

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY



AN ORDER

DENYING THE APPLICATION OF BUENA VISTA WATER SYSTEM TO INCREASE ITS RATES, ORDERING IT TO LOWER THE RATES IT WAS CHARGING BEFORE IT FILED ITS APPLICATION, AND CHANGING ITS TARIFF UNDER CERTIFICATE OF CONVENIENCE AND NECESSITY NO. 11656, BURNET COUNTY, TEXAS

**SOAH DOCKET NO. 582-08-2245
TCEQ DOCKET NO. 2007-1878-UCR**

On _____, the Texas Commission on Environmental Quality (TCEQ or Commission) considered the application of Kathie Bryant, doing business as Buena Vista Water System, to change water rates and tariff, under Certificate of Convenience and Necessity No. 11656, in Burnet County, Texas. A Proposal for Decision (PFD) was presented by William G. Newchurch, an Administrative Law Judge (ALJ) with the State Office of Administrative Hearings (SOAH).

After considering the ALJ's PFD, the Commission adopts the following Findings of Fact and Conclusions of Law:

I. FINDINGS OF FACT

Introduction

1. Kathie Bryant, does business as Buena Vista Water System, and provides retail water utility service under Certificate of Convenience and Necessity No. 11656, in Burnet County, Texas.

2. Although Buena Vista is not a separate entity and is simply Ms. Bryant's trade name, it is frequently necessary in this Order to distinguish between utility activities and expenses and Ms. Bryant's personal activities and expenses.
3. To limit confusing and awkward writing, this Order will refer to the utility business in a gender-neutral manner, as Buena Vista, Applicant, or Utility and will refer to Ms. Bryant by name only when the discussion concerns her private activities and expenses.

Procedural History and Jurisdiction

4. On June 11, 2007, Buena Vista filed its application to increase its water rates and amend its tariff.
5. The effective date of the increase was September 1, 2007.
6. Notices of the application were mailed to Buena Vista's customers and other affected parties on July 17, 2007.
7. More than ten percent of the Utility's customers filed protests by the applicable deadline.
8. On March 13, 2008, the Commission's Chief Clerk referred the application to SOAH for hearing.
9. On March 20, 2008, the Chief Clerk mailed notice of a preliminary hearing to the Applicant; and on April 1, 2008, the Applicant mailed that same notice to its customers and affected municipalities.
10. The notice contained a statement of the time, place, and nature of the hearing; a statement of the legal authority and jurisdiction under which the hearing was to be held; a reference

to the particular sections of the statutes and rules involved; and a short, plain statement of the matters asserted.

11. On June 2, 2008, the ALJ held the preliminary hearing as indicated in the notice. The following attended and were admitted as parties:

PARTY	REPRESENTATIVE
Buena Vista	Kathie Bryant
ED	Ron M. Olson
OPIC	Eli Martinez
Protestants	Michael Wortham

12. No party disputes either the Commission's or SOAH's jurisdiction.
13. The ALJ held the hearing on the merits of the application on October 13, 2008, and all of the Parties appeared. However, George Freitag and Nancy Donnelly, rather than Ms. Bryant, represented the Applicant at the hearing on the merits.
14. Nancy Donnelly is the sister of Buena Vista's owner, Ms. Bryant.
15. The ALJ left the record open until October 27, 2008, for the Parties to present evidence and argument concerning Buena Vista's rate case expenses.

Overview of the Proposed Rate Increase

16. Buena Vista serves only residential customers. At the end of the test year, on December 31, 2006, it had 119 customers with 5/8 or 3/4-inch meters and three customers with 1-inch meters.

17. The Applicant set its proposed rates in order to have an opportunity to recover revenue of \$94,943.

18. If granted, Buena Vista's rates would change as follows:

	CURRENT	PROPOSED
Base monthly rate for 5/8 or 3/4-inch meter with zero gallons	\$33.00	\$40.00
Base monthly rate for 1-inch meter with zero gallons	\$48.41	\$53.41
Charge per 1,000 gallons	\$2.75	\$3.25
Transfer fee	\$0	\$20.00
Return check charge	\$20.00	\$25.00
Meter test fee	\$0	\$25.00

19. The proposed increase in rates would increase the Utility's revenue by \$14,431.13.

Comingling of Expenses and Funds

20. The Utility's financial records include numerous expenses that have nothing to do with providing water services. They are personal expenses of the owner, Ms. Bryant.

21. When utility and non-utility funds and expenses are comingled, review of rates becomes much more complicated and a cloud of doubt is cast over all of the expenses and investments claimed by the utility.

