

**BEFORE THE  
RAILROAD COMMISSION OF TEXAS**

**STATEMENT OF INTENT OF HUGHES §  
NATURAL GAS, INC. and PETITION §  
FOR REVIEW FROM ACTION OF THE § GAS UTILITIES DOCKET  
CITY OF MAGNOLIA DENYING § NOS. 10083 and 10093  
HUGHES NATURAL GAS INC.'S §  
STATEMENT OF INTENT §**

**FINAL ORDER**

Notice of Open Meeting to consider this Order was duly posted with the Secretary of State within the time period provided by law pursuant to TEX. GOV'T CODE ANN. § 551.001, *et seq.*, (Vernon 2004 & Supp. 2010). The Railroad Commission of Texas adopts the following findings of fact and conclusions of law and orders as follows:

**FINDINGS OF FACT**

1. Hughes Natural Gas, Inc., (HNG) is a gas utility as that term is defined in the Texas Utility Code.
2. On June 2, 2011, HNG filed a Statement of Intent to change gas distribution rates in the unincorporated areas of Austin, Colorado, Grimes, Harris, Montgomery and Waller Counties, Texas.
3. The Commission has jurisdiction over HNG and over the matters at issue in this proceeding pursuant to TEX. UTIL. CODE ANN. §§ 102.001, 103.003, 103.051, 104.001, 121.051, 121.052, and 121.151 (Vernon 2007 and Supp. 2010). The statutes and rules involved in this proceeding include, but are not limited to TEX. UTIL. CODE ANN. §§ 104.101, 104.102, 104.103, 104.105, 104.106, 104.107, 104.110, 104.301, and 16 TEX. ADMIN. CODE Chapter 7.
4. The implementation of the proposed rates were suspended on June 27, 2011.
5. Notice of the proposed increase was provided by bill insert to all customers inside the City of Magnolia and to all environs customers in accordance with TEX. UTIL. CODE ANN. §104.103(b)(2) on June 7, 2011.
6. A Supplemental Notice of the proposed increase was provided by bill insert to all customers inside the City of Magnolia and to all environs customers in accordance with TEX. UTIL. CODE ANN. §104.103(b)(2) on July 7, 2011.
7. On June 14, 2011, the City of Magnolia denied the proposed rate increase.

8. On June 20, 2011, HNG filed an appeal and that case was docketed as GUD No. 10093, *Petition for Review from Action of the City of Magnolia Denying Hughes Natural Gas Inc.'s Statement of Intent*.
9. GUD No. 10093 was consolidated into this proceeding, GUD No. 10083, on July 1, 2011.
10. Staff of the Railroad Commission of Texas (Staff) intervened in this proceeding on June 9, 2011.
11. The City of Magnolia (City) intervened in this proceeding on July 21, 2011.
12. The Commission received over 200 individual letters and several petitions from homeowners and neighborhood associations. In all, approximately 470 residents and businesses served by HNG objected to the proposed rate increase.
13. Of the rate payers who filed letters objecting to the rate increase, the following individuals also formally intervened as Protestants in this proceeding: Elizabeth Nixon, Angela Arndt, Sheryl McDonald, Kathleen Garrett, Shannon Hoffart, Ashley Carter, Michael Kelley, Douglas Mendez, Sheila McLendon, Cecilia Whitaker, Robert Whitaker, William Scates, Sherleen Scates, Al Birdwell, Shirley Kerr, Rolf Kerr, and Melissa Rogers.
14. The hearing on the merits in this matter commenced on September 26, 2011, and was concluded on September 28, 2011.

*Books and Records*

15. The preponderance of the credible evidence fails to demonstrate that HNG maintains its books and records in accordance with FERC USOA and Commission Rule 7.310.
16. HNG is not entitled to the presumption of Commission Rule 7.503 allowing amounts shown on the company's books and records, as well as, summaries and excerpts taken from those records to be *prima facie* evidence of the amount of investment or expense reflected and reasonably incurred.

*Notice*

17. HNG mailed its customers an initial notice on June 7, 2011, and then sent a supplemental notice on July 7, 2011; entitled *Supplemental Notice of Request for Gas Rate Increase*.
18. The supplemental notice was necessitated due to an error in the address referenced for the Railroad Commission of Texas.
19. The *Supplemental Notice of Request for Gas Rate Increase* issued indicated that a residential customer receiving a bill for 6 Mcf would experience an increase of 33.1%.

