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

COMMISSION STAFF'S REPLY TO DOUBLE DIAMOND UTILITY COMPANY, INC.'S MOTION FOR REHEARING

COMES NOW the Staff of the Public Utility Commission of Texas (Staff), representing the public interest, and files this Reply to Double Diamond Utility Company, Inc.'s Motion for Rehearing and would show the following:

I. BACKGROUND

The Commission issued a final order in this docket on August 30, 2018. Double Diamond Utility Company, Inc. (DDU) filed a motion for rehearing on September 25, 2018. A reply to a motion for rehearing is timely if it is filed on or before the 40th day after the date a final order is signed.[1] October 9, 2018, is the 40th day after August 30, 2018. Therefore, this pleading is timely filed.

II. REPLY

Staff supports the Commission's decision in this proceeding. The Commission's Order is supported by substantial evidence, is in the public interest, and, is in compliance with the law. The Motion for Rehearing filed by DDU is without merit, fails to raise any new substantive issues, and should be denied except for Point of Error No. 6, which correctly points out that the amounts spent on replacement grinder pumps during the test year were not added to DDU's rate base.[2] Staff respectfully recommends granting DDU's Motion for Rehearing for the sole purpose of

[1] Tex. Gov't Code § 2001.146 (West 2016 and Supp. 2017); 16 Tex. Admin. Code (TAC) § 22.264(c).

[2] Double Diamond Utility Company, Inc.'s Motion for Rehearing at 9 of 18 (Sep. 24, 2018) (DDU's Motion for Rehearing).

capitalizing the cost of replacement grinder pumps purchased during the test year, recalculating the rates for the White Bluff sewer system, and revising the tariff.

DDU's catch-all argument that the administrative completeness of an application for a rate/tariff change is determinative of whether a utility has provided evidence sufficient to support its position on a contested issue incorrectly conflates the standard for administrative completeness with the utility's burden of proof.[3] Relying on Texas Water Code (TWC) § 13.1871(d) and (e), DDU claims that the Commission's decisions in this case violate the requirement that the Commission evaluate the sufficiency of the application and supporting documents.[4] However, a review of an application's administrative completeness is performed to determine whether the Commission has received the documents necessary to allow Staff to evaluate the technical merits of an application.[5] Evaluating the application's technical merits at the sufficiency phase would be akin to a requirement that a utility marshal all of its evidence at the time an application is filed, which would unduly burden the utility. In addition, a requirement that the utility provide evidence sufficient to meet its burden of persuasion at the time the application is filed would obviate the need for the utility to file direct testimony, which is a vital component of due process. Consequently, DDU's claims regarding the sufficiency of its application should be denied.

A. Points of Error Nos. 1 through 4

Points of Error Nos. 1 through 4 raise issues that DDU has already briefed three times—in post hearing briefing, in exceptions to the Proposal for Decision (PFD), and in briefing ordered by the Commission. In its Motion for Rehearing, DDU raises arguments similar to those it has already made. In addition, DDU raises two new arguments: (1) that a capital asset can only be classified as developer-contributed if the developer *intends* for it to be treated as cost-free capital,[6] and (2)

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[3] *Compare* 16 TAC § 24.8(b) (allowing the rejection of an application and suspension of the effective date until "deficiencies" are corrected), *with* TWC § 13.184(c) (requiring a utility to show that a proposed rate change is just and reasonable).

[4] DDU's Motion for Rehearing at 3-5, 8, and 12-16 of 18.

[5] *See* TWC § 13.1871(e) (allowing for the rejection of an application and suspension of the effective date if an application is not "substantially complete").

[6] DDU's Motion for Rehearing at 3 of 18.

that the Commission's decision establishes a new burden of proof by requiring a utility to show that its rate base was contributed by the utility.[7] Both of these arguments are unsupported and miscomprehend the distinction between invested capital and cost-free capital.

A utility is entitled to earn a reasonable return on its invested capital (also called rate base) over and above its reasonable and necessary operating expenses.[8] The amount of a utility's invested capital is determined using the original cost of utility property that is used and useful in providing service.[9] Cost-free capital is utility plant that is not paid for, or invested, by the utility.[10] Commission rules specifically identify contributions in aid of construction and other cost-free capital as items to be deducted from rate base[11] in order to prevent a utility's investors from earning a return on an investment the utility did not make.[12] The record supports a finding that DDU did not pay for the assets in the application comprising the rate base for White Bluff that were installed before January 1, 2008.[13] Thus, those assets are cost-free.capital regardless of whether the entity that actually paid for them intended for DDU to earn a return. Moreover, the term *cost-free* capital puts a utility on notice that it must show that it paid for all of the assets included in the rate base on which it will earn a return. For these reasons, DDU's points of error should be denied.