22. To avoid comingling and related problems in the future, Ms. Bryant should:

a. review any future construction and purchase costs closely and maintain her records according to National Association of Regulatory Utility Commissioners (NARUC) property accounts; and

b. use separate financial and accounting for her Buena Vista water-utility business.

Revenue Requirement

- 23. On the TCEQ rate-change application form, Buena Vista reported that its total cost of service during the test year was \$75,193, before deducting for \$1,072 in other revenue.
- 24. In its application, Buena Vista also contended that its rates should be set to allow it to recover an additional \$20,822 over and above its claimed test-year expenses. According to the Applicant, this additional amount is to account for known and measurable post-test-year changes in its cost of service.
- 25. An overview and breakdown of the Applicant’s claimed revenue requirement is given below:

	TEST YER PER APPLICANT (a)	APPLICANT ADJUSTMENT (b)	APPLICANT TEST YEAR (c)=(a)+(b)
Operations and Maintenance	\$65,149	\$9,039	\$74,188
Depreciation and Amortization	\$7,248	\$600	\$7,848
Other Taxes	\$2,796	\$679	\$3,475
Federal Income Taxes	\$0	\$1,588	\$1,588
Return	\$0	\$8,916	\$8,916
Revenue Requirement	\$75,193	\$20,822	\$96,015
Other Revenues – Taps	\$-1,072		\$-1,072
Base Rate Revenue	\$74,121	\$20,822	\$94,943

Return on Invested Capital

26. In its application, Buena Vista contends that it should receive a return of \$8,916 on the capital it has invested to provide water service.

Invested Capital

27. The Utility claims that it has usefully invested and used \$67,692 in capital to provide water service.
28. Except as discussed below, in the amounts that it claims, Buena Vista has usefully invested and used capital to provide water service in the amounts that it claims and no party contends otherwise.
29. In its application, Buena Vista claimed that its original cost of well pumps was \$5,869, against which had accumulated \$5,285 in depreciation, which left a net book value of \$584.
30. The Utility's original cost of various kinds of pumps was actually \$5,933.67, minus \$5,283 for depreciation, leaving \$649.67 in net plant.
31. Buena Vista has invested \$65.67 more in pumps than it stated in its application.
32. The Utility properly included \$348.40 for the original cost of a chemical feed pump but misclassified it as a cost of treatment. That cost should be reclassified. After depreciation of \$96, the chemical feed pump's net book value is \$253.
33. The Company failed to include \$1,791 for a turbidity monitor in its claimed invested capital, with depreciation of \$1,221, leaving net plant of \$570. This amount should be added to invested capital.

34. With regard to chlorinators, the Utility claimed \$5,052 in original cost, accumulated depreciation of \$1,990, leaving \$3,062 in net plant.
35. The Utility originally spent \$1,159 for a chlorinator; but it has been fully depreciated, and no investment for it should be allowed.
36. Buena Vista spent \$1,487 for a chlorine tester that it had either not claimed or misclassified. Its accumulated depreciation was \$843, yielding additional net plant of \$644.
37. In December 2006, Buena Vista spent another \$2603.95 for another chlorinator. This additionally amount was/was not used and useful to provide service during the test year and should/should not be added to invested capital.
38. In its application, Buena Vista claimed an original cost of \$3,114 for meters, with depreciation of \$1,862, leaving \$1,252 in net book value.
39. Customers have already paid for those meters through their tap fees and should not have to pay for them a second time through rates. The \$1,252 for meters should not be included in net plant in service for the purpose of calculating Buena Vista's return on investment.
40. The Applicant has a portable turbidimeter in service, which had an original cost of \$1,009 and has accumulated depreciation of \$534, leaving \$475 as net plant in service.
41. The Utility has two replacement meters in service, with original costs of \$90.04 and \$378.88, depreciation of \$15 and \$208, leaving \$75 and \$171 in net invested capital.
42. There is insufficient evidence to add additional meters to invested capital beyond those discussed above.

43. For office equipment, the Utility claimed in its application that it had originally spent \$3,542, which was depreciated by \$2,492, leaving \$1,050 in service.
44. There is no evidence to support \$1,210 of the claimed original cost of office equipment.
45. For a computer, billing software, and a credenza in service, the Utility spent \$810.79, \$962.52, and \$480.19, respectively. However, the first two items have been fully depreciated. After depreciation of \$346, the credenza's net plant of \$134 is still usefully invested and used to provide service.
46. The amount of office equipment included in investment capital is \$134, which is \$916 less than the Utility claimed. The \$916 should be disallowed.
47. Buena Vista spent \$349.99 for a printer in July 2007, but that was not used to provide water service during the test year.
48. In its application, Buena Vista included \$10,497 in its net book invested capital for a Dodge truck with an original cost of \$18,524 and accumulated depreciation of \$8,027.
49. A vehicle is to be depreciated in a straight line over five years.
50. The Dodge truck was put in service on October 1, 2003, which meant that it had depreciated for three years and three months by the end of the test year, on December 31, 2006.
51. The Dodge truck has been driven an average of 6,200 miles per year for all purposes.
52. The Dodge truck is used for both utility and no-utility purposes.

