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

DOUBLE DIAMOND UTILITY COMPANY, INC.'S SECOND MOTION FOR REHEARING

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TO THE HONORABLE PUBLIC UTILITY COMMISSION:

COMES NOW, Double Diamond Utility Company, Inc. ("DDU"), in the above styled and docketed water and wastewater rate proceeding and files this Motion for Rehearing ("Motion") of the Order on Rehearing in Public Utility Commission of Texas (the "Commission") Docket No. 46245, as issued by the Commission on December 12, 2019. This Motion is timely filed on January 6, 2020.[1] In support of this Motion, DDU respectfully shows as follows:

I. INTRODUCTION

DDU filed Applications ("Applications") with the Commission for a rate/tariff change under Certificate of Convenience and Necessity Nos. 12087 and 20705 for water and sewer utility service to The Cliffs and White Bluff resort/residential developments in Palo Pinto County and Hill County, respectively, in August of 2016. At the time of filing, DDU opted to file the Applications as a Class B utility pursuant to Texas Water Code § 13.1872(c)(2) (2016). The Commission referred the Applications to hearing in September 2016. After 12 months of discovery, including DDU's production of over 17,000 pages of documents and responding to 200 requests for information from the parties, the hearing was convened in late October 2017.

The Commission's Order on Rehearing was issued on December 12, 2019, and recommends an estimated $633,994 reduction in DDU's requested revenue requirement for the White Bluff water and sewer systems and a $89,364 increase in DDU's requested revenue requirement for The Cliffs water and sewer systems.

[1] DDU files this Motion, in relevant part, to preserve its appellate rights. *See Southern Union Gas Company v. Railroad Commission of Texas*, 690 S.W.2d 946, 948 (Tex. App—Austin 1985, writ ref'd n.r.e.).

While DDU appreciates the approval of an increase in rates for The Cliffs water and sewer systems, there are numerous errors related to the Commission's decision regarding the White Bluff water and sewer system rates that result in rates that are not in the public interest, are unreasonable and unjust, are based upon arbitrary and capricious findings and conclusions, and reflect an abuse of discretion by the Commission. These errors can be grouped into three basic categories: rate base related errors; rate of return related errors; operation and maintenance expense related errors; and other miscellaneous errors.

II. POINTS OF ERROR

A. Rate Base Errors

Point of Error No. 1. The Commission erred in concluding that most of DDU's assets are developer contributions that must be deducted from rate base under 16 TAC § 24.31(c)(2)(B)(v) and 16 TAC § 24.31 (c)(3) based on the erroneous findings that all investments at White Bluff before December 30, 1996 and a majority of the assets constructed after December 30, 1996, are developer contributions. (FOF Nos. 90A, 90B, 90C, 93A, 93B, 93C, 93D, 93E, 93F, 93G, and 93H, related FOF Nos. 93, and COL Nos. 8A, 8B, 9, 11, 12).

There is no evidence to support a finding that all funds and assets at White Bluff before December 30, 1996, and a majority of the assets constructed after December 30, 1996, are developer contributions. All the evidence supports the opposite finding and conclusion – that DDU's assets were funded by its owner and intended to earn a return on its investment on the amounts retained on the books of the utility. The Commission's findings and conclusions have no support in the record and violate a statutory mandate.

Mr. Gracy testified that payments made by Double Diamond, Inc., DDU's predecessor, to contractors to build the collection and distribution lines at White Bluff would have been recorded in Double Diamond, Inc.'s books as 80% developer and 20% utility.[2] DDU's expert witness testified that DDU has been consistent in the treatment of 80% developer-contributed assets in previous applications for rate changes filed with the TCEQ.[3] DDU has shown that it did not take

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[2] Tr. at 65:13-66:12, 67:6-69:13 (Gracy Cross) (Oct. 24, 2017).

[3] Ex. DDU-11, Rebuttal Testimony of Jay Joyce at 22:8-23:6 (Oct. 16, 2017).

advantage of federal income tax write-offs on its assets and that the portion of the assets intended as investment remain on DDU's books.[4]

Furthermore, Section 13.1871 of the Texas Water Code provides that:

> (d) ... If the utility fails to provide within a reasonable time after the application is filed the necessary documentation or other evidence that supports the costs and expenses that are shown in the application, the regulatory authority may disallow the nonsupported costs or expenses.
>
> (e) Except as provided by Subsection (f) or (g), if the application or the statement of intent is not substantially complete or does not comply with the regulatory authority's rules, it may be rejected and the effective date of the rate change may be suspended until a properly completed application is accepted by the regulatory authority and a proper statement of intent is provided.