B. Point of Error No. 5

Point of Error No. 5 lacks merit because the Commission's decision to expense costs for repairing grinder pumps and to capitalize costs for replacing grinder pumps is supported by

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[7] *Id.* at 4 of 18.

[8] TWC § 13.183(a)(1).

[9] *Id.* § 13.185(b).

[10] *Application of SJWTX, Inc. dba Canyon Lake Water Service Company to Change Water Rates*, TCEQ Docket No. 2010-1841 UCR, Final Order at Finding of Fact No. 59 ("Cost-free capital occurs when a utility does not use its own funds to obtain plant assets.").

[11] 16 TAC § 24.31(c)(3)(D)-(E).

[12] TCEQ Docket No. 2010-1841 UCR, Final Order at Finding of Fact No. 49 ("...Customer- and developer-CIAC is excluded from the rate base because the utility has not made an investment upon which it should earn a return.) (Jun. 27, 2013); 16 TAC § 24.31(c)(3)(D)-(E).

[13] Workpapers of Nelisa Heddin, Ex. WBRG-1M at WBRG000022, WBRG000132, and WBRG000135; Tr. at 67:6-20 (Gracy Cross) (Oct. 24, 2017).

evidence in the record. Specifically, the record shows that grinder pumps qualify as a capital asset under DDU's capitalization policy because they cost more than $750 and have a service life of 10 years.[14] DDU's argument that it has "always treated grinder pumps and grinder pump repairs as recurring expenses" is not evidence because, as DDU admits, its prior rates were the result of a settlement.[15] Moreover, the Commission explained that capitalizing replacement grinder pumps comports with "accounting standards regarding the installation of plant in service."[16] DDU's point of error should be denied.

C. Point of Error No. 6

Point of Error No. 6 correctly points out that the amount for replacement grinder pumps purchased during the test year was omitted from the rate base used to calculate the revenue requirement for the White Bluff sewer system. In accordance with the Commission's decision regarding which assets were developer-contributed, the Order states that assets totaling $24,029.64 for the White Bluff sewer system should remain in rate base.[17] The Order also states that DDU should capitalize all test-year costs for the purchase of replacement grinder pumps.[18] Staff's number running used a net plant of $24,029.64 for White Bluff sewer.[19] Accordingly, $76,409 should be added to the net plant for White Bluff sewer, which results in an approximately $6,000 increase to the revenue requirement for this system. DDU's point of error should be granted, the rates for White Bluff sewer should be recalculated using the new revenue requirement, and the tariff should be updated.

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[14] DDU Response to Staff RFI 1-26, Staff Ex. 6 at DDU16-015961.

[15] DDU's Motion for Rehearing at 7 of 18.

[16] Final Order at 5 of 35.

[17] *Id.* at 10 of 25.

[18] *Id.* at 5 of 35.

[19] Response to Commission's Request for Number Run at 10, White Bluff Sewer Schedule III – Invested Capital (May 21, 2018).

D. Point of Error Nos. 7 and 8

Points of Error Nos. 7 and 8 fail because they rest on an argument about witness credibility, and credibility determinations lay with the finder of fact.[20] In addition, the finder of fact's decision on conflicts in the evidence is "generally viewed as conclusive."[21] As with most rate cases, the record in this proceeding contains a battle of the experts regarding return on equity (ROE), and both experts developed models to support their recommendations.[22] Staff witness Emily Sears, who contrary to DDU's assertion has nine years of experience with rate of return issues for utilities,[23] used a Discounted Cash Flow analysis and a Capital Asset Management analysis to support her recommendation.[24] The Commission adopted her recommendation concluding that, "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."[25] Therefore, the Commission's decision on ROE is supported by credible evidence and DDU's points of error should be denied.

E. Points of Error Nos. 9 and 10

In Points of Error Nos. 9 and 10, DDU incorrectly asserts that the Commission's decision to disallow expenses for the salaries of two of DDU's employees imposes a new burden of proof on utilities even though it does not. Commission rules limit the types of expenses that may be included in a utility's cost of service to expenses that are "reasonable and necessary to provide service to the ratepayers."[26] DDU had ample opportunity to show why these two salaries were reasonable and necessary expenses when it received a discovery request asking for the job

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[20] *Lilley v. Lilley*, 43 S.W.3d 703, 705 (Tex. App.—Austin 2001, no pet.).

[21] *Id.* at 706.

[22] *Compare* Ex. DDU-10, Rebuttal Testimony of Gregory Scheig, *with* Direct Testimony of Emily Sears, Staff Ex. 2 at 33-41.

[23] Staff Ex. 2 at Attachment 1.

[24] *Id.* at 33 and 36.

[25] Final Order at 15 of 35.