53. Ms. Bryant drives the Dodge truck from her home to the water plant nearly every day, which would be a round trip of 1.5 miles and equate to at least 550 miles per year for utility service.
54. The Dodge truck is driven up to 1,000 miles per year for utility purposes, and no party contends otherwise.
55. Sixteen percent of the Dodge truck's use is for utility purposes.
56. Based on the above, the original cost of the Dodge truck was \$18,524, the value that was used and useful to provide water service was \$2,964 (\$18,524 times 16 percent), the annual depreciation was \$593 (\$2,964 divided by 5), its accumulated depreciation at the end of the test year was \$1,927 (\$593 times 3.25), and its net plant in service was \$1,037 (\$2,964 minus \$1,927) at the end of the test year.
57. Because Buena Vista included \$10,497 in its net book invested capital for the Dodge truck, \$9,460 should be disallowed from its claimed invested capital amount.
58. Based on the above, the Utility's net capital invested in water service is \$ _____ as shown below:

CALCULATION OF NET PLANT INVESTED	
Claimed	\$67,692
Pumps	\$66
Turbidity Monitor	\$570
Meters	\$-1,252
Office Equipment	\$-916
Printer Purchase In July 2007	\$-350
Dodge Truck	\$-9,460
Other Disallowances	
Net Plant	

Rate of Return

59. The Applicant has notified customers on several occasions that trihalomethanes in the water were extraordinarily high and the problem has not been corrected.
60. In the water that the Applicant provides to its customers, chlorine levels fluctuate wildly, resulting in corrosion of customers' pipes.
61. At the end of its last rate case, the Commission denied the rate increase proposed by the Utility and ordered Buena Vista to refund with interest the amounts that it had over-collected by implementing the increase while that case was pending.
62. Buena Vista did not make the ordered refunds for two years following its last rate case.
63. Some adjustments to customers' bill were made after two years, but Buena Vista was unable to explain those adjustments to customers.
64. Buena Vista often provides low quality water to its customers and regularly over-bills them.
65. In its current application, Buena Vista uses a 12-percent rate of return to calculate the return on investment that it seeks.
66. No party disputes the 12-percent rate of return.
67. Based on the above, Buena Vista should receive a 12-percent return on its usefully invested and used capital.

Return on Invested Capital Summary

68. Based on the above, the just and reasonable 12-percent return on Buena Vista's \$_____ of capital usefully invested and used to provide water service is \$_____.

Operation and Maintenance Expenses Salary or Contract Services and Payroll Taxes

69. In its application, Buena Vista included \$15,000 in expenses and post-test-year adjustments for the salary paid to Ms. Bryant.
70. Ms. Bryant's salary is a necessary and reasonable expense of providing water service.
71. Buena Vista also included \$1,738 in its application for payroll taxes on Ms. Bryant's salary and on the amount that Ms. Donnelly was paid for her services during the last year.
72. Buena Vista listed the \$1,738 in payroll taxes as an expense in its records in 2006, but never paid that amount to the United States Internal Revenue Service (IRS).
73. The Utility filed a return with the IRS for a least one quarter indicating that it owed a portion of the payroll taxes.
74. An expense that is accrued in a test year should be included as an expense of that test year even if not paid until a later date.
75. Buena Vista continues to owe the payroll taxes, though it has not yet paid them, and the portion of them that was reasonable and necessary to provide water service was a test-year expense.

76. As set out below in this Order, \$4,200 of what Buena Vista paid Ms. Donnelly for accounting was reasonable and necessary to provide water service, but \$2,300 of it was not.
77. The portion of the \$1,738 in payroll taxes that was related to Ms. Bryant's \$15,000 salary and to the \$4,200 that Buena Vista reasonably and necessarily paid Ms. Donnelly for accounting related to water service was a necessary and reasonable expense of providing water service.
78. Based on the above, the necessary and reasonable amount of payroll taxes to provide water services during the test year was \$_____.
79. Based on the above, \$_____ of the \$1,738 that Buena Vista claimed in its application for payroll taxes was not reasonable or necessary to provide water service and should be disallowed.

