather, the Commission would prefer to allocate salaries based on accurate timekeeping records that demonstrate the amount of time an employee actually worked on a particular system.

¹ Double Diamond Utilities Ex. 8, Rebuttal Testimony of Randy Gracy at 4:14 – 5:1 (Oct. 16, 2017).

² PFD at 9.

To reflect its decision on this issue, the Commission deletes findings of fact 22 and 25 and adds new findings of fact 26A through 26C.

B. Salaries of Mr. Whitworth and Mr. Keeton

Double Diamond Utilities' requested employee labor expenses for its White Bluff systems included \$20,800 for the salary of Jerry Whitworth and \$22,880 for the salary of Danny Keeton. According to Double Diamond Utilities, Mr. Whitworth and Mr. Keeton are backhoe operators that are involved in all tap installations, excavation for installing taps, clean-up of the work site after the installations, and also perform other duties as needed within the utility department.³

Commission Staff argued that the salaries of employees Mr. Whitworth and Mr. Keeton. Commission Staff should be excluded because the work orders provided by Double Diamond Utilities show that Mr. Whitworth and Mr. Keeton spend only 1% of their time installing taps, leaving 99% of their time unaccounted for as *other duties*. Because Double Diamond Utilities did not provided any supporting documentation detailing what these other duties include, Commission Staff recommended removing these salaries from employee labor because the other duties job description is too vague to determine whether the salaries are reasonable and necessary expenses.

The ALJ concluded that Double Diamond Utilities met its burden to show that Mr. Whitworth's and Mr. Keeton's salaries are reasonable and necessary expenses because they worked on and answered service calls related to both systems.⁴ However, the ALJ also concluded that evidence provided gives no explanation of what that work was, how long it took, or what any of the service calls involved.⁵

The Commission disagrees with the ALJ's determination regarding the salaries of Mr. Whitworth and Mr. Keeton. Double Diamond Utilities has the burden to show that the salaries for the positions held by Mr. Whitworth and Mr. Keeton are a reasonable and necessary expense. The record reflects that Mr. Whitworth and Mr. Keeton only spent a small time installing taps and spent their other remaining time performing other duties as needed. Double Diamond Utilities did not provided any documentation explaining or detailing what these other duties include. In addition,

³ Rebuttal Testimony of Randy Gracy 4:17-19 (Oct. 16, 2017); *see also* Commission Staff Ex. 2A, Workpapers of Emily Sears, at ES Workpaper 4 (Sept. 22, 2017).

⁴ PFD at 8-9.

⁵ *Id.*

Double Diamond Utilities presented no evidence on whether any of these other duties required skill operating a backhoe, why Double Diamond Utilities needs more than one full-time backhoe operator, the market-salary rate for a backhoe and equipment operator, or the experience and skill level of these employees.

Further, the Commission notes that even the ALJ describes the evidence in the record supporting how Mr. Whitworth and Mr. Keeton spend 99% of their time as “scant and non-specific.”⁶ Thus, removing the salaries of Mr. Whitworth and Mr. Keeton from Double Diamond Utilities’ cost of service is warranted because Double Diamond Utilities has not shown that the salaries related to the positions held by these employees are reasonable and necessary to provide service to ratepayers.

To reflect its decision on this issue, the Commission deletes finding of fact 23, modifies findings of fact 24 and 26, and adds new findings of fact 26D through 26F.

C. Other Plant Maintenance Expenses

Double Diamond Utilities requested a total of \$142,010 in expenses for other plant maintenance at its White Bluff systems. This total included a request of \$79,590.73 for grinder-pump expenses for the White Bluff sewer system.

Double Diamond Utilities asserted that it treats costs related to grinder pumps as recurring annual expenses because these costs recur from year-to-year and are a constant maintenance issue in the operation of the White Bluff sewer system. In support of its position, Double Diamond Utilities provided the testimony of Dr. Victoria Harkins. She testified that each year twenty to thirty grinder pumps are replaced and approximately half of its grinder pumps are repaired, and concluded that the costs should be treated as recurring annual expenses.⁷ In response to Double Diamond Utilities, Commission Staff argued that Double Diamond Utilities should reclassify all of its grinder-pump expenses as capitalized assets because grinder pumps have a service life of more than one year.

⁶ PFD at 8.

⁷ Tr. 484:12-488:25 (Harkins Direct) (Oct. 26, 2017).

The ALJ determined that Double Diamond Utilities' treatment of grinder pump costs as recurring annual expenses is appropriate because these costs are incurred on an annual basis by Double Diamond Utilities to repair and replace the pumps in the White Bluff sewer system.⁸

The Commission disagrees with the ALJ's determination. Instead, the Commission concludes that for White Bluff sewer, Double Diamond Utilities should expense all test-year costs incurred to repair grinder pumps and capitalize all test-year costs to purchase replacement grinder pumps. This approach ensures that the cost of all grinder pumps used to make normal and routine repairs to the utility system are expensed, while the actual replacement of grinder pumps are capitalized in accordance with accounting standards regarding the installation of plant in service.

To reflect its decision on this issue, the Commission deletes findings of fact 39 and 41, modifies finding of fact 37, and adds new finding of fact 38A.

D. Professional Services

Double Diamond Utilities requested professional-services expenses of \$2,907 for obtaining its CCN amendment to provide sewer service at The Cliffs. Although the ALJ noted that a CCN amendment is not a recurring expense, the ALJ concluded that the cost associated with the CCN amendment is reasonable and necessary to provide sewer service to customers at The Cliffs, and recommended that these expenses be recovered through a rate rider.

The Commission disagrees with the ALJ's conclusion to allow recovery of the cost of the CCN amendment for The Cliffs system. The Commission finds that costs associated with CCN amendments are not recurring expenses and should not be included in the utility's revenue requirement such that this amount is recovered from ratepayers on a recurring basis.

To reflect its decision on this issue, the Commission deletes findings of fact 45 and 46 and adds new finding of fact 46A.

E. Miscellaneous Expenses

Double Diamond Utilities requested total miscellaneous expenses of \$55,685 for its White Bluff systems and \$41,113 for its systems at The Cliffs. These requested amounts include expenses incurred by Double Diamond Utilities for resort overhead expenses billed from the White Bluff and The Cliffs resorts to the water and sewer systems at White Bluff and The Cliffs. Double

⁸ PFD at 16-17.

Diamond Utilities explained that because the utility offices are located within the resorts' administrative buildings, the utility uses some of the resorts' resources, and is then billed by the resorts for the resources used.⁹ The utility systems are billed a total of 3% of all overhead and general and administrative expenses incurred by each resort. The expenses billed by the resorts to the utility systems include expenses related to the general manager and office manager at the resorts, employee compensation (including commissions and bonuses), payroll expenses, electricity, water and sewer, office space, phones, computers, copiers, uniforms, and small tools.