But instead of complying with these statutory requirements and rejecting the application, the Commission allowed DDU's application to proceed, at great expense,[5] and over a period of two years, as though DDU's application did comply with the Commission's rules and that DDU had "filed the necessary documentation or other evidence that supports the costs and expenses that are shown in the application." And now, after the reasonable time period allowed for the Commission to disallow costs or expenses has passed, the Commission seeks to impose new requirements and arbitrarily disallow nearly $4,300,000 in DDU's rate base.

In addition, there is no evidence in the record to support the Commission's conclusions and findings that the costs incurred by Double Diamond – Delaware, whether by DDU, its parent company, its predecessors or an affiliate, were intended to be contributions of cost-free capital. The Commission's decision is arbitrary, capricious, and an abuse of discretion. The final rates set by the Commission are unjust and unreasonable and not in the public interest because they deny DDU the opportunity to earn a reasonable return on its investment and recover its reasonable and necessary operating expenses.

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[4] DDU Ex. 12, DDU Depreciation Schedule; WBRG-8, Confidential Exhibit – Response to WBRG 4-3, DDU16-016086, Excerpts from Double Diamond Financial Statements DDU003567-DDU003568, DDU003571-DDU003572, DDU003576-DDU003577, DDU003580, DDU003584, 2015 Depreciation and Amortization Report, DDU16-015470 to DDU16-015475.

[5] DDU's rate case expenses will be dealt with in PUC Docket No. 47748, but currently amount to nearly $400,000 or more.

Point of Error No. 2. The Commission erred in finding that only seven assets paid for by the utility could be included in rate base. (FOF No. 100, 100A, 100B, 100C, and 100D, and COL Nos. 8A, 8B, 9, 11, 12).

As discussed above, DDU presented ample evidence to support its investment in the utility and for the Commission to find and conclude, without evidentiary support, that a utility owner would simply donate cost-free capital to the public is arbitrary and capricious. The evidence shows that DDU, and its owner, intended to contribute 80% of certain assets of the system as it was initially being constructed, but that the remainder were to be considered invested capital and retained on the utility's books.[6] There is no evidence to the contrary. And, as discussed above, §13.1871 of the Texas Water Code required the Commission to evaluate the sufficiency of DDU's application and supporting documentation with regard to the Commission's rules well before the hearing commenced.[7]

The Order seeks to impose a new requirement and burden of proof on DDU to show that its assets are *contributed by the utility.* Nothing in the plain language of the Texas Water Code, Chapter 13, or the Commission rules requires such a showing or even explains what is meant by the Commission's use of the phrase "contributed by the utility."[8] The statute cited in the Order provides only:

> In any proceeding involving any proposed change of rates, the burden of proof shall be on the utility to show that the proposed change, if proposed by the utility, or that the existing rate, if it is proposed to reduce the rate, is just and reasonable.[9]

This new burden of proof related to the requirement to show that rate base is *contributed by the utility* is neither clear nor established by statute or rule. For the first time, the Commission seeks to impose a new requirement on DDU that deviates from prior rules and practices without any prior notification or explanation. The Commission's new requirement as stated in the Order is that

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6 Tr. at 65:13-66:12, 67:6-69:13 (Gracy Cross) (Oct. 24, 2017); Ex. DDU-11, Rebuttal Testimony of Jay Joyce at 22:8-23:6 (Oct. 16, 2017); DDU Ex. 12, DDU Depreciation Schedule; WBRG-8, Confidential Exhibit – Response to WBRG 4-3, DDU16-016086, Excerpts from Double Diamond Financial Statements DDU003567-DDU003568, DDU003571-DDU003572, DDU003576-DDU003577, DDU003580, DDU003584, 2015 Depreciation and Amortization Report, DDU16-015470 to DDU16-015475.

7 TWC §13.1871(d) and (e).

8 Order on Rehearing, Conclusion of Law 8, p. 67 (Dec. 12, 2019).

9 TWC §13.184(c).

the only way to meet this new requirement is to show canceled checks of the payment for the asset from the utility.[10]

In *Oncor Elec. Delivery Co. v. Pub. Util. Comm'n of Tex.*, the utility challenged the Commission's order that imposed a new requirement on the utility to obtain prior authorization before certain rate case expenses from prior proceedings and outside the test year would be recoverable.[11] The court determined that *Oncor* had a right to know what is expected of it in the administrative process and held that the Commission acted arbitrarily and capriciously.[12]

As required by TWC §13.1871 and the *Oncor* case, DDU has a right to know what is expected of it in the administrative process and how to reconcile and account for a utility's invested capital. The Commission's decision is arbitrary, capricious, an abuse of discretion, and violates DDU's due process rights. The final rates set by the Commission are unjust and unreasonable and not in the public interest as a result.