Office Expenses

80. In its Application, the Utility claims that it spent \$9,759 during the test year for office expenses to provide water service.
81. Of the amount Buena Vista claimed for offices expenses, \$4,137 was also claimed as an expense for electricity service. The duplicative \$4,137 claimed as an office expense should be disallowed.
82. The Utility's office is in Ms. Bryant's home.
83. The cost of sealing Ms. Bryant's driveway, property taxes for a personal lot, and taxes paid for 2005 were claimed as office expenses but were not necessary and reasonable to

provide water service during the test year. The \$135 claimed for them should be disallowed.

84. Some of the claimed office expenses were for services provided to Ms. Bryant's home that were partially necessary to provide water service and partially for her personal benefit. These included Dish Satellite, personal phones, and residential propane, trash pickup, electricity, property tax, *etc.*
85. The Utility office occupies 7.24 percent of the floor space in Ms. Bryant's home.
86. Based on the above, 7.24 percent of the expenses described in Finding of Fact No. 84 were necessary and reasonable to provide water service; hence, \$208 of those office expenses should be disallowed.

Repairs and Maintenance

87. In its test year expenses, Buena Vista double-booked \$240 for electrical repair, which should be disallowed.
88. In its application, the Utility claimed \$330 that was actually for personal repair and maintenance expenses of Ms. Bryant and Tracy Dubose, her daughter. This \$330 should be disallowed.
89. Buena Vista claims a post-test-year adjustment to its repair and maintenance expenses to add \$3,200 that it necessarily and reasonably spent for repair and maintenance in 2007, after the test year, to provide water service. Among other things, this amount includes the costs of cleaning the sedimentation basin and for sludge disposal.
90. There is no evidence that Buena Vista's annual repair and maintenance expenses in the future would regularly be \$3,200 higher than what it spent in the test year.

91. Based on the above, the claimed \$3,200 post-test-year adjustment in repair and maintenance expenses is not based on known and measurable changes in the cost of providing water service after the test year and should be disallowed.

Accounting and Legal Expenses

92. Ms. Donnelly provided all of the accounting service that Buena Vista claims as expenses to provide water service.

93. Ms. Donnelly also provided accounting services to Ms. Bryant for her non-utility, personal transactions.

94. In its application, Buena Vista claimed \$500 for accounting service rendered by Ms. Donnelly concerning a previous rate-change application that was filed in 2004. This expense was incurred before the test year and should be disallowed.

95. In its application, Buena Vista also claimed \$6,500 in expenses for accounting services provided by Ms. Donnelly during the test year.

96. Ms. Bryant used the same checking accounts, credit cards, and accounting ledgers for her personal expenses and those related to her water-service business.

97. The personal transactions totaled at least \$29,990, which is approximately 40 percent of the revenue requirement that Buena Vista proposes in its application.

98. Based on the above, much of the accounting service that Ms. Donnelly provided during the test year was personal accounting for Ms. Bryant that was not related to Buena Vista's provision of water service.

99. Utilities that are similar in size to Buena Vista typically pay \$350 per month, or \$4,200 per year, for accounting services.
100. Based on the above, Buena Vista's accounting expense that was reasonable and necessary to provide water service during the test year was \$350 per month, or \$4,200 for the year. Thus, \$2,300 of the claimed test-year accounting expense should be disallowed.

Insurance Expense

101. Buena Vista claims a test-year expense of \$852 that was used to pay for a life insurance policy for Ms. Bryant that names her estate as the beneficiary.
102. The \$852 paid for the life insurance was a purely personal expense of Ms. Bryant to benefit her heirs and not an expense necessary to provide water service. The \$852 should be disallowed.
103. It is very common for businesses to provide health insurance benefits to their employees and officers.
104. The \$3,250 that Buena Vista paid during the test year for Ms. Bryant's health insurance was a necessary and reasonable expense of providing water service.

Miscellaneous Expenses

105. In its application, Buena Vista failed to claim \$5,230 in legitimate miscellaneous expenses that were necessary and reasonable to provide water service during the test year. That \$5,320 should be added to the Applicant's cost of service.