20. Protestants raised issues about the clarity of the notice and the confusion stemmed from the calculation of the proposed increase.
21. A residential gas bill is generally made up of two broad components: the amount due as a result of base rates and the amount due for natural gas consumption, as pass through cost to the customer.
22. The percentage change proposed, with the cost of gas, for environs customers who consume 6 Mcf is 33.1%.
23. The percentage change in base rates, excluding the cost of gas, for environs customers who consume 6 Mcf, is 68.73%.
24. The percentage change proposed, with the cost of gas, for customers within the City of Magnolia who consume 6 Mcf, is 23.92%.
25. The percentage change proposed, excluding the cost of gas, for customers within the City of Magnolia who consume 6 Mcf, is 52.84%.
26. By including the pass through cost of gas in the calculation of the percentage change, the notice dampened the effect of the proposed increase on base rates. Removal of the pass through cost of gas reveals the effect of the base rate increase.
27. The company's notice did not provide an analysis of the rate increase with and without gas costs.
28. It has been the practice of other utilities before the Commission in several cases to carefully delineate the effect of the proposed increase with and without gas costs.
29. The notice issued by HNG complied with the minimum requirements of the statute and regulations. The notice issued is consistent with the prior notice submitted in HNG's last rate proceeding, GUD No. 9731.
30. Customers were aware of the proposed increase as evidenced by over 470 residents and businesses who filed letters of protest.
31. Enough information was included in the notice to provide an opportunity for customers to determine the impact with and without gas costs.
32. In order to avoid confusion in the future and unnecessary controversy, HNG is directed to precisely describe the proposed rate increase with and without gas costs in all future rate proceedings in addition to the statutory and regulatory requirements of the GURA.

*Affiliate Issues*

33. Hughes Gas Resources, Inc. ("HGR") is a holding company organized as a Subchapter S corporation and is the parent company that owns the following four subsidiaries: (1) Hughes Natural Gas ("HNG") (the applicant), (2) Alamo Pipeline LLC., ("Alamo"), (3)

Goliad Midstream Energy, LLC. (“Goliad”), and (4) Pinehurst Utility Construction, LLC. (“Pinehurst” or “PUC”).

34. Hughes Gas Resources is owned by Frank Hicks and Real Provencher and HGR provides the capital required by the subsidiaries, including HNG.
35. These four companies as a group are related affiliates through their common ownership of the parent company Hughes Gas Resources and are referred to as the “Hughes Resources Affiliated Group of Companies.”
36. Mr. Provencher and Mr. Hicks serve alternately as President and Vice President of the various companies, as follows: (a) Hughes Gas Resources – President is Mr. Hicks and Vice President is Mr. Provencher; (b) HNG – President is Mr. Provencher and Vice President is Mr. Hicks; (c) Goliad – President is Mr. Provencher and Vice President is Mr. Hicks; and (d) Alamo – President is Mr. Provencher and Vice President is Mr. Hicks; (e) Pinehurst – President is Mr. Hicks and Vice President is Mr. Provencher.
37. Decker Properties, LLC (“Decker”), a fifth affiliate, is owned exclusively by Frank Hicks and Karen Hicks.
38. Decker is an affiliate company due to Mr. Hick’s association with Hughes Gas Resources, Inc. and the remainder of the affiliated group of companies.
39. All of the affiliates provide services to HNG.
40. Work conducted among the affiliates is often conducted on an informal basis and some of some of the transactions are not memorialized in writing.
41. The work performed by HNG for affiliates is not consistently tracked.
42. Mr. Hicks employs timesheets for his work for HNG.
43. The accounts payable human resources employee allocated her expenses to HNG based upon an informal estimate.
44. Mr. Provencher who performs services for all affiliates, maintains no timekeeping records for HNG or the other affiliates.
45. The affiliate entities are not stand-alone entities and benefit from the use of several physical assets and services provided by HNG personnel for which no costs are assigned to the affiliate.

Alamo Pipeline, LLC

46. Alamo is a natural gas transmission utility that provides natural gas transportation in Harris and Montgomery County and much of the gas supplied to HNG is transported on Alamo’s Pinehurst Pipeline.
47. Alamo delivers gas for Goliad to HNG and XTX Pipeline, LLC.
48. During the test year HNG paid \$565,049 for transportation services.

Goliad Midstream Energy, LLC

49. Goliad buys and sells natural gas delivered to local distribution companies in Montgomery and Harris County. All of its sales are delivered on the Pinehurst Pipeline owned by Alamo.
50. During the test year HNG paid \$1,000,615 to Goliad for natural gas purchases.
51. Together expenses of Alamo and Goliad made up 81% of HNG's total gas costs during the test year in the amount of \$1,928,971.

Pinehurst Utility Construction, LLC

52. Pinehurst provides construction services to HNG, to Alamo and to unrelated third parties and also performs services such as yard-line installations for customers of HNG.
53. HNG's test-year-operating expenses included \$85,365 for services that were provided by Pinehurst.
54. HNG's plant in service includes \$1,306,940 for plant construction services provided by Pinehurst during the test year.
55. HNG provided uncompensated advertising on its website on behalf of Pinehurst.

Decker Properties, LLC

56. Decker is a property management company.
57. HNG and several of the other affiliates lease office and warehouse space from Decker.
58. HNG pays a monthly rent of \$3,500.
59. The lease among the other affiliates are not memorialized in writing.

Physical Assets

60. The preponderance of the credible evidence established that the following entities were able to use the following *physical assets* without paying for those assets:
  - a. Hughes Gas Resources lists as its principal office and/or the principal place of business: 31830 State Highway 249, Pinehurst, Texas 77382. This address is listed on all business filings with the Secretary of State. Hughes Gas Resources receives mail at that address. Mr. Provencher and Mr. Hicks perform tasks for Hughes Gas Resources at this address. Hughes Gas Resources does not pay rent for this property.
  - b. Goliad lists as its principal office and/or the principal place of business: 31830 State Highway 249, Pinehurst, Texas 77382. This address is listed on all business filings with the Secretary of State. Goliad receives mail at this address. Mr. Provencher and Mr. Hicks perform tasks for Goliad at this address. Goliad does not pay rent for this property.