The ALJ concluded that the resort overhead expenses billed to Double Diamond Utilities' water and sewer systems at White Bluff and The Cliffs are reasonable and necessary to furnish service to Double Diamond Utilities' customers.¹⁰ The ALJ reasoned that although there are costs that appear in both Double Diamond Utilities' cost of service and the resort budget, a 3% portion of the resorts' total overhead expenses is reasonable because Double Diamond Utilities is saving money on office space, supplies, and employees through the assignment of these overhead costs.

The Commission disagrees with the ALJ's recommendation and instead adopts Commission Staff's recommended disallowances of \$8,380 for water and \$6,068 for sewer from White Bluff's requested miscellaneous expenses, and \$20,075 for water and \$18,270 for sewer from The Cliffs requested miscellaneous expenses.¹¹ The Commission finds that the evidence in the record shows that the amount of resort overhead expenses billed to White Bluff systems and The Cliffs systems includes the cost of items unrelated to the provision of utility service. The amounts billed to Double Diamond Utilities are not based on the Double Diamond Utilities' share of resort expenses that it directly uses; instead, it is an across-the-board charge of 3% of all overhead and general and administrative expenses incurred by the resort. Thus, a reduction in Double Diamond Utilities' requested expense is warranted.

The Commission further concludes that expenses paid by Double Diamond Utilities to the resorts are an affiliate transaction under Texas Water Code (TWC) § 13.185(e).¹² The entities that own and operate the resorts are wholly-owned subsidiaries of Double Diamond-Delaware, Inc.,

⁹ Tr. at 329:25–330:6 (Sears Cross) (Oct. 25, 2017); Rebuttal Testimony of Randy Gracy at 8:12–9:2 (Oct. 16, 2017); Tr. at 474:4–475:6 (Gracy Cross Rebuttal) (Oct. 26, 2017).

¹⁰ PFD at 25.

¹¹ Commission Staff Ex. 2, Direct Testimony of Emily Sears at 9:11–10:2 (Sept. 22, 2017).

¹² TWC § 13.185(e)

and qualify as an affiliate under TWC § 13.002(2). Thus, expenses paid from Double Diamond Utilities to the resorts are an affiliate payment under TWC § 13.185(e). TWC § 13.185(e) requires that the Commission find that the price to the utility is no higher than prices charged by the affiliate to others for the same item or class of items to others. No evidence was admitted showing what other entities or persons would pay the resorts for the same class of comparable amenities. Further, there is no evidence to establish the market price for the same class of items provided to the systems. Without these findings, the Commission may not allow Double Diamond Utilities to recover these expenses.

To reflect its decision on this issue, the Commission modifies finding of fact 60, deletes findings of fact 61 through 65, finding of fact 67, conclusion of law 6, and adds new findings of fact 66A through 66D and new conclusions of law 6A through 6E.

F. Federal Income Tax Expense

After the issuance of the proposal for decision, Commission Staff recommended that the rates ultimately adopted by the Commission for Double Diamond Utilities reflect a lower tax expense resulting from the change in the federal income tax rate as a result of the Tax Cuts and Jobs Act of 2017.¹³ The Commission's accounting order in Project No. 47945 directed Commission Staff to review each investor-owned utility in Texas, on a case-by-case basis, to determine the appropriate mechanism to adjust its rates to reflect the changes to the federal tax rate.¹⁴ Double Diamond Utilities agreed with Commission Staff's recommendations regarding the effects of the change in the federal income tax rate.¹⁵ In its correction letter filed on May 2, 2018, the ALJ stated that the Commission should adopt Commission Staff's recommendations.¹⁶

The White Bluff and The Cliffs water and sewer systems are owned and operated by Double Diamond Utilities.¹⁷ Double Diamond Utilities is a subchapter S corporation,¹⁸ which is a pass-through entity for purposes of federal income taxes.¹⁹ Double Diamond-Delaware, Inc.,

¹³ Commission Staff's Exceptions to the Proposal for Decision at 10–11 (Mar. 28, 2018).

¹⁴ *Proceeding to Investigate and Address the Effects of Tax Cuts and Jobs Act of 2017 on the Rates of Texas Investor-Owned Utility Companies*, Project No. 47945, Amended Order Related to Changes in Federal Income Tax Rates at 1 (Feb. 15, 2018).

¹⁵ Double Diamond Utilities' Responses to Exceptions to the Proposal for Decision at 12 (Apr. 12, 2018).

¹⁶ Letter from Administrative Law Judge Casey Bell, State Office of Administrative Hearings to Stephen Journey, Commission Counsel, Public Utility Commission of Texas (May 2, 2018) (filed in the docket).

¹⁷ Direct Testimony of Randy Gracy at 6:15–21 (Aug. 4, 2017).

¹⁸ See 26 U.S.C. § 1361.

¹⁹ Direct Testimony of Debi Loockerman at 3:15–4:2 (Sept. 22, 2017).

also a subchapter S corporation, is the parent company and sole shareholder of Double Diamond Utilities.²⁰ R. Mike Ward is the majority shareholder of Double Diamond-Delaware, owner of 94.8% of the shares, with an employee stock ownership plan owning 5.2%.²¹ Because Double Diamond-Delaware is also a pass-through entity, it is likely that the majority of tax expenses of Double Diamond Utilities are paid at the individual level by Mr. Ward, the majority shareholder of Double Diamond-Delaware. However, the record does not reflect what amount of Double Diamond Utilities' tax expense is paid by Mike Ward or the applicable tax rate.

In *Suburban Utility Corporation v. Public Utility Commission of Texas*,²² the Texas Supreme Court held that Suburban Utility, a subchapter S corporation, "is entitled to a reasonable cost of service allowance for federal income taxes actually paid by its shareholders on [the utility's] taxable income or for taxes it would be required to pay as a conventional corporation, whichever is less."²³ In setting rates, the Commission has considerable discretion to determine the appropriate method and amount of income-tax expense because "[t]he income tax calculation is no different than other elements of utility ratemaking."²⁴

The Commission notes that recent changes to federal income tax law have reduced the income tax rate for corporations from 35% to 21%.²⁵ Therefore, the Commission concludes that it is reasonable to calculate Double Diamond Utilities' tax expense as if it were a C corporation with a federal income tax rate of 21% for ratemaking purposes. This treatment will provide Double Diamond Utilities a reasonable amount for federal income tax expense.

To reflect its decision on this issue, the Commission adds new findings of fact 79A through 79H and corresponding ordering paragraphs.

G. Invested Capital

The Commission must set a rate that will permit a utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over

²⁰ *Id.* at Attachment 8, Double Diamond Utilities' Response to Response to Staff RFI 1-34.

²¹ Direct Testimony of Nelisa Heddin at 11:3-6 (Sept. 8, 2017).

²² *Suburban Util. Corp. v. Pub. Util. Comm'n*, 652 S.W.2d 358 (Tex. 1983).

²³ 652 S.W.2d at 364.

²⁴ *Pub. Util. Comm'n v. GTE Sw. Inc.*, 901 S.W.2d 401, 409-411 (Tex. 1995).