106. The test-year expenses claimed by the Utility included \$675 for personal expenses for Ms. Bryant and her family that were not necessary to provide water service and should be disallowed. These included:
 - a. \$304 for insurance and expenses for a Ford truck;
 - b. \$271 for credit-card interest due to non-utility expenses; and
 - c. \$50 in 2006 and \$50 in 2007 for a property owners' association fee on a personal lot.
107. As discussed above, only 16 percent of the use of the Dodge truck was for the water business.
108. Based on the above, only 16 percent of the insurance expense for the Dodge truck, or \$95.68, was necessary and reasonable to provide water service.
109. Based on the above, \$502.32 of the insurance expense for the Dodge truck should be disallowed.
110. Buena Vista claims \$1,353 for a Commission regulatory assessment fee that the Utility separately collected from its customers. This \$1,353 should be disallowed.
111. Buena Vista claims \$600 for penalties that it paid during the test year due to a TCEQ enforcement action. This \$600 was not a cost of providing water service to its customers and should be disallowed.
112. In a prior rate case, the Commission found that Buena Vista had overcharged its customers and ordered it to refund the overcharge with interest.
113. In the current case, Buena Vista claims that the \$428 in interest that it paid customers during the test year because it over-charged them during the prior case was a miscellaneous expense of providing service to those customers during the test year

114. The interest paid on the prior overcharge was not an expense that was necessary for Buena Vista to provide water service, and the \$428 should be disallowed.
115. Buena Vista incurred a \$9,966 engineering expense during the test year, which was necessary and reasonable to provide water service.
116. The \$9,966 engineering expense was unusually large relative to the Utility's cost of service and will not recur each year.
117. The \$9,966 engineering expense should be amortized over three years, so only one third of it, \$3,322, would be included in cost of service. That way, Buena Vista will recover that cost once over a three-year period rather than indefinitely each year.
118. Based on the above, \$6,644, which is two-thirds of the \$9,966 engineering expense, should be disallowed.
119. In addition to miscellaneous costs incurred during the test year, Buena Vista claims \$4,710 for allegedly known and measurable changes in those costs that occurred after the test-year.
120. This \$4,710 does not represent known and measurable changes in the Applicant's cost of service, but the same types of expenses that occur every year, such as automobile expenses, bank charges, rental equipment, repairs and maintenance, etc.
121. A year's worth of expenses like the above is separately claimed among the test-year expenses.
122. Based on the above, the \$4,710 should be disallowed.

123. Based on the above, Buena Vista's claimed miscellaneous expense should be reduced by a total of \$9,682, as set out below and rounded off to the nearest dollar:

MISCELLANEOUS EXPENSES SUMMARY	
Item	Amount
Claimed	\$19,254
Unclaimed	\$5,230
Personal expenses	\$-675
Dodge truck insurance	\$-502
Regulatory assessment separately collected	\$-1,353
Enforcement penalties	\$-600
Previously overcharged interest	\$-428
Portion of amortized engineering fee	\$-6,644
Recurring expense claimed as post-test-year adjustment	\$-4,710
Total	\$9,572

Federal Income Taxes

124. In its application, the Utility claimed \$1,588 as its income tax expense on the return as investment that is claimed.
125. The federal incomes tax that a utility must pay on its return on invested capital is a legitimate cost of providing water service.
126. For income up to \$42,500, the tax expense is 15 percent.
127. Based on the above, the income tax expense necessary and reasonable to provide water service is \$_____, and \$_____ should be disallowed from the amount claimed by Buena Vista.

Rate-Case Expenses

128. In its application, Buena Vista included \$500 for rate-case expenses in its test-year costs of service, but there is no evidence that it spent that amount for that purpose during the test year. The \$500 should be disallowed.
129. On October 20, 2008, Buena Vista submitted a list of the expenses that it claimed it incurred in this proceeding and asked that it be allowed to recover them, either as a cost of service or through a surcharge.
130. In that submission, Buena Vista claimed to have incurred \$7,887 in 2008 to prepare and present this case.
131. Because Buena Vista has not substantially prevailed in this proceeding, the claimed rate-case expenses should be disallowed.

Financial Integrity

132. In some cases, a utility's financial integrity might be at risk if it charged only the amounts necessary to recover a reasonable return on its investment that was used and useful to provide service over and above its reasonable and necessary expenses.
133. There is no evidence that Buena Vista is at risk of a financial collapse.

Rate Design

134. Once a utility's reasonable and necessary cost of service is calculated, that cost must be apportioned among its customers. To do that, each cost item must be separated into fixed and variable components.