- c. Mr. Provencher, Mr. Hicks, and Ms. Miller provide services for various members of the Hughes Resources Affiliated Group of Companies. The proposed allocation for rent, however, does not allocate any of the rental expense for the spaced occupied by those individuals to any of the affiliated members in that group of companies.
- d. The contract between Goliad, as the seller of natural gas, and HNG, as the buyer of gas provides that notices required by the contract are to be made at the following address, telephone number and facsimile:
  - o Physical Address: 31830 State Highway 249, Pinehurst, TX 77362
  - o Telephone: (281)766-1280 (Goliad) and (281) 766-1290 (HNG)
  - o Facsimile: (281) 259-7773 (both Goliad and HNG)
  - o Attn: Real Provencher (Goliad) and Frank Hicks (HNG)
- e. The contract between Goliad, as the seller of natural gas, and a third party not affiliated with HNG, provides that notices to Goliad are to be made at the following address, telephone number and facsimile:
  - o Physical Address: 31830 State Highway 249, Pinehurst, TX 77362
  - o Telephone: (281)766-1280
  - o Facsimile: (281) 259-7773
  - o Attn: Real Provencher
- f. Goliad does not pay any portion of the telecommunications equipment expenses at the above referenced address.
- g. Frank Hicks and Real Provencher each drive a vehicle provided by HNG vehicle. Mr. Hicks and Mr. Provencher drive to work in this vehicle and perform tasks on behalf of Hughes Gas Resources, Inc., Alamo, Goliad, Pinehurst and Decker. None of these affiliates pay for the vehicle or the gasoline to operate the vehicle.
- h. Goliad and HGR do not pay for telephone services at the office address of 31830 State Highway 249, Pinehurst, Texas 77382. Calls are routed to Mr. Provencher related to all affiliates at that address.
- i. No evidence was provided that any allocation was made of HNG information technology equipment to Alamo. Mr. Provencher exchanged several emails with Staff of the Commission at the time the initial rates for Alamo were filed. The email address referenced in some of those documents is as follows:  
[RealP@hughesnaturalgas.com](mailto:RealP@hughesnaturalgas.com).

Employee Services

- 61. The preponderance of the credible evidence established that the following *services* were rendered to the affiliates at no cost to the affiliate:

- a. Several affiliates do not pay for any vehicle insurance associated with HNG vehicles that are used in providing service to the affiliates.
- b. Several affiliates do not pay for property insurance associated with HNG property that is used in providing service to the affiliates.
- c. Real Provencher who is an officer of HNG provides administrative, directional, accounting, managerial, clerical, secretarial duties, and other essential business functions on behalf of all affiliates and none of the affiliates compensate him for those services.
- d. On behalf of Alamo, the President of HNG, Mr. Provencher, worked with Staff of the Railroad Commission to establish Alamo's initial rates in 2010 to establish initial rates. Discussions and email exchanges between the President and the Gas Services Division regarding the proposed tariff spanned from May of 2010 to November of 2010.
- e. The President of HNG, Mr. Provencher, submitted the initial study, prepared by GDS Associates, in support of that tariff that he reviewed.
- f. The Distribution Annual Report on file at the Commission is signed by Mr. Provencher on behalf of Alamo included a declaration that it "was prepared by me or under my supervision, and that the data and facts stated therein are true, correct, and complete to the best of my knowledge."
- g. Mr. Provencher is a signatory on the Gas Services Agreement entered into between HNG and Goliad and XTX Pipeline and Goliad.
- h. Mr. Provencher signed on behalf of Goliad as the supplier to Goliad's contract with XTX Pipeline and HNG and negotiated on behalf of Goliad.

Specific Expense Adjustments Related to Affiliate Transactions

62. The company's filing includes a salary request for nine full-time employees and two part-time employees. The total initial salary request of the company was \$511,397.
63. The company recognized that an adjustment should be made to the salary of the accounts payable and human resources employee, Barbara Miller.
64. Ms. Millers' salary was reduced by \$17,005.
65. Thus, the total salary request to be included in the cost of service as adjusted in FOF No.62 above is \$494,392.
66. Included in the salary request was an adjustment to increase salaries for all personnel.
67. HNG has not met its burden with regards to the salary levels included in the cost of service.