²⁵ Pub. L. No. 115-97, 131 Stat. 2054 (Dec. 22, 2017). An Act to provide for reconciliation pursuant to titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018.

and above its reasonable and necessary operating expenses.²⁶ Double Diamond Utilities' invested capital (rate base) has never been established or approved by TCEQ or the Commission because prior cases were settled and no such determinations were made. Thus, the Commission must determine the invested capital of Double Diamond Utilities in accordance with TWC § 13.185 and Commission rules. Under Commission rules, all contributions in aid of construction, developer contributions, and other sources of cost-free capital must be deducted from rate base.²⁷

Double Diamond-Delaware began construction of the White Bluff resort in 1990 and began construction of the utility systems at White Bluff in 1990 or 1991.²⁸ Double Diamond Utilities, the applicant in this proceeding, did not exist until December 1996. Until December 1996, Double Diamond, Inc., a wholly-owned subsidiary of Double Diamond-Delaware, was both the developer and the utility company at White Bluff, and contracted for the construction of the original infrastructure of the utility systems.

After Double Diamond Utilities was created in December 1996, also as a wholly-owned subsidiary of Double Diamond-Delaware, Double Diamond Utilities claims that the original utility infrastructure and other assets existing at that time were "transferred in some form or fashion from Double Diamond, Inc. to [Double Diamond Utilities]."²⁹ However, there is no evidence in the record to corroborate this assertion. The record also reflects that the majority of assets installed after the creation of Double Diamond Utilities in December 1996 were paid for by Double Diamond Properties Construction Co., another wholly-owned subsidiary of Double Diamond-Delaware.³⁰

Despite the fact that Double Diamond Utilities did not exist until 1996, Double Diamond Utilities initially filed an application stating that all of its investment in the White Bluff water and sewer systems is used and useful, and therefore the appropriate amount of developer contributions is zero.³¹ However, Double Diamond Utilities later agreed to reclassify 80% of the costs of its assets as paid by the developer and 20% as paid by the utility in accordance with company

²⁶ TWC § 13.183(a)(1).

²⁷ 16 TAC § 24.31(c)(2)(B)(v); 16 TAC § 24.31 (c)(3).

²⁸ Direct Testimony of Randy Gracy at 7:13, 23; 10:17 (Aug. 4, 2017).

²⁹ Tr. at 57:10–12 (Gracy Cross) (Oct. 24, 2017).

³⁰ Direct Testimony of Nelisa Heddin at 18:11–19:10 (Sept. 8, 2017).

³¹ See Application at 12:13-15; see also Double Diamond Utilities Initial Brief at 21 (Nov. 22, 2017);

practice.³² Double Diamond witness Gracy testified that Double Diamond has been allocating costs in this manner since 1990 or 1991.³³ Mr. Gracy stated that Double Diamond has applied the 80% developer and 20% utility split to all capital investments in the systems, including those in the initial infrastructure until 2008, when the infrastructure for the systems was finally completed. At that point, it was decided that all future capital investments would be 100% funded by the utility.³⁴ However, he admitted that he could not find any documentation reflecting any of these assertions.³⁵

The ALJ determined that Double Diamond Utilities did not meet its burden to show that its proposed split was appropriate or supported by the record evidence. The ALJ further concluded that Double Diamond Utilities failed to show what amount of the original cost of utility assets included in its proposed rate base for White Bluff were contributed by the utility.³⁶ Accordingly, the ALJ recommended that the majority of White Bluff's assets should be treated as developer contributions and removed from rate base. However, the ALJ also found that the evidence showed that seven utility assets claimed as part of Double Diamond Utilities' rate base were paid for by Double Diamond Utilities, and the net book value of these assets should remain in Double Diamond Utilities' rate base as invested capital.³⁷ The amount of the assets that should remain in rate base are \$68,355.48 for White Bluff water and \$24,029.64 for White Bluff sewer. The Commission agrees with the ALJ's conclusions regarding the invested capital of Double Diamond Utilities that should be classified as developer contributions.

To reflect its decision on this issue, the Commission deletes finding of fact 98 and modifies finding of fact 100 and conclusion of law 8.

H. Sunbelt Utilities v. Public Utility Commission

In addition to arguing against Double Diamond Utilities' proposed split, the White Bluff Ratepayers Group also argued that the holding in *Sunbelt Utilities v. Public Utility Commission*³⁸ is applicable and controlling in this proceeding. In that case, Sunbelt, a newly formed water and

³² Direct Testimony of Randy Gracy at 8:3–10 (Aug. 4, 2017); Double Diamond's Initial Brief at 21 (Nov. 22, 2017).

³³ Tr. at 67:10–20 (Gracy Cross) (Oct. 24, 2017).

³⁴ *Id.*; see also Direct Testimony of Nelisa Heddin at 38:6–39:12 (Sept. 8, 2017).

³⁵ *Id.*

³⁶ PFD at 49–50.

³⁷ PFD at 50.

³⁸ *Sunbelt Utilities v. Public Utility Commission*, 589 S.W.2d 392 (Tex. 1979).

sewer utility, filed an application to change its water and sewer rates in Harris County.³⁹ A development company affiliated with the utility installed the initial utility system and transferred the assets to the utility without charge. The developer then wrote off the entire cost of the utility system in one year.⁴⁰ The Commission's examiner determined that because the development company recovered the cost of the utility assets through lot sales, the purchasers of the lots should not pay for the utility assets a second time through utility rates.⁴¹ Thus, the utility assets paid for by the development company and recovered through lot sales should be excluded from rate base.⁴² The Commission agreed with the examiner.

In 1979, the Sunbelt Utilities case came before the Supreme Court of Texas.⁴³ The court stated that the principal question in that case was "whether the Commission properly excluded the developer's cost of the utility system from the rate base because the rate payers had already paid for this system as part of the purchase price of their lots."⁴⁴ In answering this question, the court evaluated the issue of customer contributions of assets by courts and regulatory bodies in other states.⁴⁵ Specifically, the court discussed "the rule which is well established in other jurisdictions that contributions by a customer in aid of construction are properly excluded from the rate base. Under this rule the utility is not allowed to earn a rate of return on property acquired from or paid for by the rate payer."⁴⁶ The court ultimately held that "this rule is correct and here hold that consumer contributions in aid of construction should be excluded from a utility's rate base."⁴⁷ Therefore, that "the costs were properly excluded [by the Commission's examiner] as contributions in aid of construction."⁴⁸

In this proceeding, the ALJ disagreed with the White Bluff Ratepayers Group's reading of *Sunbelt* and its holding. The ALJ concluded that the primary basis for the Commission's determination that the cost of the Sunbelt utility system should be removed from rate base was that

³⁹ *Id.* at 393.

⁴⁰ *Id.* at 393-394.

⁴¹ See Examiner's Report, *Petition of Sunbelt Utilities for Authority to Change Rates*, Docket No. 804, 3 P.U.C. Bull. 1167 (Mar. 22, 1978).