Point of Error No. 3. The Commission erred in concluding that Double Diamond did not 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). (FOF Nos. 87, 88 and COL Nos. 8, 8A, 8B, 9, 11, 12)

Under the Texas Water Code, there are only two types of contributions that may have an impact on a utility's rate base: (1) customer contributions in aid of construction; and (2) developer or governmental entity contribution in aid of construction. Throughout the ratemaking process DDU has carried the burden of proof that its rates are just and reasonable and further presented evidence that its invested capital is not developer contributions.[13] The Commission's conclusion that DDU has the 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* is a new requirement and burden of proof. This new burden of proof is not clear, or established by statute or rule, and its imposition on DDU for the first time at hearing is not allowed under the law.

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[10] Order on Rehearing, p. 27-28 (Dec. 12, 2019).

[11] *Oncor Elec. Delivery Co. v. Pub. Util. Comm'n of Tex.*, 406 S.W.3d 253 (Tex. App.—Austin 2013, no writ).

[12] *Id.* at 272.

[13] *See* discussion in Points of Error 1 and 2, above.

As required by TWC §13.1871 and the *Oncor* case, DDU has a right to know what is expected of it in the administrative process and how to reconcile a utility's invested capital. The Commission's decision is arbitrary, capricious, an abuse of discretion, and violates DDU's due process rights. The final rates set by the Commission are unjust and unreasonable and not in the public interest as a result.

Point of Error No. 4. The Commission erred in setting rates that were based upon a rate base that excluded the amounts determined to be developer contributions by the Commission in violation of the United States and Texas Constitutions. (FOF Nos. 80A, 80B, 87, 87B, 88, 90A, 90B, 90C, 93, 93A, 93B, 93C, 93D, 93E, 93F, 93G, 93H, 93I, 100, COL Nos. 8, 8A, 8B, 9, 11, 12, and Ordering Provisions 2, 4, 5, 6, and 7)

The United States and Texas Constitutions safeguard private property from government takings.[14] DDU has a legal obligation to provide service,[15] and is entitled to earn a return on its property that is used and useful in rendering service to the public.[16] The Commission's decision to exclude nearly all of DDU's investment in the White Bluff water and sewer systems is effectively a government taking of DDU's property through its regulatory process.

As an investor owned utility, DDU made an investment in its assets upon which it is entitled to earn a return. The Commission's decision is arbitrary, capricious, an abuse of discretion, and a violation of DDU's constitutional rights. The final rates set by the Commission are unjust and unreasonable and not in the public interest because they deny DDU the opportunity to earn a reasonable return on its investment and exclude DDU's invested capital in its rate base, which is a taking and confiscation of DDU's private property for public use.

Point of Error No. 5. The Commission erred in concluding that costs of grinder pump replacements during the test year should be capitalized based on erroneous findings that costs to purchase replacement

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14 United States Constitution, Fifth Amendment, and Texas Constitution, Art. I, § 17(a).

15 Water Certificate of Convenience and Necessity (CCN) No. 12087 and sewer CCN No. 20705.

16 TWC §13.183(a).

grinder pumps are not operation and maintenance expenses. (FOF No. 38D, 38E, 38F and 38M and COL Nos. 11, 12).

There is no evidence to support the Commission's conclusions related to treatment of grinder pump costs. DDU's engineering expert, Dr. Victoria Harkins,[17] who holds a Ph.D. in Civil Engineering and is a registered professional engineer in Texas with 20 years of experience in the utility industry[18] – was the sole witness in the proceeding with any experience in the operation and maintenance of grinder pumps.[19] In fact, Dr. Harkins was the only witness with any experience at all in designing and operating utility systems.[20] No other witnesses challenged her expert testimony that grinder pumps require constant repair and maintenance.[21] The Administrative Law Judge recognized this fact in preparing the proposal for decision and recommending that the costs be expensed.[22]

The Commission fails to justify its deviation from the proposal for decision as required by Tex. Gov't Code Ann. § 2003.049. There is no credible evidence in the record to support its findings and conclusions. No Commission witness had any experience or understanding of the operation of grinder pumps.