68. Services provided by an employee of a regulated utility to an affiliate should be compensated by that affiliate because an uncompensated service to an affiliate is a subsidy to that affiliate paid by the rates charged to customers of the system.
69. Any subsidy provided by HNG to an affiliate that, in turn, provides services to HNG is necessarily part of the cost of that service.
70. Unless the costs of uncompensated services are accounted for through a direct assignment or allocation the affiliate standard set out in 104.055(b)(2) cannot be satisfied.
71. Uncompensated service paid for by captive customers results in rates that are not just and reasonable and result in a restriction on competition.
72. The President of HNG performed work activities and provided uncompensated services to the affiliates.
73. Absent the services provided by Mr. Provencher, Alamo and Goliad would cease to function.
74. The following employees provided services to the affiliates of HNG: President, Staff Accountant, Customer Service Representative, and Accounts Payable and Human Resources.
75. The allocation proposed by Staff is based upon an objective verifiable standard and should be applied in the case of Ms. Miller.
76. The proposed increase is not just and reasonable because HNG has not established that the increased labor requirement for the Vice President is not due to the fact that employees of the HNG, provide uncompensated services to the affiliates of HNG.
77. Vehicles are part of the total compensation package provided to the President and the Vice President of HNG and the vehicle expense is included in the cost of service calculation. The amounts included include expenses for fuel, maintenance, and lease.
78. After the hearing, HNG conceded that the expenses related to Mr. Hick's vehicle should be allocated.
79. The vehicle expense adjustment only captured the fuel expense component of the vehicle.
80. It is reasonable that the allocation adjust the entire vehicle expense and not be limited the fuel expense.
81. The adjustment results in a reduction to the vehicle expense included in the cost of service request of \$15,039.79.

82. The affiliate Decker collects rent for the property located at 31830 State Highway 249, Pinehurst, TX 77362.
83. The rental expense is calculated based on the square footage of four entities that occupy the physical space: HNG, Pinehurst, Alamo and a third party.
84. The total annual rental expense collected from those members of the Hughes Resources Affiliated Group of Companies is \$62,688.
85. The rental expense collected from HNG is \$42,072 and that amount has been included in the cost of service calculation.
86. The space occupied by Mr. Provencher, Mr. Hicks, and Ms. Miller is allocated exclusively to HNG.
87. The phone system installed in the office is shared among all Hughes Resources Affiliated Group of Companies.
88. All of the affiliates have utilized and continue to use the original server owned by Hughes Propane for file storage and data retrieval.
89. HNG failed to meet its burden of proof regarding the allocation of rental expenses.
90. None of the space occupied by shared employees is allocated to the affiliates.
91. Goliad and Hughes Resources pay no rent and are provided telephone services at no charge at that address.
92. Applying the allocation factors developed by Staff to the entire rental expense of the Hughes Resources Affiliated Group of Companies results in a just and reasonable allocation of rental expense.
93. Proper allocation of the rental expense results in a reduction of \$15,053.47.
94. It is not reasonable that the lease agreement applicable to each affiliate has not been reduced to writing and it is reasonable to direct that HNG be required to execute a written agreement and that the agreement be maintained in the files of the utility in order to comply with the requirements of the FERC USOA.
95. The company included \$57,890 in office supply expense.
96. HNG established that each affiliate in the Hughes Resources Affiliated Group of Companies pays an amount for office supply expense.
97. The record in this case does not establish that policies and procedures are in place to ensure that assets of HNG are shared among affiliates.

98. The total workforce associated with Pinehurst has not been established in this record.
99. An accurate employee count is relevant rental allocation process proposed by HNG.
100. The company has not included all costs of receiving services from Pinehurst for construction projects undertaken for HNG.
101. HNG provides an array of uncompensated services to Pinehurst.
102. In the market-place these services have a value and their expense should have been included in the calculation of the costs of receiving service from Pinehurst.
103. Failure to account for the cost of the services provided by the President of HNG to Pinehurst is not just and reasonable for ratepayers to bear that expense, it is not consistent with the requirements of the FERC USOA, and it is unfair to competitors of the affiliate.
104. None of these services provided by HNG to Pinehurst were factored into the calculation of the costs of construction services provided to Pinehurst and there is no way to assess whether the rate charged by Pinehurst is competitive and therefore includable as a just and reasonable expense.
105. HNG has failed to establish that expenses related to activities conducted by Pinehurst on behalf of HNG are just and reasonable and all of those expenses are properly excludable from rate base.
106. The amount of plant in service contributed by Pinehurst to the cost of service is \$1,306,940 and the amount necessarily includes the materials installed.
107. The AMR devices were \$202,520.75 and it is reasonable to include that amount in the rate base calculation.
108. The labor component that is a result of work conducted by Pinehurst to install the AMR devices is \$102,240 and the company has not established that that amount is just and reasonable.
109. Based on the installation expense associated with the AMR devices it appears that approximately 33.55% of installations conducted by Pinehurst are related to the labor expenses of Pinehurst.
110. Except for the installation of the AMR devices, the company has not included the amounts associated with the materials. The total cost of those devices was \$202,520.75. It is reasonable to include that amount may be included in rate-base.