⁴² *Id.*

⁴³ *Sunbelt Utilities v. Public Utility Commission*, 589 S.W.2d 392 (Tex. 1979).

⁴⁴ *Id.* at 392.

⁴⁵ *Id.* at 393.

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.* at 392.

the cost had been expensed by the Sunbelt developer against the amount it realized from the sale of the lots served by the utility system.⁴⁹ Therefore, according to the ALJ, the separate finding by the Commission in *Sunbelt* that the lot purchasers had paid the developer's cost of the utility system as part of the purchase price of the lots was not dispositive.⁵⁰

The Commission agrees with the ALJ that the holding in *Sunbelt* is not controlling under the facts in this proceeding. However, the Commission reaches this decision for a different reason. In *Sunbelt*, the Supreme Court of Texas determined that the funds used to pay for the utility system originated with the customer and ultimately concluded that "consumer contributions in aid of construction should be excluded from a utility's rate base."⁵¹ Unlike *Sunbelt*, the Commission in this proceeding has determined that the funds used to pay for the utility systems at White Bluff originated with the developer at White Bluff not from White Bluff customers. Thus, the Commission concludes that *Sunbelt* is not applicable to this proceeding because the majority of the investment at White Bluff was contributed by the developer, not by customer contributions as was the case in *Sunbelt*.

I. Briefing Issues

After the Commission considered the proposal for decision, the Commission asked for briefing related to customer contributions in aid of construction and developer contributions to better inform its decision regarding the initial investment in the White Bluff systems.⁵² Customer contributions in aid of construction and developer contribution are not defined in the Texas Water Code or Commission rules; nor are there any court decisions regarding the interpretation or application of these terms. In addition, there was no discussion by the parties in this proceeding regarding the meaning or application of these terms or whether the initial investments in this case were properly classified as developer contributions. Thus, the Commission deemed it appropriate to ask for briefing to assist its determination on the appropriate interpretation and application of these terms in this proceeding.

There is no difference in the treatment of customer and developer contributions when determining a utility's invested capital. Under Commission rules, all contributions in aid of

⁴⁹ PFD at 47.

⁵⁰ PFD at 47–48.

⁵¹ *Id.*

⁵² Briefing Order (May 30, 2018).

construction, developer contributions, and other sources of cost-free capital, must be deducted from rate base.⁵³ There is, however, a difference in the treatment of depreciation expense between customer-contributed property and developer-contributed property.⁵⁴ The depreciation expense claimed by a utility may not include depreciation on property provided by explicit customer agreements or funded by customer contributions in aid of construction.⁵⁵ However, a utility's claimed depreciation expense may include property contributed by a developer or governmental entity, so long as it is currently used and useful.⁵⁶

After considering the parties' briefs and *Sunbelt*, the Commission concludes that it is appropriate to adopt a straightforward and common-sense interpretation of these terms based on the plain language of the water code. In determining whether a contribution is a customer contribution in aid of construction or a developer contribution, the Commission will consider the source of the funds or assets and how the funds or assets ultimately reached the utility. Accordingly, the Commission concludes that developer contributions shall include monies or assets transferred from a developer to a utility for utility facilities, not including such items originally obtained from customers. Customer contributions in aid of construction shall include monies provided by customers to a utility for the express purpose of funding utility facilities, even if the funds pass through the hands of other persons before reaching the utility.

To reflect its decision on this matter and related procedures, the Commission adds new findings of fact 17H through 17J, 90A and 93A, and conclusions of law 8A and 8B.

J. Used and Useful Investment at White Bluff

Throughout the proceeding, the White Bluff Ratepayers Group argued that a large percentage of the water and sewer lines at White Bluff are not used and useful because the White Bluff systems were designed and built to serve many more lots than are currently served. Therefore, the costs associated with the water and sewer lines should not be included in rate base.

⁵³ 16 TAC § 24.31(c)(2)(B)(v); 16 TAC § 24.31 (c)(3); *see also* TWC § 13.185(b).

⁵⁴ *See* TWC § 13.185(j).

⁵⁵ TWC § 13.185(j).

⁵⁶ *Id.*; 16 TAC § 24.31(b)(1)(B).

The ALJ concluded that the question of whether the water and sewer lines are used and useful was moot because the majority of the investment in the water and sewer lines at White Bluff were determined to be developer contributions, and thus removed from rate base.⁵⁷

The Commission agrees with the ALJ that for purposes of rate base, the question of whether the water and sewer lines at White Bluff are used and useful is moot. However, because the Commission concluded that the initial investment at White Bluff—including the investment in the water and sewer lines—should be treated as developer contributions, the Commission must still determine whether the developer contribution at White Bluff is currently used and useful in accordance with TWC § 13.185(j) for purposes of depreciation.

TWC § 13.185(j) states that “[d]epreciation on all currently used and useful developer or governmental entity contributed property shall be allowed in the cost of service.” Thus, Double Diamond Utilities is entitled to recover its depreciation expense on its developer-contributed property at White Bluff only if the property is currently used and useful in the provision of water service.

According to Double Diamond Utilities, there are approximately 65 miles of water lines and 60 miles of sewer lines at White Bluff, which were designed to serve 6,314 lots across over approximately 3,500 acres.⁵⁸ The White Bluff water and sewer systems were built in phases as the White Bluff subdivision developed. As new sections of development were opened, the distribution lines for new sections were installed and connected back to the original systems.⁵⁹ At the end of the 2015 test year, Double Diamond Utilities asserted that 85% to 90% of the lots at White Bluff had been sold.⁶⁰

The sales contract used to sell lots in the White Bluff subdivision states that “potable water service will be provided to all lots in the subdivision” and “sewage collection and disposal will be provided to all lots in the subdivision.”⁶¹ Therefore, the sales contract imposes an obligation to provide water and sewer service to any lot at White Bluff when requested. Further, because White

⁵⁷ PFD at 53.

⁵⁸ Tr. at 196:1–197:6 (Harkins Cross) (Oct. 24, 2017).

⁵⁹ Direct Testimony of Randy Gracy at 8:7–8, 11:1–2 (Aug. 4, 2017).

⁶⁰ Tr. at 63:22–64:3 (Gracy Cross) (Oct. 24, 2017).

⁶¹ White Bluff Subdivision Sale Contract, WBRG-1G, Direct Testimony of Nelisa Heddin at 90 (Sept. 8, 2017).

Bluff is within Double Diamond Utilities' certificated service area, the Texas Water Code also imposes such an obligation.⁶²

Whether a developer contribution is used and useful is a fact-specific determination to be made in each case. Based on the specific facts in this case, the Commission concludes that Double Diamond Utilities' investment at White Bluff is currently used and useful. It was reasonable for the White Bluff developer to build out the water and wastewater systems in phases as the subdivision developed such that when any lot within White Bluff was sold and a new owner requested service, service can be immediately provided. In addition, Double Diamond Utilities is currently obligated to provide service if a lot owner decides to build a house on her lot. Therefore, Double Diamond Utilities is permitted to recover a depreciation expense on its developer-contributed assets at White Bluff in accordance with TWC § 13.185(j).