135. When some customers receive service through larger meters, each of their meters is equivalent to several smaller meters; and an equivalency factor must be included to account for that difference.
136. At the end of the test year, Buena Vista served only residential customers and had 119 customers with 5/8- or 3/4-inch meters and three customers with 1-inch meters.
137. Each 1-inch meters is equivalent to 7.5 of the 5/8- and 3/4-inch meters.
138. The Utility's costs of service should be divided into fixed and variable percentages by major categories as set out below:

DIVISION OF COSTS OF SERVICE IN TO FIXED AND VARIABLE PERCENTAGES		
Item	Fixed	Variable
Salaries and wages	50	50
Contract labor	90	10
Purchased water	0	100
Chemicals for treatment	0	100
Utilities (electricity)	0	100
Repairs/maintenance/supplies	50	50
Office expenses	50	50
Accounting and legal fees	100	0
Insurance	100	0
Rate case expenses	100	0
Miscellaneous	50	50
Payroll taxes	50	50
Property and other taxes	100	0
Annual depreciation and amortization	100	0
Income taxes	100	0
Return	100	0

139. Based on the above, Buena Vista's fixed and variable costs of service by major categories are as set out below:

FIXED AND VARIABLE COSTS OF SERVICE		
Item	Fixed	Variable
Salaries and wages		
Contract labor		
Purchased water		
Chemicals for treatment		
Utilities (electricity)		
Repairs/maintenance/supplies		
Office expenses		
Accounting and legal fees		
Insurance		
Rate case expenses		
Miscellaneous		
Payroll taxes		
Property and other taxes		
Annual depreciation and amortization		
Income taxes		
Return		

Refunds

140. The Utility has been collecting the rates proposed in its application since they went into effect on September 1, 2007.

II. CONCLUSIONS OF LAW

1. Kathie Bryant, doing business as Buena Vista Water System, is a retail public utility under Texas Water Code Ann. (Water Code) § 13.002(19) and a public utility under Water Code § 13.002(23).
2. The Commission has jurisdiction to consider an application for a rate increase filed by a retail public water utility, pursuant to Water Code § 13.042(e).

3. All required notices of the application and the contested case hearing on it were given as required by law, including Water Code § 13.187 and Tex. Gov't Code Ann. (Government Code) §§ 2001.051 and 2001.052.
4. The ALJ conducted a contested case hearing and proposed a decision on the application under the authority of chapter 2003 of the Government Code and chapter 13 of the Water Code.
5. Water Code § 13.183(a) requires the Commission, in setting the rates for water service, to fix a utility's overall revenues at a level that will:
 - a. permit the utility a reasonable opportunity to earn a reasonable return on its i invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses; and
 - b. preserve the financial integrity of the utility.
6. Buena Vista has the burden of proving that its proposed rates are just and reasonable. Water Code § 13.184(c).
7. The Commission is generally prohibited from setting rates that would allow Buena Vista to earn more than a fair return on its capital that is used and useful in providing water service. Water Code § 13.184(a).
8. The Commission may promulgate reasonable rules and regulations with respect to the allowance or disallowance of certain expenses for ratemaking purposes. Water Code 13.185(g).
9. Rates are based on a utility's cost of rendering service. The two components of cost of service are allowable expenses and return on invested capital. Only those expenses that are reasonable and necessary to provide service to the ratepayers may be included in allowable expenses. In computing a utility's allowable expenses, only the utility's

historical test year expenses as adjusted for known and measurable changes may be considered. 30 TEX. ADMIN. CODE (TAC) §291.31(a) and (b).

10. "Test year" means the most recent 12-month period for which representative operating data for a retail public utility are available. A utility rate filing must be based on a test year that ended less than 12 months before the date on which the utility made the rate filing. Water Code § 13.002(22).
11. Utility rates shall be based on the original cost of property used by and useful to the utility in providing service, including, if necessary to the financial integrity of the utility, construction work in progress at cost as recorded on the books of the utility. Utility property funded by explicit customer agreements or customer contributions in aid of construction such as surcharges may not be included in invested capital. Water Code § 13.185(b).
12. Depreciation on all currently used and useful developer or governmental entity contributed property shall be allowed in the cost of service. Depreciation expense included in the cost of service includes depreciation on all currently used, depreciable utility property owned by the utility, except for property provided by explicit customer agreements or funded by customer contributions in aid of construction. Water Code § 13.185(j).
13. Under 30 TAC § 291.31(b)(1), allowable expenses, to the extent they are reasonable and necessary, and subject to that section, may include, but are not limited to, the following general categories:

(A) operations and maintenance expense incurred in furnishing normal utility service and in maintaining utility plant used by and useful to the utility in providing such service (payments to affiliated interests for costs of service, or any property, right, or thing, or for interest expense are not allowed as an expense for cost of service except as provided in Texas Water Code (TWC), §13.185(e));

(B) depreciation expense based on original cost and computed on a straight line basis over the useful life of the asset as approved by the commission. Depreciation is allowed on all currently used depreciable utility property owned by the utility except for property provided by explicit customer agreements or funded by customer contributions in aid of construction. Depreciation on all currently used and useful developer or governmental entity contributed property is allowed in the cost of service;

(C) assessments and taxes other than income taxes;

(D) federal income taxes on a normalized basis (federal income taxes must be computed according to the provisions of TWC, §13.185(f), if applicable);

(E) reasonable expenditures for ordinary advertising, contributions, and donations; and

(F) funds expended in support of membership in professional or trade associations, provided such associations contribute toward the professionalism of their membership.