111. The remaining amount related to work done by Pinehurst that was included in plant and service is \$1,104,420 and HNG has not established that this amount is just and reasonable.
112. The Pinehurst labor component of that amount may reasonable be calculated at 33.55% based upon the ratio of labor to materials for the work done related to AMR devices.
113. Based upon that ratio, the Pinehurst labor component of the \$1,104,420 included in plant and service is \$370,532.91.
114. Based upon the foregoing findings of fact, HNG has not established that expenses charged by Pinehurst are just and reasonable.
115. Based upon the foregoing findings of fact, it is reasonable that HNG should obtain at least three bids from its suppliers and materials in addition to Pinehurst or a company owned or controlled by Mr. Provencher or Mr. Hicks.
116. It is just and reasonable that the required bids should be identical to all third-party contractors and suppliers for materials in addition to any bid from Pinehurst.
117. It is just and reasonable that HNG should make efforts to solicit the bids from local contractors.
118. It is just and reasonable that HNG should file an annual report showing each new installation project and each repair project and that the report shall show the reason for the project, the date the project was initiated and completed, the request for bids solicited, the bids the vendors provided, the vendor the project or material request was awarded, a list of materials used in the new installation or repair and the vendor performing the work or material supplied.
119. Projects should be booked as instructed by the FERC USOA at original cost with on adjustment of its value.
120. Materials and supplies held in inventory and then used in projects or expensed should be accounted for according to FERC USOA.
121. HNG's practice of requiring preapproval of third party construction hinders competition.
122. HNG facilitates approval by the utility of work conducted by the affiliate because HNG provides the unique requirement on competitors of Pinehurst that customers who chose to employ a competitor must submit the construction plans for prior approval to HNG.
123. HNG provides pricing information related to work conducted by Pinehurst to the customers of Pinehurst at HNG's expense.

124. Pinehurst participated in 78% of the yard line constructions undertaken during the test year.
125. HNG should be required to remove all references to Pinehurst in materials provided through its website or other documentation with customers of HNG.
126. Contract provisions of Pinehurst may not include any reference to HNG as that may mislead customers into believing that the charges made by Pinehurst are rates set by the Commission or another state agency.
127. Contract documents provided by its affiliate should state that none of the charges made by Pinehurst are set by the Commission or any other state agency.
128. Documents provided to customers of HNG by HNG, or any of its affiliates, should not include the acronym "PUC" as this may mislead the public into believing that those rates are set by a state agency.
129. The tariffs set out the standards and charges that HNG may charge for service lines.
130. HNG is unique because other entities do not allow customers to install service lines.
131. The installation of service line is governed by the utility's line extension policy as set out in the company's tariff and it is reasonable that HNG should provide installation of all service lines that are to be owned and controlled by the utility under the terms of its tariff.
132. The tariff provides that the installation and extension of new mains under normal conditions, no larger than two inches in diameter and not more than 100 feet in length at no cost and at cost after the first 100 feet.
133. In GUD No. 9731, HNG's last rate proceeding, the issue of affiliate expenditures was also addressed and the Commission disallowed \$166,920 for the company's rate request.

Recommended Audit

134. In light of the management practices described in findings of fact above, it is reasonable that HNG be directed to conduct a management audit.
135. The management audit is to be conducted by a company approved by the City of Magnolia and Staff of the Railroad Commission.
136. The audit shall include a detailed analysis of the work conducted by employees of HNG and identify any services provided to the Hughes Resources Affiliated Group of Companies by HNG's employees.
137. It is reasonable that the expense of the management audit be borne exclusively by HNG and not passed onto customers of the system.

138. The management audit is to be completed within nine months of the date of the Final Order in this proceeding, unless otherwise extended by Staff, but is not to be extended beyond twelve months.
139. It is reasonable that the management audit develop a policies and procedures manual for employees of HNG to track time worked for the various members of the Hughes Resources Affiliated Group of Companies.
140. It is reasonable that the policies and procedures manual include policies and procedures to ensure that all office expenses are properly segregated including, but not limited to, telephone and computer equipment.
141. It is reasonable that the results of the management audit be filed with Staff within one year of the date of this order, or before the next rate proceeding, and the audit is be considered at the next rate proceeding.

*Yard Line Installation Standards*

142. HNG has standards for yard line, customer owned and maintained lines from the meter to the customer's home, that are higher than yard-line standards for other utilities in the state.
143. The standards for yard-line installation are just and reasonable.

*Allocation Methodology and Confidentiality Issues*

144. A composite allocation formula based upon composite allocation factors derived from the following components is just and reasonable: Percentage of Total Assets/Liabilities, Plant/Investment/Income from Operations, and O&M Expenses.
145. A composite allocation factor for the Hughes Resources Affiliated Group of Companies is just and reasonable.
146. HNG proposed an allocation of rental expense based upon space occupied.
147. The proposed allocation results in none of the costs being allocated to several of HNG's affiliates who use the property and is therefore not just and reasonable.
148. The allocation of rental expense proposed by HNG that results in zero expense for two members of the Hughes Resources Affiliated Group of Companies is not reasonable.
149. The allocation of rental expense proposed by HNG is not just and reasonable because it fails to allocate the space occupied by executive officers to all members of the Hughes Resources Affiliated Group of Companies.
150. The underlying data used to derive the allocation factors is not confidential.

151. The prior practice at the Commission has been that figures that make up the allocation of costs included in schedules setting the rates are subject to public disclosure to ensure a transparent rate setting process.