To reflect its decision on this issue, the Commission modifies findings of fact 103 through 105, deletes finding of fact 107, adds new findings of fact 105A and 107A, and adds new conclusions of law 8C and 8D to reflect its determination that Double Diamond Utilities is permitted to recover a depreciation expense on its developer-contributed assets at White Bluff in accordance with TWC § 13.185(j). In addition, the Commission deletes conclusion of law 7 as moot.

K. Return on Equity

The ALJ recommended that the Commission approve a 9.84% return on equity for Double Diamond Utilities. The ALJ determined Double Diamond Utilities' use of four different analyses to calculate a return on equity for Double Diamond Utilities was more persuasive than the analyses performed by Commission Staff, who used only the discounted cash flow analysis and capital asset pricing model.

The Commission disagrees with the ALJ's conclusion and instead adopts Commission Staff's recommended return on equity of 8.79%. The discounted cash flow model is widely accepted by the regulatory industry and the Commission, and is often used to calculate the appropriate return on equity for a utility.

⁶² TWC § 13.250(a).

To reflect its decision on this issue, the Commission deletes findings of fact 113 and 119, modifies findings of fact 110 through 112, 114, and 126, and modifies conclusion of law 10.

L. Other changes

The Commission makes additional changes to findings of fact and conclusions of law to correct citations, spelling, numbering, and punctuation and for stylistic purposes. In addition, the Commission adds new findings of fact 3A and 12A and conclusion of law 1A to more completely describe the applicant.

After the issuance of the proposal for decision, the parties filed exceptions and replies to exceptions, and the ALJ filed a response to the exceptions and replies and made clarifications to the proposal for decision. In addition, the Commission heard oral argument at the May 10, 2018 open meeting and instructed Commission Staff to conduct a number run to reflect the Commission's discussion at the open meeting. The Commission adds new findings of fact 17A through 17G to address events that transpired after the issuance of the proposal for decision. In addition, the Commission modifies findings of fact 127 and 128 to address changes to Double Diamond Utilities' rate schedules after Commission Staff's number run.

The Commission adopts the following findings of fact and conclusions of law:

II. Findings of Fact

Applicant

1. Double Diamond Utilities is an investor-owned company that provides water and sewer utility service to several communities in North Texas through facilities and equipment it operates.
2. Double Diamond Utilities provides water and sewer utility service to The Cliffs development in Palo Pinto County and White Bluff development in Hill County under water certificate of convenience and necessity (CCN) number 12087 and sewer CCN number 20705.
3. Double Diamond Utilities has approximately 640 water customers and 567 sewer customers in White Bluff and approximately 287 water customers and 239 sewer customers in The Cliffs.

- 3A. Double Diamond Utilities has four existing tariffs, one for each of the water and sewer systems at White Bluff and The Cliffs.
4. White Bluff is a resort and residential development with amenities such as a golf course, marina, hotel, restaurant, conference center, spa, and swimming pools.
5. The White Bluff water system obtains its water from four wells in the Trinity aquifer, which is regulated by the Prairielands Groundwater Conservation District.
6. The Cliffs is a resort and residential development with amenities similar to those at White Bluff. The Cliffs water system obtains its water from Lake Possum Kingdom.
7. Double Diamond Utilities is a wholly-owned subsidiary of Double Diamond-Delaware, Inc.

Application, Notice, and Protest

8. On August 1, 2016, Double Diamond Utilities filed two rate-filing packages, one for White Bluff and one for The Cliffs. Each rate-filing package requested a rate increase and related tariff changes for water and sewer rates.
9. The application is based on a test year of January 1, 2015 through December 31, 2015.
10. Double Diamond Utilities mailed notice of the proposed rate change to all of its customers in White Bluff and The Cliffs on or about August 10, 2016.
11. Between August 10, 2016 and September 1, 2016, more than 10% of Double Diamond Utilities' ratepayers in White Bluff and The Cliffs filed timely protests to the rate changes proposed by the application.
12. The application was found to be administratively complete on September 7, 2016.
- 12A. The application considered in this Order consists of the application filed by Double Diamond Utilities on August 1, 2016, as amended and supplemented by its filing on April 26, 2017.

General and Procedural Findings

13. On September 8, 2016, the Commission referred this docket to the State Office of Administrative Hearings (SOAH) for a contested case hearing.

14. On October 7, 2016, the Commission issued its preliminary order, identifying 41 issues to be addressed in this proceeding.
15. On October 18, 2016, a SOAH administrative law judge (ALJ) convened a prehearing conference in Austin, Texas. The following appeared and were admitted as the parties in this case: Double Diamond Utilities; the White Bluff Ratepayers Group; The Cliffs Utility Committee and Commission Staff.
16. By agreement between the parties, a SOAH order set the effective date for the proposed rate changes as April 1, 2018, and set February 21, 2018, as the relate-back date for purposes of determining refunds or surcharges.
17. The hearing on the merits convened on October 24, 2017 and concluded on October 26, 2017. The parties filed initial briefs on November 22, 2017, and reply briefs on December 15, 2017, which is when the record closed.
- 17A. On February 13, 2018, the SOAH ALJ issued the proposal for decision.
- 17B. Double Diamond Utilities, Commission Staff, the White Bluff Ratepayers Group, and The Cliffs Utility Committee filed exceptions to the proposal for decision on March 28, 2018.
- 17C. Double Diamond Utilities, Commission Staff, and the White Bluff Ratepayers Group filed replies to exceptions on April 12, 2018.
- 17D. The Commission granted Double Diamond Utilities request for oral argument, filed on May 1, 2018.
- 17E. On May 2, 2018, the SOAH ALJ filed a response to the exceptions and replies and made clarifications to the proposal for decision.
- 17F. The Commission heard oral argument at the May 10, 2018 open meeting.
- 17G. At the May 10, 2018 open meeting, the Commission instructed Commission Staff to conduct a number run to reflect the Commission's discussion at the open meeting.
- 17H. On May 30, 2018, the Commission issued an order requesting briefing on the differences between customer contributions in aid of construction and developer contributions.
- 17I. Double Diamond Utilities, Commission Staff, and the White Bluff Ratepayers Group filed initial briefs on July 2, 2018.

- 17J. Double Diamond Utilities, Commission Staff, and the White Bluff Ratepayers Group filed reply briefs on July 9, 2018.

Revenue Requirement

Operation and Maintenance (O&M) Expenses

Other Revenues

18. Double Diamond Utilities received \$3,600 in revenue from Nextlink that should be added to White Bluff water's other revenues.

Other Volume-Related Expenses

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

Employee Labor Expense

22. DELETED.
23. DELETED.
24. Double Diamond Utilities employees Clovis Wilhelm, Jody Bledsoe, and Dwayne Cota worked on both the water and sewer systems at White Bluff and responded to service calls on both systems during the test year.
25. DELETED.
26. The salaries of Clovis Wilhelm, Jody Bledsoe, and Dwayne Cota were reasonable and necessary for Double Diamond Utilities to provide water and sewer services to its customers at White Bluff.
- 26A. Double Diamond Utilities failed to provide any evidence of the actual time each employee spends working on each system.