14. Certain types of expenses are not allowed as a component of cost of service. Among those that are relevant to this case are expenditures found by the Commission to be unreasonable or unnecessary, including civil penalties or fines. Water Code § 13.185(h)(3) and 30 TAC § 291.31(b)(2)(I).

15. Under 30 TAC § 291.31(c)(2), the rate of return is applied to the invested capital, also referred to as rate base. Components to be included in determining the rate base are as follows:

(A) original cost, less accumulated depreciation, of utility plant, property, and equipment used by and useful to the utility in providing service:

(i) original cost is the actual money cost, or the actual money value of any consideration paid other than money, of the property at the time it was dedicated to public use, whether by the utility that is the present owner or by a predecessor;

(ii) reserve for depreciation is the accumulation of recognized allocations of original cost, representing recovery of initial investment, over the estimated useful life of the asset. Depreciation must be computed on a straight line basis over the expected useful life of the item or facility;

(iii) the original cost of plant, property, and equipment acquired from an affiliated interest may not be included in invested capital except as provided in TWC, §13.185(e);

(iv) utility property funded by explicit customer agreements or customer contributions in aid of construction such as surcharges may not be included in original cost or invested capital; and

(B) working capital allowance to be composed of, but not limited to, the following:

(i) reasonable inventories of materials and supplies, held specifically for purposes of permitting efficient operation of the utility in providing normal utility service;

(ii) reasonable prepayments for operating expenses (prepayments to affiliated interests) are subject to the standards set forth in TWC, §13.185(e); and

(iii) a reasonable allowance up to one-eighth of total annual operations and maintenance expense excluding amounts charged to operations and maintenance expense for materials, supplies, and prepayments (operations and maintenance expense does not include depreciation, other taxes, or federal income taxes).

16. In determining the return on investment that would be reasonable, the Commission must consider several factors. Those include the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management. Water Code § 13.184 (b).

17. Under 30 TAC § 291.31(c)(1), the return on invested capital is the rate of return times invested capital. The commission shall allow each utility a reasonable opportunity to earn a reasonable rate of return, which is expressed as a percentage of invested capital. The Commission fixes the rate of return in accordance with the following principles.

(A) The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

(B) The commission shall consider the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the

efficiency of the utility's operations, and the quality of the utility's management, along with other relevant conditions and practices.

(C) The commission may, in addition, consider inflation, deflation, the growth rate of the service area, and the need for the utility to attract new capital. In each case, the commission shall consider the utility's cost of capital, which is the composite of the cost of the various classes of capital used by the utility.

18. Based on the above Findings of Fact and Conclusions of Law, \$_____ should be disallowed from the \$94,943 revenue requirement that Buena Vista claimed in its application, as set out below:

CALCULATION OF DISALLOWANCES	
Expense Item	Disallowance
Return on invested capital (preliminary calculation)	
Payroll taxes	
Office Expenses	\$4,480
Repairs and Maintenance	\$3,370
Accounting and Legal Expenses	\$2,300
Insurance Expense	\$852
Rate Case Expense	\$500
Miscellaneous Expenses	\$9,682
Federal income taxes	
Total	

19. The Commission has adopted rules concerning alternative rate methods. 30 TAC § 291.34.
20. Buena Vista has not applied and there is no evidence to show that its rates should be set according to such an alternative method.
21. The Water Code allows the Commission to set rates at a level necessary to preserve a utility's financial integrity. Water Code § 13.183 (a)(2).