*Rate Base*

152. HNG's proposed level of rate base is not reasonable.
153. The amounts reflected in the attached schedules are just and reasonable and provide a rate base on HNG's used and useful investments, which allow HNG an opportunity to earn a reasonable rate of return on its investment.
154. On January 4, 2009, HNG acquired the assets of CapGas, a local natural gas distribution company with approximately 1,100 customers and 177,652 feet of mains in Harris, Waller, Grimes, Austin and Colorado Counties, Texas.
155. The 2007 Annual Report filed for CapGas is reliable as to the valuation of plant and service of the CapGas assets.
156. Mr. Provencher attested to the veracity of the valuation figures included in the 2007 Annual Report for CapGas.
157. It is reasonable to allow the utility to set rates on the net purchase price of \$421,158 with a book value of plant and service of \$218,089 and allowing an acquisition adjustment of \$203,069.
158. An amount of \$421,158 for rate base on the used and useful investment for the CapGas assets allows HNG an opportunity to earn a reasonable rate of return on its investment.
159. HNG's inclusion of \$269,189 in rate base for Automatic Meter Reading (AMR) devices is not reasonable.
160. The AMR devices are a utility asset that is used and useful but the preponderance of the credible evidence fails to demonstrate that the entirety of the investment is just and reasonable or a cost consistent with a prudent utility investor.
161. A rate base amount for the AMR devices that is consistent with a revenue requirement for the investment, return, taxes, and operation and maintenance that is no higher than the costs to customers prior to the installation of the meters with manual meter reading is a just and reasonable rate base amount, as reflected in the attached schedules.
162. The preponderance of the credible evidence fails to show that the utility's calculations are just and reasonable for the inclusion of approximately \$23,000 in proposed rate base for cash working capital from the one-eighth rule in the absence of a lead lag study.

163. It is proper to disallow this proposed approximately \$23,000 amount of cash working capital in rate base.

*Rate of Return*

164. The preponderance of the credible evidence regarding capital infusions does not support HNG's proposed capital structure of 90% equity and 10% debt.
165. HNG failed to show by a preponderance of the credible evidence that the company infused capital in the amount of \$1,352,289 between January 2011 and March 2011.
166. The proposed capital structure is significantly outside of the industry range, which would result in an inflated rate of return in comparison to other LDCs and is contrary to ratemaking principles that require rates to be fair and sufficient to ensure safe and reliable service and avoid ratepayers paying unnecessarily high rates.
167. It is just and reasonable to rely upon a comparable group of companies and set HNG's capital structure at 44.5% debt and 55.5% equity.
168. A cost of debt of 6.5% is just and reasonable.
169. The DCF analysis results of the Railroad Commission Staff for a comparable set of companies that indicate in both the 30 day constant growth and the 90 day constant growth, common equity percentages from 7.65% to 9.35% and 7.56% and 9.29%, respectively, are reasonable.
170. The current economic conditions have adversely affected the utility industry and it is appropriate to add an adjustment for the size of the utility and the economic conditions.
171. A return on equity of 10.4% is just and reasonable.
172. A weighted average cost of capital or overall rate of return of 8.66% is just and reasonable.

*Gas Costs Inquiry*

173. The tariffed rate for Alamo is the appropriate rate to be charged by Alamo. The Commission may initiate an inquiry at any time to analyze those rates.
174. Alamo receives an array of services from HNG that are not compensated.
175. The President of HNG, Mr. Provencher, serves as the President of Alamo.
176. Mr. Provencher is not compensated for holding that office or providing services to Alamo.

177. Mr. Provencher provides an array of essential services for Alamo including preparation of billing invoices, preparation and filing of the proposed initial tariffs; discussions with the Commission Staff regarding the initial rates; review of the rate study filed on behalf of Alamo, preparation of the Distribution Annual report with the Commission; and, participation in contract negotiations on behalf of Alamo involving Goliad, HNG, and XTX Pipeline.
178. A portion of the overall rental expense paid by the Hughes Resources Affiliated Group of Companies is paid by Alamo. None of the space occupied by Mr. Provencher, Mr. Hicks, or Ms. Miller is allocated to Alamo.
179. It is reasonable that the management audit ordered above specifically address the shared services provided by HNG employees and HNG assets used by Alamo.
180. The management audit is to identify any services provided by HNG to Alamo and any shared assets used by Alamo whose costs have not previously been assigned to Alamo. It is reasonable that the management audit estimate of the value of those services and assets. The amount identified shall be credited to the customer through the operation of the purchase gas adjustment clause.
181. HNG failed to establish the total number of individuals providing services to Goliad.
182. The actual expense for service from Goliad includes a host of uncompensated services.
183. Mr. Provencher serves as President of Goliad and performs essential business services, such as preparing invoices.
184. The April 27, 2010 gas services agreement between Goliad and HNG has the same contact address and facsimile number for Goliad and HNG. Goliad neither pays rent nor telephone expenses at that address.
185. Goliad incurs no vehicle expense and instead the vehicle expense for the President and Vice President of Goliad is paid for by HNG.
186. Until the rebuttal filing in this case, none of the expenses associated with the accountant, Barbara Miller, have previously been allocated to Goliad.
187. Goliad incurs no rental expense because the rent of its office address is paid for by HNG.
188. Goliad has no insurance expenditure.
189. It is reasonable that the allocations made in Findings of Fact Nos. xx – xx, above be made to recognize the costs incurred on behalf of Goliad.
190. It is reasonable that the management audit ordered above specifically address the shared services provided by HNG employees and HNG assets used by Goliad.