On the other hand, Dr. Harkins explained at length the challenges of maintaining grinder pumps in a wastewater system.[23] Based upon her review of 10 years of DDU's grinder pump invoices, Dr. Harkins testified that the grinder pump costs are recurring costs every year and that those cost should be expensed and not capitalized.[24] She also provided testimony about how the costs should be treated if the Commission Staff decided to require recurring grinder pump repair costs to be capitalized.[25]

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[17] Strangely, the Commission's Order seems to discount and disparage Dr. Harkins extensive experience and education by changing all references to her in the Order from "Dr. Harkins" to "Ms. Harkins." It is surprising that such an effort was made, especially given that Dr. Harkins has earned her extensive experience through years of education and work, as shown on her résumé (Exhibit DDU-5A).

[18] Ex. DDU-5, Pre-filed Direct Testimony of Dr. Victoria Harkins (Attachment DDU-5A), page 12 of 52 through page 23 of 52 (Aug. 4, 2017).

[19] Tr. at 484:6-7 (Harkins Direct) (Oct. 26, 2017).

[20] Tr. at 343:16-344:10 (Sears Cross) (Oct. 25, 2017); Tr. at 304:23-306:3 (Mathis Cross) (Oct. 25, 2017).

[21] Tr. at 484:6-485:12 (Harkins Direct) (Oct. 26, 2017).

[22] Proposal for Decision, p. 16 (Feb. 13, 2018).

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

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

[25] Ex. DDU-9, Pre-filed Rebuttal Testimony of Dr. Victoria Harkins, at page 4 of 527 through page 5 of 527 (Oct. 16, 2017).

DDU has filed several rate applications and has always treated the grinder pumps and grinder pump repairs as recurring expenses.[26] Staff also states that DDU's prior year costs have already been recovered in rates[27] — but there is no evidence in the record that these costs have been recovered. The prior rates were based on a settlement, and DDU filed this rate application because it was not recovering its costs as shown in the application documents themselves.[28] There has been no change in treatment of these costs by DDU that would require a change in the recovery of these costs. The costs have been treated and continue to be appropriately treated as annual expenses. The chart below summarizes the recurring grinder pump expenses established by DDU Exhibit 9C:

Chart 1

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

As Chart 1 shows, DDU incurs recurring expenses related to grinder pump repairs. Dr. Harkins' recommendation to classify these costs as expenses because of their recurring nature is reasonable and justified.

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

27 Staff's Exceptions at p. 8-9 (Mar. 28, 2018).

28 Ex. DDU-1 and DDU-2.

And, as discussed above, §13.1871 of the Texas Water Code required the Commission to evaluate the sufficiency of DDU's application and supporting documentation with regard to the Commission's rules well before the hearing commenced.[29] To determine after that fact that DDU's documentation was insufficient, violates the Commission's statutory mandate.

There is more than sufficient evidence in the record to support the Administrative Law Judge's findings on this issue, and the Commission erred in changing the recommendation in the proposal for decision. The Commission's decision is arbitrary, capricious and an abuse of discretion. The final rates set by the Commission are unjust and unreasonable and not in the public interest because they do not include these costs as expenses.

Point of Error No. 6. The Commission erred in adopting findings of facts regarding NARUC system of accounts because there is no evidence regarding NARUC accounting in the record (FOF No. 38J, 38K and 38L, COL Nos. 11 and 12, and Ordering Provisions 2 and 4).

The Commission's Order on Rehearing extensively discuss the requirements of the NARUC system of accounts and DDU's books as a foundation to its decision to exclude assets from DDU's rate base and certain costs and expenses from DDU's revenue requirements. Whether DDU used the NARUC system of accounting was not an issue raised by any party at the hearing. In fact, there is absolutely no testimony, either written or live, regarding the NARUC system of accounting, whether DDU's accounting records were adequately maintained using the NARUC system of accounts or any other uniform system of accounts. The Commission's discussion and findings related to NARUC are not supported by any evidence at all in the record.

The Commission's decision is arbitrary, capricious, an abuse of discretion, and a violation of its statutory mandate. The final rates set by the Commission are unjust and unreasonable and not in the public interest because they are based upon findings of fact and conclusions of law that are not supported by any evidence in the record.

B. Rate of Return Errors

Point of Error No. 7. The Commission erred concluding that the rate of return on equity should be 8.79% based upon the erroneous finding that a reasonable return can be based upon a discounted cash flow

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[29] TWC §13.1871(d) and (e).

analysis employed with the capital asset pricing model standing alone and without a risk premium. (FOF Nos. 110, 111, 112, 114, and 126, and COL Nos. 9, 10, and 12.)

Point of Error No. 8. The Commission erred in setting rates that are based upon an 8.79% return on equity. (FOF Nos. 110, 111, 112, 114, and 126, COL Nos. 9, 10, and 12, and Ordering Provisions 2 and 4.)