- 26B. In determining whether an employee salary is reasonable and necessary, the amount of time an employee spends working on a system and providing service to the ratepayers is reflected in the amount of that employee's salary allocated to the system.
- 26C. Double Diamond Utilities' employee salaries should be allocated to White Bluff water or White Bluff sewer based on the type of license held by each employee.
- 26D. The record reflects that Mr. Whitworth and Mr. Keeton only spent a small time installing taps and spent their other remaining time performing other duties as needed.
- 26E. Double Diamond Utilities did not provided any supporting documentation explaining or detailing what these other duties include.
- 26F. Removing the salaries of Mr. Whitworth and Mr. Keeton from Double Diamond Utilities' cost of service is warranted because Double Diamond Utilities has not shown that the positions held by Mr. Whitworth and Mr. Keeton are a reasonable and necessary expense.

Contract Work

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

Transportation

- 31. Mr. Dilworth and another employee have Double Diamond Utilities vehicles that they can use to respond at any time to a service call at White Bluff.

32. Mr. Dilworth drives one of the trucks to and from work daily, and the other truck is used by the Double Diamond Utilities employee assigned to be on call to drive to and from work during such assignment.
33. Mr. Dilworth and the on-call Double Diamond Utilities employee do not use the trucks for any personal reasons. Although they use the trucks to drive to and from work, this use is reasonable and necessary so that they can respond to a service call from home if such a call is made.
34. The fuel costs incurred by Double Diamond Utilities for Mr. Dilworth and the other employee driving to and from work in company trucks while on-call are not purely commuter miles and are reasonable and necessary expenses incurred by Double Diamond Utilities in providing service at White Bluff.
35. A vehicle lease expense (\$2,912 for both the water and sewer systems) and a tool box expense for White Bluff of \$850 should be removed from transportation expenses and added to the depreciation schedule.

Other Plant Maintenance

36. Grinder pumps are part of the White Bluff wastewater system and installed at each service location in the White Bluff system.
37. There are significant, typical, and recurring maintenance, repair, and replacement costs associated with the grinder pumps in the White Bluff sewer system.
38. Approximately 20 to 30 grinder pumps are replaced and approximately half of the pumps are repaired every year in the White Bluff sewer system.
- 38A. It is appropriate for Double Diamond Utilities to expense the amounts spent in the test year for all grinder-pump repairs for White Bluff sewer and capitalize the amounts spent in the test year to purchase replacement grinder pumps for White Bluff sewer.
39. DELETED.
40. The \$709 included in the trial balance for the White Bluff water system reflects costs incurred in the operation and maintenance of the water system at White Bluff and is appropriately included as other plant maintenance expense.

41. DELETED.
42. The invoice from Industrial Electric Repair and Sales referencing rewind 3 phase, machine work on pump, and pump repair, and reflecting charges for bearings and a pump seal pertains to repairs, and the costs reflected in this invoice are appropriately designated as other plant maintenance expenses.
43. The invoice from Wallace Controls & Electric referring to a call regarding a well not running and reflecting a burned-out motor protector and service wire and a motor protector replacement pertains to repairs, and the costs reflected in this invoice are appropriately designated as other plant maintenance expenses.

Professional Services

44. The cost of renewing Double Diamond Utilities' wastewater permit for White Bluff, which Double Diamond Utilities has historically incurred approximately every three years, should be allowed to be recovered in equal parts in Double Diamond Utilities' rates over three years.
45. DELETED.
46. DELETED.
- 46A. Double Diamond Utilities' cost associated with its CCN amendment for The Cliffs system is not a recurring expense and should not be recovered from ratepayers.
47. Double Diamond Utilities did not incur any cost to obtain a CCN amendment for White Bluff during the test year, and the costs of such amendment reflected in the White Bluff professional services account should be removed.

Insurance

48. The premiums paid by Double Diamond Utilities for worker's compensation insurance (\$1,444 for water and \$373 for sewer) are not recoverable insurance expenses.
49. Some portion of the premium paid by Double Diamond Utilities for an umbrella insurance policy is attributable to insurance coverage that is incurred as part of providing service and maintaining plant.

50. The amount of the umbrella premium attributable to coverage for providing utility service and maintaining plant does not correlate to the base premium for such coverage.
51. Double Diamond Utilities failed to prove the cost of the umbrella coverage that relates to Double Diamond Utilities' provision of water and sewer utility service.

Salaries

52. Seven employees worked for the White Bluff systems at some point during the test year, however, not all seven employees worked the entire test year.
53. The seven employees who worked for the White Bluff utility systems during the test year earned and were paid \$151,074 in salary during the test year; they did not earn and were not paid their full yearly salaries.
54. Between August 4, 2017 and October 24, 2017, there were only four employees working for the White Bluff systems.
55. Employee salaries totaling \$151,074 are reasonable and necessary expenses for Double Diamond Utilities to provide services through the White Bluff systems.

Regulatory Fees

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

Miscellaneous Expenses

58. Equipment lease fees of \$19,728 for White Bluff water and \$20,148 for White Bluff sewer associated with automatic meter reading and the 50,000 gallon wastewater treatment plant should be removed from the miscellaneous expense accounts.
59. Sewer-tap-fee expenses of \$500 should be removed from the White Bluff sewer miscellaneous expense account.

60. Double Diamond Utilities' utility offices are located within the White Bluff and The Cliffs resorts' administrative buildings.
61. DELETED.
62. DELETED.
63. DELETED.
64. DELETED.
65. DELETED.
66. The resorts incur and pay costs for overhead and general and administrative expenses, and 3% of those costs are then expensed to Double Diamond Utilities.
- 66A. The amounts billed to Double Diamond Utilities are not based on the Double Diamond Utilities' share of resort expenses that it directly uses; instead, it is an across-the-board charge of 3% of all overhead and general and administrative expenses incurred by the resort.
- 66B. The entities that own and operate the resorts are wholly-owned subsidiaries of Double Diamond-Delaware.
- 66C. No evidence was admitted showing what other entities or persons would pay the resorts for the same class of comparable amenities.
- 66D. No evidence was admitted establishing the market price for the same class of items provided to the systems.
67. DELETED.

Depreciation

68. The \$80 expense for a truck bed mat should be removed from the White Bluff sewer depreciation schedule.

Use of Trending Study to Determine Original Cost

69. Double Diamond Utilities retained Victoria Harkins to perform an analysis of the utility assets at White Bluff and The Cliffs and determine the original cost of such assets.

