

State Office of Administrative Hearings



Shelia Bailey Taylor
Chief Administrative Law Judge

October 16, 2007

TEXAS
COMMISSION
ON ENVIRONMENTAL
QUALITY
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CHIEF CLERKS OFFICE

VIA FACSIMILE 512/239-5533

Celeste Baker
Acting General Counsel
Texas Commission on Environmental Quality
PO Box 13087
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Re: SOAH Docket Nos. 582-05-2770 and 582-05-2771; TCEQ Docket Nos. 2004-1120-UCR and 2004-1671-UCR; In Re: Application by Aqua Development Company and Aqua Utilities, Inc. d/b/a Aqua Texas, Inc. to Change Water and Sewer Tariffs and Rates in Various Counties

Dear Mr. Seal:

We have reviewed the exceptions and replies to exceptions to the Proposal for Decision (PFD) in this case. At this time, we are not making any changes to either the PFD or the proposed order that we have presented to the Commission. Therefore, we continue to stand by the analyses presented in the PFD and we recommend that the Commission adopt the proposed order. However, we do wish to respond to some of the exceptions to clarify our recommendations.

Aqua Texas' Exceptions

Aqua Texas has excepted to the ALJs' recommendation against allowing phased rates or a regulatory asset. Both of these issues are not fact-specific, but rather are legal issues that the Commission has discretion to decide as it sees fit. Therefore, the ALJs' recommendations are simply guidance, and the Commission may choose to decide the issues differently. However, the ALJs still believe their recommendations are appropriate, so they do not modify them at this time.

Aqua Texas also excepts to the ALJs' proposed disallowance of the municipal rate case expenses. Aqua Texas argues that, because the municipal rate case expenses are "associated" with this consolidated proceeding, they should be allowed to recover them in this case. Aqua Texas' argument ignores a significant fact—one which the ALJs believe makes it *entirely inappropriate* to allow the municipal rate case expenses to be recovered in this proceeding. Namely, the municipal rate cases that were previously consolidated in this docket have been severed and removed from this docket.

So, essentially, Aqua Texas is seeking to have ratepayers who live outside the municipalities and who have nothing to do with the municipal appeals pay for the municipalities' rate case expenses. This cannot be a reasonable interpretation of TEX. WATER CODE § 13.084, which allows a municipality's rate case expenses to be recovered in the proceeding in which they are incurred. That clearly anticipates that it will be the municipality's own residents who will primarily be reimbursing the rate case expenses—because they were the ones who benefitted from the municipality's participation in the case (ostensibly on the residents' behalf). The ALJs believe that it is entirely untenable to shift those costs to ratepayers who have no relationship whatsoever to the municipality nor to the service provided under the municipality's jurisdiction. Therefore, the ALJs strongly recommend that these costs be disallowed in this case.

Lastly, Aqua Texas excepts to the ALJs' recommendation for the apportionment of rate case expenses. In its exceptions, Aqua Texas states that the "ALJs also propose that Aqua Texas' total rate case expenses should be reduced by a proportion equal to the number of non-settling customers divided by the total number of customers served." That is a complete mischaracterization, as the ALJs have made no such recommendation.

Rather, as it states on page 76 of the PFD, the ALJs "recommend that Aqua Texas recover the allowed rate case expenses from all of the company's systems." Therefore, the ALJs have not proposed a reduction to rate case expenses. Any reduction would be the result of Aqua Texas' settlement agreements, not the ALJs' recommendations. If Aqua Texas has chosen to forego the recovery of rate case expenses from settled systems, that is a result of its business decision and the Commission should not penalize customers who are served by other systems (who may have never even challenged the rate change in the first place) because of Aqua Texas' settlement decision. Fairness dictates that rate case expenses be apportioned across all systems covered by the initial application in this proceeding, without regard to whether those systems have settled or not.

However, the ALJs do agree that Aqua Texas should be permitted to request and recover rate case expenses accrued between February 19, 2007, and the issuance of a final order by the Commission, pursuant to TEX. WATER CODE §§ 13.043(e), 13.084, and 13.185(d).