The following discussion addresses Points of Error Nos. 7 and 8.

The Commission ignores both DDU's expert and the proposal for decision on this issue and bases its findings solely on Staff testimony. The Commission fails to justify its deviation from the proposal for decision as required by Tex. Gov't Code Ann. § 2003.049 because there is no evidence in the record to support its finding and conclusions that is credible.

DDU's expert on rate of return, Greg Scheig, has been providing expert analysis of return on equity for over 25 years.[30] He is a Certified Public Accountant and holds a Master of Business Administration in Finance and Accounting, along with numerous other relevant certifications.[31] By comparison, Staff's witness on this topic is not a Certified Public Accountant, does not have a Master's Degree, and has little to no experience with investment rate of return issues.[32]

There are two United States Supreme Court rulings that are oft-cited as establishing the legal criteria for determining a fair rate of return for regulated industries such as utilities: *Bluefield Water Works and Improvement Co. v. Public Service Comm'n of West Virginia*[33] and *Federal Power Comm'n v. Hope Natural Gas Co.*[34] In *Bluefield*, the United States Supreme Court stated:

> A public utility is entitled to such rates as will permit it to earn a return on the value of property which it employs for the convenience of the public equal to that general being made ... on investments in other business undertakings *which are attended by corresponding risks and uncertainties*.[35] (emphasis added)

In the *Hope* decision, the United States Supreme Court broadened the concept of a reasonable return to allow for increasing national competition for capital:

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

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

32 Staff Ex. 2, Attachment ES-1 – Résumé (Sept. 22, 2017).

33 *Bluefield Water Works and Improvement Co. v. Public Service Comm'n of West Virginia,* 262 U.S. 679 (1923).

34 *Federal Power Comm'n v. Hope Natural Gas Co,* 320 U.S. 591 (1944).

35 *Bluefield* at 692.

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. *By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks*.[36] (emphasis added)

The proposal for decision recommended that the Commission approve a 9.84% return on equity ("ROE").[37] The recommended ROE in the proposal for decision excluded an adjustment for a "small stock risk premium" ("SSRP") and violates the principles of the *Hope* and *Bluefield* cases.

Additionally, the Staff witness' analyses have mathematical errors and does not adequately account for the risk of an illiquid common stock equity investment in a small private company such as DDU as required by *Hope* and *Bluefield*.[38] The Commission's decision to rely on only two limited and incorrect analyses, excluding other recognized financial models, results in a return on equity that does not adequately compensate DDU's equity investors for the risk of an illiquid common stock equity investment in DDU, a small private company.[39]

As DDU's expert noted, the Constant Growth DCF model relied upon by the Commission is based upon very simplistic assumptions which limit its reliability. Those assumptions are (1) a single, constant growth rate into perpetuity and (2) investors depend on dividends as their sole source of returns.[40] But, as DDU's expert testified, many growth companies never pay dividends, reflecting the expectation that equity capital will earn a higher rate of return for investors by reinvesting it in the business, rather than by paying a dividend.[41] In addition, the Commission erroneously relies upon a DCF analysis that "mechanically" averaged disparate growth rates for each comparable company, in a barometer group made without using informed judgment, resulting in an unsupportable conclusion. Simply averaging two growth rates, without any additional analyses, does not automatically result in a reliable conclusion.[42]

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36 *Hope* at 603.

37 Proposal for Decision, p. 66 (Feb. 13, 2018).

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

39 *Id.* at 7 of 123, lines 6-9.

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

41 *Id.* at 8.

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

There are also significant problems in the Commission's reliance on the Staff's CAPM analyses. The CAPM analyses are unreliable because of the assumptions of risk-free rate inputs, equity risk premia, and failure to consider a small stock risk premium.[43] Had the CAPM analysis used the 2018-2022 Blue Chip forecast rate of 3.80%, this would have increased the ROE by approximately 100 basis points to 9.68%.[44] The CAPM analysis also used a historical ERP, but a forward-looking ERP is a more reasonable input for the CAPM analysis because the CAPM is a forward-looking model.[45]

The Commission's application of the CAPM is more appropriate for larger public utilities, with which the Commission is familiar. Small private companies like DDU require an adjustment for small stock risk and lack of liquidity.[46] To adjust for this difference, a small stock risk premium (SSRP) must be utilized.[47]

And once again, as discussed above, §13.1871 of the Texas Water Code required the Commission to evaluate the sufficiency of DDU's application and supporting documentation with regard to the Commission's rules well before the hearing commenced. To determine after that fact that DDU's proposed rate of return on equity was inappropriate, violates the Commission's statutory mandate.