[26] 16 TAC § 24.31(b).

descriptions for these employees.[27] However, as DDU admits, "the only evidence in the record is that these two employees work for White Bluff Water and sewer systems and that a very limited amount their time is spent installing taps."[28] As Ms. Sears explained, the record does not show what duties these employees spend 99% of their time on.[29] Accordingly, the evidence (or lack thereof) supports the Commission's decision that DDU did not meet its burden of persuasion to show that it is more likely than not that these salaries are reasonable and necessary to provide service, and DDU's points of error should be denied.

F. Point of Error No. 11

Point of Error No. 11 also incorrectly asserts that the Commission's decision to disallow expenses related to DDU's application to amend the certificate of convenience and necessity (CCN) for the Cliffs imposes a new burden of proof on utilities. Commonsense dictates that if a cost is not recurring, it should not be recovered from ratepayers year after year. And as DDU states, expenses must occur within the test year upon which an application is based.[30] Inherent in the use of an historic test year is the requirement that only recurring costs are properly claimed as operations and maintenance expenses. Otherwise, a utility could artificially inflate the operations and maintenance expense included in its revenue requirement by saving all of its one-time expenses for the test year. In addition, DDU argues for the first time that the cost of filing this application to amend its CCN should be amortized.[31] Not only is this argument untimely, it is unsupported because, unlike the renewal of a wastewater permit, an application for a CCN amendment is not filed at regular intervals. So, there is no way to determine the appropriate number of years over which to amortize this cost. Therefore, DDU's point of error should be denied.

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[27] Workpapers of Emily Sears, Staff Ex. 2A at ES Workpaper 6.

[28] DDU's Motion for Rehearing at 14 of 18.

[29] Tr. at 338:15-24 (Sears Cross) (Oct. 25, 2017).

[30] DDU's Motion for Rehearing at 15 of 18 (citing to TWC § 13.185(d)).

[31] *Id.*

G. Point of Error No. 12

Point of Error No. 12 lacks merit because the Commission's decision to disallow the miscellaneous expenses for both White Bluff and the Cliffs does not rest solely on the Commission's finding that these expenses are affiliate transactions under TWC § 13.185(e). The Commission also relied on Staff's argument that the amount of resort overhead expenses billed to DDU include costs unrelated to the provision of utility service and that DDU is not billed for the expenses it directly uses and is instead allocated 3% of all resort overheard.[32] Thus, the Commission's decision is supported by evidence in the record and DDU's point of error should be denied.

H. Point of Error No. 13

Finally, Point of Error No. 13 fails because it is misinterprets the Commission's findings and is based on an inconsistency that does not actually exist. The Commission adopted the PFD's recommendation that the known and measurable changes in the depreciation expense for White Bluff and the Cliffs should be disallowed.[33] The PFD reasoned that DDU failed to show that the use of a trending study was appropriate because its account balances (historical records) did not reflect the original costs of the trended assets.[34] The PFD also found that "if the Commission is inclined to allow the use of a trending study to estimate the original costs..." then the use of January 1, 1996 as the installation date for the trended assets was reasonable.[35]

DDU's assertion that the Commission erred in its decision incorrectly interprets the finding regarding the reasonableness of the installation date as support for a finding that the known and measurable changes in depreciation expense were allowable. However, the reasonableness of the installation date used in a trending study has no bearing on whether the use of a trending study was appropriate in the first place under Commission rules. Furthermore, the Commission's decision

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[32] Final Order at 6 of 35; Tr. at 33:6-8 (Sears Cross) (Oct. 26, 2017); Staff Ex. 2 at 22; Tr. at 474:4-5, 474:6-475:5, 475:10, and 476:7-14 (Gracy Rebuttal Cross) (Oct. 26, 2017).

[33] Final Order at Findings of Fact Nos. 60-74.

[34] Proposal for Decision at 29 (Feb. 13, 2018) (PFD); *see also*, Final Order at Finding of Fact No. 76.

[35] PFD at 30.

to disallow the known and measurable changes to the depreciation expense is not inconsistent with TWC § 13.185(j) because it was not based on whether the trended assets were developer-contributed—it was based on whether the use of a trending study to estimate the original costs of these assets was appropriate. Therefore, DDU's point of error should be denied.

III. CONCLUSION

For the reasons stated above, Staff respectfully recommends that DDU's Motion for Rehearing be granted for the narrow purpose of adding the amounts spent on replacement grinder pumps to the rate base for the White Bluff sewer system and recalculating the final rates for this system.

Dated: October 5, 2018

Respectfully Submitted,

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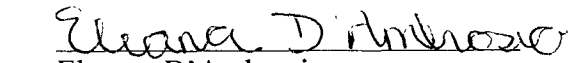

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CERTIFICATE OF SERVICE

I certify that a copy of this document will be served on all parties of record on October 5, 2018, in accordance with 16 TAC § 22.74.

Eleanor D'Ambrosio

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