ED's Exceptions

The ED has excepted to the ALJs' proposed treatment of the deferred expenses. While the ALJs do not necessarily disagree with the ED's recommendation that Aqua Texas' recovery for deferred expenses be reduced by any over-recovery because of higher rates than those finally set by the Commission, the ED's discussion can somewhat confusing, leading to the blending of deferred expenses with deferred revenues. This is not an accurate representation, however, of what has occurred. For the Commission to decide the deferred expense issue, it need only determine that deferred expenses are reasonable. In this case, the expenses that were deferred have been outlined in the evidence and, by letter, the ED previously allowed Aqua Texas to defer them. In this case, the ED has also reviewed Aqua Texas' expenses and disallowed those found to be unreasonable. Therefore, no additional adjustment is needed for the deferred expenses. Aqua Texas adequately addresses this issue in its response to exceptions, and the ALJs will offer nothing further other to note their agreement with Aqua Texas on this issue.

In regard to the ED's recommendation to offset any deferred expense surcharge with any over-collection by Aqua Texas during the pendency of this case, that argument has some merit. It would seem somewhat inefficient to allow Aqua Texas to recover by a surcharge its uncollected expenses, while at the same time making refunds in some fashion for prior over-collections. For simplicity, the ED's request to offset the deferred recovery surcharge by any over-collections is reasonable. The specific methodology and amounts can be better determined once the Commission has ruled upon the various rate issues in this case.

The ED also excepts to the ALJs' recommended allowance of \$93,559.52 in rate case expenses for the services of Severn Trent, Mattias Jost, and Peter Marek. The ED points out that Aqua Texas was later required by the ED to use actual numbers from 2004, instead of pro forma numbers for the second half of the test year. Yet, Aqua Texas offered credible testimony that Mattias Jost and Peter Marek developed accurate bill analysis for the revenue requirement and ultimately rate design. Severn Trent gathered the information used by Marek and Jost. Furthermore, both Jost and Marek assisted in discovery responses. The ALJs continue to recommend that Aqua Texas be permitted to recover these expenses as reasonable and necessary, because at the time the expenses were incurred, Aqua Texas' approach was justified. In a case of this magnitude, Aqua Texas was entitled to develop a methodology and pursue it, although some of the information was later determined to be irrelevant.

Finally, the ED excepts to the ALJs' conclusion that Aqua Texas has not double collected \$62,015.61 in corporate charges. As noted in the PFD, the ALJs found Aqua Texas witness Richard Hugus to be credible and his explanation for the corporate charge entries to be persuasive. Therefore, the ALJs do not alter their recommendation on the corporate charges.

Protestants' Exceptions

The Protestants' exceptions are largely reiterations of their post-hearing briefing and those arguments are already addressed in the PFD. Therefore, the ALJs do not specifically respond to those exceptions but rather defer to the discussion in the PFD.

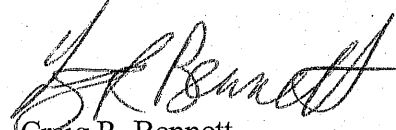
Other Issues

In exceptions, the ED acknowledged that an additional \$2,058.034, as a working capital allowance, should be included in the ED's rate-setting data set forth by the ALJs in the PFD. Therefore, this amount should be included in the rate-setting calculations performed based off the ED's figures which were adopted as correct by the ALJs. This reduces the overall discrepancy between Aqua Texas' figures and the ED's figures to less than 1%. This is not a change in recommendation from the PFD, but merely reflects the correct numbers from the ED's rate-setting data.

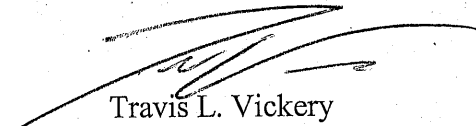
Both Aqua Texas and the ED have presented unphased rates that purportedly incorporate the recommendations in the PFD. However, their rates are not the same. This discrepancy may be due to the use of different customer counts or gallonage charges. Regardless, it is not necessary to resolve this at this time. Rather, once the Commission rules on the issues presented in the PFD, the parties, with the assistance of the ALJs if needed, should be able to resolve these discrepancies and reach an agreement on appropriate rates using the same rate determinants. This can be done through the rate-setting procedure outlined on page 78 of the PFD.

In conclusion, we continue to maintain the recommendations contained in the PFD. From our perspective, this matter may be set for Open Meeting at the Commission's earliest convenience, and the ALJs will appear and be prepared to answer any questions the Commissioners may have at that time.

Sincerely,



Craig R. Bennett
Administrative Law Judge



Travis L. Vickery
Administrative Law Judge

CRB/l
cc: Mailing List