191. The management audit is to identify any services provided by HNG to Goliad and any shared assets used by Goliad whose costs have not previously been assigned to Goliad. It is reasonable that the management audit estimate of the value of those services and assets. The amount identified shall be credited to the customer through the operation of the purchase gas adjustment clause.
192. HNG shall make a request for proposal for bids for gas supply to HNG and file the proof of the proposal for bids with the Commission on a quarterly basis.
193. Copies of all proposals for bids shall be maintained at the HNG offices and available for inspection by Commission Staff or the City of Magnolia.

*Rate Design*

194. HNG has established that the proposed rate design is reasonable.
195. As established in the findings of fact set forth above and the attached schedules, the following rates are just and reasonable for residential and commercial customers: \$16.96 monthly service fee plus a volumetric service fee of \$5.2296 per Mcf.

**CONCLUSIONS OF LAW**

1. Hughes Natural Gas, Inc., (HNG) is a "Gas Utility" as defined in TEX. UTIL. CODE ANN. §101.003(7) (Vernon 2007 and Supp. 2010) and §121.001(Vernon 2007) and is therefore subject to the jurisdiction of the Railroad Commission of Texas ("Commission").
2. The Commission has jurisdiction over HNG and HNG's Statement of Intent and appeals under TEX. UTIL. CODE ANN. §§ 102.001, 103.022, 103.054, 103.055, 104.001 and 104.201 (Vernon 2007 and Supp. 2010).
3. Under TEX. UTIL. CODE ANN. §102.001 (Vernon 2007 and Supp. 2010), the Commission has exclusive original jurisdiction over the rates and services of a gas utility that distributes natural gas in areas outside of a municipality and over the rates and services of a gas utility that transmits, transports, delivers, or sells natural gas to a gas utility that distributes the gas to the public.
4. This proceeding was conducted in accordance with the requirements of the Gas Utility regulatory Act (GURA), and the Administrative Procedure Act, TEX. GOV'T CODE ANN. §§ 2001.001 *et seq.* (Vernon 2008 & Supp. 2010) ("APA").
5. TEX. UTIL. CODE ANN. §104.107 (Vernon 2007 and Supp. 2010) provides the Commission's authority to suspend the operation of the schedule of proposed rates for 150 days from the date the schedule would otherwise go into effect.

6. The proposed rates constitute a major change as defined by TEX. UTIL. CODE ANN. §104.101 (Vernon 2007 and Supp. 2010).
7. In accordance with TEX. UTIL. CODE ANN. §104.103 (Vernon 2007 and Supp. 2010), 16 TEX. ADMIN. CODE ANN. §§ 7.230 and 7.235, adequate notice was properly provided.
8. In accordance with TEX. UTIL. CODE ANN. §104.102 (Vernon 2007 and Supp. 2010), 16 TEX. ADMIN. CODE ANN. §§ 7.205 and 7.210, HNG filed its Statement of Intent to change gas distribution rates.
9. HNG failed to meet its burden of proof in accordance with the provisions of TEX. UTIL. CODE ANN. §104.008 (Vernon 2007 and Supp. 2010) on the elements of its requested rate increase identified in this order.
10. The revenue, rates, rate design, and service charges proposed by HNG are not found to be just and reasonable, not unreasonably preferential, prejudicial, or discriminatory, and are not sufficient, equitable, and consistent in application to each class of consumer, as required by TEX. UTIL. CODE ANN. §104.003 (Vernon 2007 and Supp. 2010).
11. The revenue, rates, rate design, and service charges proposed by HNG, as amended by the Commission and identified in the schedules attached to this order, are just and reasonable, are not unreasonably preferential, prejudicial, or discriminatory, and are sufficient, equitable, and consistent in application to each class of consumer, as required by TEX. UTIL. CODE ANN. (Vernon 2007 and Supp. 2010).
12. The Commission has assured that the rates, operations, and services established in this docket are just and reasonable to customers and to the utilities in accordance with the stated purpose of the Texas Utilities Code, Subtitle A, expressed under TEX. UTIL. CODE ANN. §101.002 (Vernon 2007).
13. The overall revenues as established by the findings of fact and attached schedules are reasonable; fix an overall level of revenues for HNG that will permit the company a reasonable opportunity to earn a reasonable return on its invested capital used and useful in providing service to the public over and above its reasonable and necessary operating expenses, as required by TEX. UTIL. CODE ANN. § 104.051 (Vernon 2007 and Supp. 2010); and otherwise comply with Chapter 104 of the Texas Utilities Code Annotated.
14. The revenue, rates, rate design, and service charges proposed will not yield to HNG more than a fair return on the adjusted value of the invested capital used and useful in rendering service to the public, as required by TEX. UTIL. CODE ANN. § 104.052 (Vernon 2007 and Supp. 2010).
15. The rates established in this docket comport with the requirements of TEX. UTIL. CODE ANN. §104.053 (Vernon 2007 and Supp. 2010) and are based upon the adjusted value of invested capital used and useful, where the adjusted value is a reasonable balance

between the original cost, less depreciation, and current cost, less adjustment for present age and condition.