The Commission's failure to address these issues results in violations of the requirements in the holdings of *Hope* and *Bluefield.* The Commission's final rate excludes return calculated at an appropriate rate. Consequently, the Commission's decision is arbitrary, capricious, an abuse of discretion, and a violation of its statutory mandate, and the final rates set by the Commission are unjust and unreasonable and not in the public interest because the rate will not permit DDU "to earn a return on the value of property which it employs for the convenience of the public equal to that generally being made ... on investments in other business undertakings *which are attended by corresponding risks and uncertainties*.[48] (emphasis added).

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43 *Id.* at 11, lines 9-10.

44 *Id.* at lines 10-15.

45 *Id.* at 13, lines 1-2.

46 *Id.* at lines 11-14.

47 *Id.* at 21, lines 13-15.

48 *Bluefield* at 692.

C. Operating Expense Errors

Point of Error No. 9. **The Commission erred in finding that the labor costs associated with two individuals who are employed by the utility to work on the utility systems and spend less than 1% of their time working on new taps are not reasonable and necessary and should be excluded from operations and maintenance expense. (FOF Nos. 23Q, 26D, 26E and 26F, COL Nos. 6A, 9 and 12.)**

Point of Error No. 10. **The Commission erred in finding that Double Diamond did not provide any supporting documentation explaining or detailing the duties of the two individuals who are employed by the utility to work on the utility systems and spend less than 1% of their time working on new taps. (FOF Nos. 23Q, 26E, and 26F, COL Nos. 6A, 9 and 12.)**

The following discussion addresses Points of Error Nos. 9 and 10.

Section 13.1871 of the Texas Water Code required the Commission to evaluate the sufficiency of DDU's application and supporting documentation with regard to the Commission's rules well before the hearing commenced. To determine after that fact that DDU's documentation was insufficient, violates the Commission's statutory mandate.

Nonetheless, DDU presented evidence to show costs for these employees as well as testimony that the employees work on the utility systems through Randy Gracy.[49] There is no evidence to the contrary. The Commission's Order cites to the Staff's position that:

> Because Double Diamond Utilities did not provided [sic] 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.[50]

The Commission then states that:

> Double Diamond Utilities did not provided [sic] any documentation explaining or detailing what these other duties include. In addition, 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

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[49] DDU Ex. 3, Direct Testimony of Randy Gracy at 15:3-8 (Aug. 4, 2017); DDU Ex. 3-E, Tap Expense Calculations, at page 27 of 27 (Aug. 4, 2017); DDU Ex. 8, Rebuttal Testimony of Randy Gracy at 4:14-5:4 (Oct. 16, 2017); Staff Ex. 2A, Workpapers of Emily Sears, at ES Workpaper 5 (Sept. 22, 2017).

[50] Order on Rehearing, p. 7 (Dec. 12, 2019).

> a backhoe and equipment operator, or the experience and skill level of these employees.[51]

This is the Commission's only justification for changing the recommendation of the Administrative Law Judge in its Order on Rehearing.

Neither the Texas Water Code nor the Commission's Rules contain a requirement or standard for justification of employee labor expenses.[52] Nor is there any Commission guidance related to this "standard" cited by the Commission in its Order on Rehearing. Neither the Commission Application form or its instructions provide any guidance, and the Staff did not ask any questions in discovery for the types of evidence now cited by the Commission as justification for denying DDU's costs.

The only evidence in the record is that these two employees work for the White Bluff water and sewer systems and that a very limited amount of their time is spent installing taps.[53] There is no evidence to suggest anything otherwise.

As required by TWC §13.1871 and the *Oncor* case, DDU has a right to know what is expected of it in the administrative process and how to justify its operating expenses. The Order on Rehearing imposes a new requirement and burden of proof on DDU. The Commission's decision is arbitrary, capricious, an abuse of discretion, and a violation of its statutory mandate. The final rates set by the Commission are unjust and unreasonable and not in the public interest because the rates exclude these labor costs.

Point of Error No. 11. The Commission erred in concluding that the costs associated with an application to amend a certificate of convenience and necessity should be excluded from the operation and maintenance expenses in the revenue requirement because it is not a recurring expense. (FOF No. 46B, COL Nos. 6A, 9 and 12.)

The Commission erred in excluding the costs associated with DDU's application to amend its certificate of convenience and necessity (CCN). The Commission adopts its Staff's recommendation to remove $2,907 in costs for a CCN application related to The Cliffs. While

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[51] *Id.* at pages 3-4.