70. To perform her analysis, Ms. Harkins looked only at invoices provided to her by Double Diamond Utilities for the utility assets and did not review any balance sheets or general ledgers.
71. The invoices reviewed by Ms. Harkins for purposes of determining the original cost of utility assets did not reflect the entirety of the pipe work for the White Bluff and The Cliffs systems.
72. Ms. Harkins performed a trending study to establish the original cost for certain of White Bluff's and The Cliffs's assets for which no invoice was available.
73. Double Diamond Utilities' Chief Financial Officer understood that the costs of Double Diamond Utilities' utility infrastructure would have been recorded in a balance sheet based on invoices for such expenses.
74. It is unclear whether historical records exist (or existed at the time the application was prepared) showing the original construction costs for the collection and distribution lines at White Bluff and The Cliffs.
75. Construction of the collection and distribution lines at the White Bluff development began around 1990. Construction was ongoing through 2007 or 2008.
76. Ms. Harkins's use, in her trending study, of January 1, 1996, as an installation date for the pipe work was reasonable and appropriate.
77. Any increase in the calculated original cost resulting from the use of 1996 as the installation date was corrected by installation performed up to ten years after that date and beyond, at which time the cost would have been even greater.

Fully Depreciated Assets

78. All assets that have fully depreciated should be removed from Double Diamond Utilities' White Bluff depreciation schedules, as set forth in Tables NDH-14, NDH-15, NDH-16, and NDH-17 of the direct testimony of the White Bluff Ratepayers Group witness Nelisa Heddin.

Federal Income Tax Expense

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

- 79A. The White Bluff and The Cliffs systems are both owned and operated by Double Diamond Utilities. Double Diamond Utilities is a subchapter S corporation, a pass-through entity.
- 79B. Double Diamond-Delaware, is a subchapter S corporation.
- 79C. Double Diamond-Delaware is the parent company and sole shareholder of Double Diamond Utilities.
- 79D. R. Mike Ward is the majority shareholder of Double Diamond-Delaware, owner of 94.8% of the shares with an employee stock ownership plan owning 5.2%.
- 79E. Because Double Diamond-Delaware is also a subchapter S corporation, it is likely that the majority of tax expenses of Double Diamond Utilities are paid at the individual level by Mr. Ward, the majority shareholder of Double Diamond-Delaware.
- 79F. The record does not reflect what amount of Double Diamond Utilities' tax expense is paid by Mr. Ward or the applicable tax rate.
- 79G. It is appropriate to treat Double Diamond Utilities as a subchapter C corporation for the purpose of determining its federal income tax expense.
- 79H. A subchapter C corporation's applicable federal income tax rate is 21% for ratemaking purposes.

Other Assessments and Taxes

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

Original Cost of Plant In Service

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

Cash Working Capital

83. A reasonable cash working capital allowance for the White Bluff utility system is 1/12 of the system's operation and maintenance expenses.
84. Double Diamond Utilities maintains cash balances for both White Bluff and The Cliffs systems under one CCN, filed one annual report for both developments, and filed a single rate case for both developments.
85. Both the White Bluff and The Cliffs systems are operated and maintained by Double Diamond Utilities and have access to the same capital.
86. A reasonable cash working capital allowance for The Cliffs utility system is 1/12 of the system's operation and maintenance expenses.

Developer Contributions

87. In determining the original cost of used and useful utility plant, property, and equipment for purposes of calculating its rate base, Double Diamond Utilities used an asset list prepared jointly by Double Diamond Utilities' President Randy Gracy and Double Diamond Utilities witness Ms. Harkins, which identifies certain assets to be 80% developer-contributed. The 80% portion of the cost of those assets was removed from Double Diamond Utilities' rate-base calculation.
88. There is no contemporaneous accounting or other documentation showing that the assets on the asset list prepared by Mr. Gracy and Dr. Harkins were 80% developer-contributed.
89. Until December 1996, when Double Diamond Utilities was created, Double Diamond, Inc., another wholly-owned subsidiary of Double Diamond-Delaware, was the developer and the utility company at White Bluff and contracted for the construction of the original infrastructure of the White Bluff utility systems.
90. Before December 1996, most of the utility infrastructure was paid for by Double Diamond, Inc.
- 90A. All investments at White Bluff before December 30, 1996 are developer contributions.
91. In 1997, Double Diamond Properties Construction Co., also created in December 1996 as a wholly-owned subsidiary of Double Diamond-Delaware, began paying for most of the utility infrastructure.

92. Approximately 61% of the water system assets and 60% of the sewer system assets included in Double Diamond Utilities' requested rate base for White Bluff were constructed before December 1996.
93. Most of the White Bluff assets included in Double Diamond Utilities' requested rate base for White Bluff that were constructed after December 1996 were paid for by Double Diamond Properties Construction Co.
- 93A. The majority of White Bluff assets constructed after December 30, 1996 are developer contributions.
94. In December 1997, Double Diamond Utilities filed an application to change rates at White Bluff, The Cliffs, and Oakwood, another development that it serves. In that filing, there were no contributions in aid of construction identified.
95. In August 2007, Double Diamond Utilities filed an application to change water rates at White Bluff, The Cliffs, and the Retreat, another development that it serves. The application was amended in December 2007, but neither the August 2007 nor the December 2007 amendment indicated that a portion of Double Diamond Utilities' assets included in rate base was developer contributed.
96. In October 2008, Double Diamond Utilities filed another rate change application for the water systems at White Bluff, The Cliffs, and the Retreat, which identified the amount of developer contributions as approximately \$1.9 million.
97. In February 2009, Double Diamond Utilities filed another rate change application for the water systems at White Bluff, The Cliffs, and the Retreat, and the application indicated a total of \$1,119,399 in developer contributions for the three systems.
98. DELETED.
99. Double Diamond Utilities is in the best position to access and discover the evidence necessary to differentiate between plant, equipment, and property contributed by the developer and that invested by Double Diamond Utilities.

100. The net book value of the seven utility assets claimed as part of Double Diamond Utilities' rate base and paid for by Double Diamond Utilities are properly included in Double Diamond Utilities' invested capital.

Property Not Belonging to Double Diamond Utilities

101. Tract 2 in White Bluff was conveyed by Double Diamond, Inc. to the White Bluff Property Owners Association in December 1995, as well as certain facilities included on such tract, including a water well, the water plant, and the water storage tank.
102. Double Diamond Utilities' request for the net book value of Tract 2 and the facilities on Tract 2 of \$88,565 and an annual depreciation of \$2,060 to be included in its rate base should be denied.

Developer Contribution - Used and Useful

103. The White Bluff systems serve 6,314 lots.
104. There are approximately 65 miles of water lines and 60 miles of sewer lines at White Bluff.
105. Only approximately 10% of the lots at White Bluff development are actually receiving service from Double Diamond Utilities.
- 105A. The White Bluff water and sewer systems were built in phases as the White Bluff subdivision developed. As new sections of development were opened, the distribution lines for new sections were installed and connected back to the original systems.
106. Approximately 85 to 90 percent of the lots at White Bluff have been sold.
107. DELETED.
- 107A. The developer-contributed assets at White Bluff are currently used to serve residents and are available to serve any new residents.