22. There is no evidence that any portion of the proposed rate increase is necessary to preserve Buena Vista's financial integrity.
23. Based on the above Findings of Fact and Conclusions of Law, Buena Vista has failed to carry its burden of proving that any portion of the \$14,431.13 increase in revenue that it proposed in its application should be approved.
24. Based on the above Findings of Fact and Conclusions of Law, none of the proposed \$14,431.13 increase should be approved and Buena Vista's application to increase its rates should be denied.
25. Commission rule 30 TAC § 291.28(7) and (8) provide:
 - (7) A utility may recover rate case expenses, including attorney fees, incurred as a result of a rate change application only if the expenses are reasonable, necessary, and in the public interest.
 - (8) A utility may not recover any rate case expenses if the increase in revenue generated by the just and reasonable rate determined by the commission after a contested case hearing is less than 51% of the increase in revenue that would have been generated by a utility's proposed rate.
26. Based on the above Findings of Fact and Conclusions of Law, none of Buena Vista's expenses to prepare and present this rate case were necessary and reasonable costs of providing service and the Utility's request to recover those rate case expenses should be denied.
27. Water Code § 13.187(h) provides:

If, after hearing, the [Commission] finds the rates currently being charged or those proposed to be charged are unreasonable or in violation of law, the regulatory authority shall determine the rates to be charged by the utility and shall fix the rates by order served on the utility.

28. Based on the above Findings of Fact and Conclusions of Law, the \$_____ that should be disallowed from the \$96,015 that the Buena Vista claimed as its revenue requirement exceeds the \$14,431.13 increase in revenue included in that \$96,015.
29. Based on the above Findings of Fact and Conclusions of Law, Buena Vista's current rates are designed to recover \$_____ more than its necessary and reasonable cost of service, including a return on and of its capital usefully invested and used to provide service.
30. Based on the above Findings of Fact and Conclusions of Law, Buena Vista's pre-application rates should be reduced so as to reduce its revenue by \$_____.
31. The fixed portion of a utility's cost of service should be recovered through base rates per meter and the variable portion should be recovered by a per-1000-gallons charge. 30 TAC §291.32(c).
32. Based on the above Findings of Fact and Conclusions of Law, Buena Vista rates should be changed as follows:

	CURRENT	NEW
Base monthly rate for 5/8 or 3/4-inch meter with zero gallons	\$33.00	
Base monthly rate for 1-inch meter with zero gallons	\$48.41	
Charge per 1,000 gallons	\$2.75	
Transfer fee	\$0	\$20.00
Return check charge	\$20.00	\$25.00
Meter test fee	\$0	\$25.00

33. Water Code § 13.187 (i) provides:

. . . Unless otherwise agreed to by the parties to the rate proceeding, the utility shall refund or credit against future bills all sums collected during the pendency of the rate proceeding in excess of the rate finally ordered plus interest as determined by the [Commission].

34. Based on the above Findings of Fact and Conclusions of Law, Buena Vista should refund or credit to customers all sums collected since September 1, 2007, which was the effective date of the rates at issue in this case, that exceed the rates approved by the Commission in this case, plus six percent interest on the over-collection

III. ORDERING PROVISIONS

NOW, THEREFORE, BE IT ORDERED BY THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY, IN ACCORDANCE WITH THESE FINDINGS OF FACT AND CONCLUSIONS OF LAW, THAT:

1. The application of Kathie Bryant, doing business as Buena Vista Water System, to increase the rates that she charges for the retail water utility service that she provides under Certificate of Convenience and Necessity No. 11656, in Burnet County, Texas, is denied.
2. Ms. Bryant shall immediately cease collecting the rates she proposed in this case.
3. Ms. Bryant shall immediately begin collecting the following rates:

	CURRENT	NEW
Base monthly rate for 5/8 or 3/4-inch meter with zero gallons	\$33.00	
Base monthly rate for 1-inch meter with zero gallons	\$48.41	
Charge per 1,000 gallons	\$2.75	
Transfer fee	\$0	\$20.00
Return check charge	\$20.00	\$25.00

Meter test fee	\$0	\$25.00
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4. Within _____ days, Ms. Bryant shall refund or credit to customers all sums collected since September 1, 2007, which was the effective date of the rates at issue in this case, that exceed the rates approved by the Commission in this case, plus six percent interest on the over-collection.
5. Ms. Bryant shall review any future construction and purchase costs closely and maintain her records by NARUC property accounts.
6. Ms. Bryant shall immediately begin using separate financial accounts and accounting for her Buena Vista water-utility business.
7. All other motions, requests for entry of specific Findings of Fact or Conclusions of Law, and any other requests for general or specific relief, if not expressly granted herein, are hereby denied.
8. The effective date of this Order is the date the Order is final, as provided by 30 TAC § 80.273 and Gov't Code § 2001.144.
9. As required by Water Code § 7.059, the Commission's Chief Clerk shall forward a copy of this Order to Ms. Bryant.

10. If any provision, sentence, clause, or phrase of this Order is for any reason held to be invalid, the invalidity of any provision shall not affect the validity of the remaining portions of this Order.

ISSUED:

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Buddy Garcia, Chairman
For the Commission