16. The rates established in this case comply with the affiliate transaction standard set out in TEX. UTIL. CODE ANN. § 104.055 (Vernon 2007 and Supp. 2010). Namely, in establishing a gas utility's rates, the regulatory authority may not allow a gas utility's payment to an affiliate for the cost of a service, property, right or other item or for an interest expense to be included as capital cost or an expense related to gas utility service except to the extent that the regulatory authority finds the payment is reasonable and necessary for each item or class of items as determined by the regulatory authority. That finding must include (1) a specific finding of reasonableness and necessity to each class of items allowed; and (2) a finding that the price to the gas utility is not higher than the prices charged by the supplying affiliate to its other affiliates or divisions or to a nonaffiliated person for the same item or class of items.
17. In accordance with TEX. UTIL. CODE ANN. §104.054 (Vernon 2007 and Supp. 2010) and TEX. ADMIN. CODE §7.5252, book depreciation and amortization was calculated on a straight line basis over the useful life expectancy of HNG's property and facilities.
18. In accordance with TEX. UTIL. CODE ANN. §104.054 (Vernon 2007 and Supp. 2010) a gas utility may not discriminate against a person who sells or leases equipment or performs services in competition with the gas utility or engage in a practice that tends to restrict or impair that competition.
19. In this proceeding, HNG has the burden of proof under TEX. UTIL. CODE ANN. §104.008 (Vernon 2007 and Supp. 2010) to show that the proposed rate changes are just and reasonable.
20. Rate case expenses for GUD Nos. 10083 and 10093 will be considered by the Commission in accordance with TEX. UTIL. CODE ANN. §104.008 (Vernon 2007 and Supp. 2010), and 16 TEX. ADMIN. CODE §7.5530 (2008), in a separate proceeding.
21. It is reasonable for the Commission to allow HNG to include a Purchased Gas Adjustment Clause in its rates to provide for the recovery of all of its gas costs, in accordance with 16 TEX. ADMIN. CODE § 7.5519.
22. All expenses for lost and unaccounted for gas in excess of 5.0 percent shall be disallowed, consistent with TEX. ADMIN. CODE § 7.5519.
23. HNG is required by 16 TEX. ADMIN. CODE §7.315 to file electronic tariffs incorporating rates consistent with this Order within thirty days of the date of this Order.
24. HNG is required by 16 TEX. ADMIN. CODE § 7.310 to utilize the Federal Energy Regulatory Commission's (FERC) Uniform System of Accounts (USOA) prescribed for natural gas companies.

25. The FERC USOA defines a cost to mean the amount of money actually paid for property or services. When the consideration given is other than cash in a purchase and sale transaction, the value of such consideration shall be determined on a cash basis. 16 CFR Part 201, Definitions, 9.
26. The FERC USOA requires that each entry in the books and records of the company shall be supported by such detailed information as will permit ready identification, analysis, and verification of all facts relevant thereto. The books and records referred to in the FERC USOA include not only accounting records in a limited technical sense, but all other records such as minute books, stock books, report, correspondence, memoranda, etc., which may be useful in developing the history of or facts regarding any transaction. 16 CFR Part 201, General Instructions, 2 A & B.
27. The FERC USOA requires that all amounts included in the accounts prescribed by the USOA shall be just and reasonable. 16 CFR Part 201, General Instructions, 2 E.

**IT IS THEREFORE ORDERED** that HNG's proposed schedule of rates is hereby **DENIED**.

**IT IS FURTHER ORDERED** that the rates, rate design, and service charges established in the findings of fact and conclusions of law and shown on the attached Schedules for HNG are **APPROVED**.

**IT IS FURTHER ORDERED** that, in accordance with 16 TEX. ADMIN. CODE §7.315, within 30 days of the date this Order is signed, HNG shall file tariffs with the Gas Services Division. The tariffs shall incorporate rates, rate design, and service charges consistent with this Order, as stated in the findings of fact and conclusions of law and shown on the attached Schedules.

**IT IS FURTHER ORDERED** that all proposed findings of fact and conclusions of law not specifically adopted in this Order are hereby **DENIED**.

**IT IS ALSO ORDERED** that all pending motions and requests for relief not previously granted or granted herein are hereby **DENIED**.

**IT IS FURTHER ORDERED THAT** within 30 days of this order HNG **SHALL** electronically file tariffs and rates schedules in proper form that accurately reflect the rates approved by the Commission in this Order.

This Order will not be final and effective until 20 days after a party is notified of the Commission's order. A party is presumed to have been notified of the Commission's order three days after the date on which the notice is actually mailed. If a timely motion for rehearing is filed by any party at interest, this order shall not become final and effective until such motion is overruled, or if such motion is granted, this order shall be subject to further action by the Commission. Pursuant to TEX. GOV'T CODE ANN. §2001.146(e), the time allotted for Commission action on a motion for rehearing in this case prior to its being overruled by operation of law, is hereby extended until 90 days from the date the order is served on the parties.

**SIGNED** this 13<sup>th</sup> day of December, 2011.

**RAILROAD COMMISSION OF TEXAS**

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**CHAIRMAN ELIZABETH AMES JONES**

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**COMMISSIONER DAVID PORTER**

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**COMMISSIONER BARRY T. SMITHERMAN**

**ATTEST:**

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**SECRETARY**