Accumulated Deferred Federal Income Tax (ADFIT)

108. There is no accounting evidence that Double Diamond Utilities incurred a net operating loss or documentary proof in the record that Double Diamond Utilities did not defer payment of federal income taxes because of a net operating loss.
109. The estimate of the effect of the alleged net operating loss carryover on the ADFIT calculated by Commission Staff witness Debi Loockerman was unsupported.

Rate of Return

Return on Equity

110. A reasonable return on equity for Double Diamond Utilities, based on a discounted cash flow analysis employed with the capital asset pricing model is 8.79%.
111. A return on equity of 8.79% is reasonably sufficient to assure confidence in Double Diamond Utilities' financial soundness and will be adequate to maintain and support its credit and allow it to raise necessary capital.
112. A return on equity of 8.79% will yield a fair return on Double Diamond Utilities' invested capital.
113. DELETED.
114. A small stock risk premium on top of Double Diamond Utilities' return on equity is not warranted.
115. Approximately 40% of the unaccounted for water noted in the application is water loss due to brine discharge after water from the lake goes through a reverse osmosis plant, and thousands of gallons a day used to backwash sand filters.
116. Additional water is used to regularly flush out the lines at White Bluff and The Cliffs and is therefore unaccounted for.
117. Double Diamond Utilities employs various methods at The Cliffs to track down leaks, and Double Diamond Utilities has responded to and repaired, discovered, and reported leaks in a reasonable manner.
118. The utility crew at The Cliffs is instructed to respond to reports of leaks as quickly as possible and make the necessary repairs. Some leaks can be fixed in a few hours, and most leaks are repaired the same day or the day after they are reported.
119. DELETED.

Cost of Debt

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

Capital Structure

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

Overall Rate of Return

126. Double Diamond Utilities' overall rate of return should be set as follows:

Component	Ratio	Cost Rate	Weighted Cost Rate
Debt	47.27%	4.91%	2.32%
Equity	52.73%	8.79%	4.63%
Overall			6.95%

Rate Design

127. The rate structures set forth in the attachments to this Order will recover Double Diamond Utilities' revenue requirements for White Bluff water and White Bluff sewer.
128. The rate structures set forth in the attachments to this Order will recover Double Diamond Utilities' revenue requirement for The Cliffs water and The Cliffs sewer.

III. Conclusions of Law

1. Double Diamond Utilities is a utility and a public utility as defined in Texas Water Code (TWC) § 13.002(23), and a retail public utility as defined in TWC § 13.002(19).
- 1A. Double Diamond Utilities is a class B utility as defined in TWC § 13.002(4-b).
2. The Commission has jurisdiction over the application under TWC §§ 13.041, 13.043(b), 13.181–.185, 13.1871, and 13.1872.
3. All required notices of the application and the contested case hearing were given as required by law in TWC § 13.1871 and Administrative Procedure Act⁶³ §§ 2001.051–.052.
4. The ALJ conducted a contested case hearing and proposed a decision on the application under the authority of chapter 2003 of the Texas Government Code and chapter 13 of the TWC.
5. Double Diamond Utilities bears the burden of proof that its proposed rates are just and reasonable under TWC § 13.184(c).
6. DELETED.
- 6A. A utility may only include expenses that are reasonable and necessary to provide service to the ratepayers in its cost of service.
- 6B. The entities that own and operate the resorts are affiliates of Double Diamond Utilities under TWC § 13.002(2).
- 6C. The 3% charge of overhead and general and administrative expenses from the White Bluff and The Cliffs resorts to Double Diamond Utilities is an affiliate transaction under TWC § 13.185(e).
- 6D. Expenses paid from Double Diamond Utilities to the resorts are an affiliate payment under TWC § 13.185(e).
- 6E. The Commission may not include costs related to affiliate transactions in Double Diamond Utilities' rates based on the record in this docket.
7. DELETED.

⁶³ Tex. Gov't Code Ann. §§ 2001.051–.052 (West 2016).

8. Double Diamond Utilities failed to meet its burden to show how much of the original cost of the utility assets included in its proposed rate base for White Bluff were contributed by the utility under TWC § 13.184(c).
- 8A. All investments at White Bluff before December 30, 1996 are developer contributions.
- 8B. The majority of White Bluff assets constructed after December 30, 1996 are developer contributions.
- 8C. Double Diamond Utilities' developer contribution at White Bluff is currently used and useful.
- 8D. Double Diamond Utilities is permitted to recover a depreciation expense on its used and useful developer-contributed assets at White Bluff in accordance with TWC § 13.185(j).
9. In compliance with TWC § 13.183, and based on the findings of fact and conclusions of law, Double Diamond Utilities' overall revenues approved in this case permit Double Diamond Utilities a reasonable opportunity to earn a reasonable return on its invested capital used and useful in providing service to the public over and above its reasonable and necessary operating expenses.
10. An overall rate of return of 6.95% will permit Double Diamond Utilities a reasonable opportunity to earn a reasonable return on its invested capital in accordance with TWC § 13.184.
11. The rates approved in this Order are based on original cost, less depreciation, of property used and useful to Double Diamond Utilities' provision of service in accordance with TWC § 13.185
12. The rates approved in this Order are just and reasonable, comply with the ratemaking provisions in TWC chapter 13, and are not unreasonably discriminatory, preferential, or prejudicial.
13. The increase in revenue that would have been generated by Double Diamond Utilities' proposed rates should be calculated using the proposed rates from the amended application, which were those upon which a contested hearing was held under 16 TAC § 24.33(b).

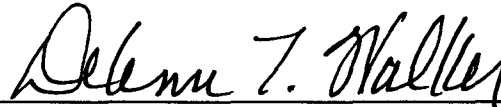
IV. Ordering Paragraphs

In accordance with these findings of fact and conclusions of law, the Commission issues the following orders:

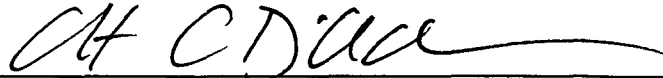
1. The Commission adopts the proposal for decision, including findings of fact and conclusions of law, except as discussed in this Order.
2. Double Diamond Utilities' application for a rate increase at White Bluff and The Cliffs is approved, as amended by the proposal for decision and this Order.
3. Double Diamond Utilities shall record its excess accumulated deferred federal income tax in a regulatory liability account for return to customers in Double Diamond Utilities' next base-rate case.
4. Within 10 days of the issuance of this Order, Commission Staff shall file a copy of Double Diamond Utilities' tariffs with Central Records to be marked *Approved* and kept in the Commission's tariff book.
5. All other motions and any other requests for general or specific relief, if not expressly granted, are denied.

Signed at Austin, Texas the 20th day of August 2018.

PUBLIC UTILITY COMMISSION OF TEXAS

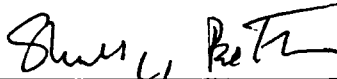


DEANN T. WALKER, CHAIRMAN



ARTHUR C. D'ANDREA, COMMISSIONER

I respectfully abstain.



SHELLY BOTKIN, COMMISSIONER