[52] TWC Chapter 13 and PUC Substantive Rules Chapter 24.

[53] DDU Ex. 3, Direct Testimony of Randy Gracy at 15:3-8 (Aug. 4, 2017); DDU Ex. 3-E, Tap Expense Calculations, at page 27 of 27 (Aug. 4, 2017); DDU Ex. 8, Rebuttal Testimony of Randy Gracy at 4:14-5:4 (Oct. 16, 2017); Staff Ex. 2A, Workpapers of Emily Sears, at ES Workpaper 5 (Sept. 22, 2017).

DDU agrees with reclassifying these costs as an expense for The Cliffs and not White Bluff, DDU does not agree with complete removal of the costs. Investor owned utilities are required to obtain a certificate of convenience and necessity in order to operate legally in Texas.[54] DDU must incur CCN application costs in order to do business. The Commission's decision that this cost should not be recovered is unreasonable and unjust. The Commission bases its decision on the fact that it is a "non-recurring expense."[55] The Commission is required to "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..."[56] There is no requirement in the Texas Water Code or in the Commission's rules related to "recurring expense." The only requirement is that the expense be reasonable and necessary and occur within the test year.[57] DDU's expense for its CCN amendment is reasonable and necessary and was incurred during the test year as discussed in the proposal for decision. There is more than sufficient evidence in the record to support the Administrative Law Judge's findings on this issue, and the Commission erred in changing the recommendation in the proposal for decision.

The Commission is once again attempting to impose a new requirement on DDU that results in excluding reasonable and necessary expenses. At a minimum, DDU's costs should be amortized over a period of time. DDU proposes the same three-year period use for the wastewater permit costs.

As required by TWC §13.1871 and the *Oncor* case, DDU has a right to know what is expected of it in the administrative process and how to justify its operating expenses. The Order on Rehearing imposes a new requirement and burden of proof on DDU. The Commission's decision is arbitrary, capricious, an abuse of discretion, and a violation of its statutory mandate, and the final rates set by the Commission are unjust and unreasonable and not in the public interest because they exclude costs associated with maintaining its certificate of convenience and necessity.

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54 Texas Water Code §13.242.

55 Order on Rehearing, p.16.

56 Texas Water Code §13.183(a)(1).

57 Texas Water Code §13.185(d).

Point of Error No. 12. The Commission erred in concluding that the costs associated with overhead for use of facilities located at the White Bluff and The Cliffs resorts should be excluded from the operation and maintenance expenses in the revenue requirement because there is no evidence to support the reasonableness of the allocation. (FOF Nos. 65L, 65M and 65N and COL Nos. 6E, 9 and 12.)

The Commission erred in excluding the costs associated with DDU's overhead. The Commission adopts its Staff's recommendation in post-hearing briefing that DDU's requested resort overhead allocation should be removed.[58] The Commission finds and concludes that DDU's allocation of costs was unsupported by any evidence in the record.

The record demonstrates that the costs are reasonable and necessary and not affiliated transactions. Mr. Gracy testified at length about how the expense allocations were developed based upon historical costs.[59] Mr. Gracy explained that the 3% allocation was a weighted average with some costs appropriately allocated to the utility being more than 3% and some being less.[60] The overall impact is that allocation of 3% of resort overhead, or $12,000/year, is reasonable for the services that the utility receives from the resort as Mr. Gracy's testimony demonstrates.

The Administrative Law Judge properly addressed the issue of affiliated costs by determining that "[i]t appears from the evidence that these are costs incurred by the resort, 3% of which are then expensed to DDU, and the Administrative Law Judge finds no support in the statute for an argument that this allocation would constitute a payment for such costs."[61] The Administrative Law Judge also finds that the "contention assumes that the alleged payments are made to an 'affiliated interest' as defined by Texas Water Code § 13.002(2), but [the protestants] cites to no evidence proving that payments were made to a corporation meeting the statutory definition."[62] The Commission Order provides no justification for modifying this decision by the Administrative Law Judge.

In fact, the issue of affiliated costs was first raised by the White Bluff Ratepayer's Group and Commission Staff in post-hearing briefing and after the hearing had concluded. If this was an issue, the Commission was required to raise it within a reasonable time after the application was

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58 Order on Rehearing, p. 18-19 (Dec. 12, 2019).

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

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

61 Proposal for Decision, p. 26 (Feb. 13, 2018).

62 *Id.*

filed by TWC §13.1871 by requiring DDU to supplement its application or rejecting the application. DDU had no notice of this post-hearing change in position and requirement. The Commission is once again attempting to impose a new requirement without notice on DDU, which is prohibited by law.

As required by TWC §13.1871 and the *Oncor* case, DDU has a right to know what is expected of it in the administrative process and how to justify its operating expenses. The Order imposes a new requirement and burden of proof on DDU. The Commission's decision is arbitrary, capricious, an abuse of discretion, and a violation of its statutory mandate. The final rates set by the Commission are unjust and unreasonable and not in the public interest because the rates exclude these reasonable and necessary expenses.

Point of Error No. 13. The Commission erred in concluding that the depreciation expense for assets identified in the trending study should be excluded from operation and maintenance expense even though the trending study was reasonable and the assets used and useful. (FOF Nos. 68C, 68D, 68E, 74, 74A and 74B, and COL Nos. 8D, 9, 11 and 12).

The Commission erred in excluding the value of assets identified in the trending study from the depreciation to which DDU is entitled.[63] This is an error of over $46,000 for the White Bluff revenue requirement and over $24,000 for The Cliffs revenue requirement. The Commission erroneously concluded that there were historical records available to verify the original costs. There is no evidence in the record to support such a finding. There is extensive testimony about such records being unavailable.[64] The Commission bases its findings on assertions that Tim Grout, DDU's Chief Financial Officer at the time of the hearing, admitted that records were available. However, Mr. Grout's testimony was related to "whether the collection system and distribution, the lines, at White Bluff ... were recorded in an account balance somewhere."[65] Mr. Grout did testify that those costs were included in the balance sheet if they were included on the depreciation list.[66] Mr. Grout also stated that any costs entered on the balance sheet were likely supported by

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[63] Order on Rehearing, Findings of Fact 59 through 67 and 68A through 74B (Dec. 12, 2019).

[64] DDU Ex. 5, Direct Testimony and Exhibits of Victoria Harkins, page 5, line 2 through page 6, line 16 (Aug. 4, 2017); Tr. 157: 14-17 and 158: 10-22 (Grout Cross) (Oct. 24, 2017).

[65] Tr. 158: 10-13 (Grout Cross) (Oct. 24, 2017).

[66] Tr. 158: 16-18 (Grout Cross) (Oct. 24, 2017).

an invoice.[67] What the Commission fails to acknowledge, is that Mr. Grout also testified that within DDU's financials, "you can go into the balance sheet and look at detail; but unfortunately, a lot of that detail is one-line, lump-sum numbers."[68] The Intervenors have argued that Mr. Grout's testimony is proof positive that there are historical records of the cost of the utility lines with White Bluff. This conclusion does not follow from Mr. Grout's testimony. In fact, Mr. Grout's testimony supports the idea that while there may be lump sum entries in the financials, there is no detail on particular assets. This is exactly what Dr. Harkins found and why she completed the trending study for the assets that had no supporting documentation.

Consequently, the Commission's decision is arbitrary, capricious, an abuse of discretion, and a violation of its statutory mandate, and the final rates set by the Commission are unjust and unreasonable and not in the public interest because they do not permit DDU to recover depreciation expense on its used and useful assets in accordance with TWC § 13.185(j).

III. CONCLUSION

DDU raises 13 points of error, covering errors in the calculation of rate base, errors in the calculation of rate of return and errors in the calculation of operating expenses to be included in the rates. Further, DDU's points of error show that the Commission, through its decision, is imposing upon DDU new requirements that are not contained in the Water Code or any Commission rule. The product of these errors is that the rates set by the Commission are unjust and unreasonable and against the public interest. The errors demonstrate a decision that is arbitrary, capricious, amounts to an unlawful taking, and is an abuse of discretion. For these many reasons, DDU's Motion for Rehearing should be granted in its entirety.

WHEREFORE, PREMISES CONSIDERED, Double Diamond Utility Company, Inc., respectfully requests that the Public Utility Commission of Texas grant its Motion for Rehearing, as set forth above, in all respects and grant Double Diamond Utility Company, Inc., such other and further relief to which it may be entitled.

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67 Tr. 158: 22 (Grout Cross) (Oct. 24, 2017).

68 Tr. 157: 14-17 (Grout Cross) (Oct. 24, 2017).

Respectfully submitted,

By: _____

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CERTIFICATE OF SERVICE

I hereby certify that I have served or will serve a true and correct copy of the foregoing document via hand delivery, facsimile, electronic mail, overnight mail, U.S. mail and/or Certified Mail Return Receipt Requested to all parties on this the 6th day of January 2020.

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John Carlton