

**21<sup>st</sup> ANNUAL  
CHANGING FACE OF WATER LAW**  
February 20-21, 2020  
San Antonio

**RATE APPEALS AT THE PUC:  
WHOLESALE AND RETAIL**

**JOE FREELAND**  
Mathews & Freeland, LLP  
8140 N. MoPac Expy  
Bldg. II, Suite 260  
Austin, Texas 78759  
(512) 404-7800  
jfreeland@mandf.com



# Introduction

- Going to Discuss
  - Raw Water Rate Appeals
    - Texas Water Code §§11.036, 11.041 & 12.013
  - Wholesale Drinking Water Rate Appeals
    - Texas Water Code §13.043(f)
  - Appeals of Wholesale Rates Charged by Certain Municipalities to Districts
    - Texas Water Code §13.044
  - (If time) Process for Appeals of Retail Rates Charged by Municipalities or Districts.

# Raw Water Rate Appeals

- Texas Water Code §§ 11.036 and 11.041 - a person with (1) an **entitlement** to water controlled by another entity, (2) **willing** to pay, (3) **not contracted** to others, and (4) owner **refuses** to supply or demands **unreasonable** rate, may petition TCEQ to direct that the entity controlling the water provide the petitioner with water at a just and reasonable rate, the rate may be set by TCEQ with the participation of the PUC.
- Texas Water Code §12.013 is arguably broader extending authority over rates to any purpose mentioned under Texas Water Code Chapters 11 or 12, except that PUC's jurisdiction over municipalities is limited to water furnished by the municipality to another political subdivision on a wholesale basis.

# Raw Water Rate Appeals

- BASF Petition (Tex. Water Code §11.041)
  - 1993 Agreement. Expire 10/3/19. Brazos River Rate delivered through Dow's canal at \$0.61/thousand.
  - June 2017 - Dow offers to provide water after expiration at \$2.63/thousand BASF did not accept. Dow notifies contract will be cancelled on termination date.
  - April 2018 – BASF files petition at TCEQ alleging 1) Entitled to receive, 2) Willing to pay just and reasonable rate, 3) Not contracted to others, and 4) Dow demanding price that is not reasonable.

# Raw Water Rate Appeals

- BASF Petition (Tex. Water Code §11.041) (cont.)
  - SOAH ALJ held:
    - Claim was ripe
    - TCEQ has jurisdiction
    - TCEQ (and not the PUC) has jurisdiction to determine whether rate demanded is not just and reasonable, and, if so, the PUC could fix a new rate.
  - Matter abated until March 31, 2020, to allow for settlement.
  - May be a viable approach for wholesale customers with expiring contracts.

# Wholesale Drinking Water Rate Appeals

- Texas Water Code §13.043(f)
  - Grants the PUC jurisdiction over wholesale rates charged to a retail public utility by a retail public utility or political subdivision to another retail public utility
  - An appeal under §13.043(f) must be filed within 90 days after the date of notice of the rate changed is received from the provider of water.
- Rate Set by Contract - the rate is reviewed in two phases.
  - First Phase - PUC must determine whether the challenged rate “adversely affects the public interest.” (“public interest test”). The elements of the public interest test are discussed later.
  - Second Phase - If adversely affects the public interest, or if the rate is not set pursuant to contract, the PUC may set a new rate based on the seller’s cost of service and the “ratemaking mandates of Chapters 12 and 13.”

# Public Interest Test

- *Texas Water Comm'n v. City of Fort Worth*, 875 S.W.2d 332 (Tex. App. – Austin 1994, writ denied).
  - Before setting a new rate, agency must find existing rate is unjust, unreasonable, or discriminatory.
  - Avoid Article I, Section 16 of the Texas Constitution (retroactive laws/impairment of contract) only if rate adversely affects public interest
- Since rules adopted in 1994, no rate found to adversely affect public interest by TCEQ or PUC. **PUC Docket 47742/47862 - City of Graham**

# Public Interest Test

- 16 TAC §24.311 Determination of Public Interest
  - Impairs the sellers/buyers ability to continue to provide service
  - Rate evidences seller's abuse of monopoly power
    - Disparate bargaining power (lack of alternatives, regulatory issues)
    - Seller's failure to demonstrate changed conditions as basis for changed rates
    - Seller changed method of computing revenue requirement or rate
    - Other valuable consideration received by the party
    - Incentives necessary to encourage regional projects or water conservation
    - Seller's obligation to meet federal and state water/wastewater standards
    - Rates charged by other sellers
    - Seller's retail rates for water or sewer compared to purchaser's rates
  - Rate is unreasonably preferential, prejudicial, or discriminatory compared to rates charged by seller to other wholesale customers



# Appeal of NTMWD's Wholesale Rate\*\*

- NTMWD – 13 Member Cities (add'l Customers)
- District's rate structure - Rate determined by dividing the budgeted expenses by the total annual minimum demand for each member city. The annual minimum is a member city's highest annual usage for any year.
- Petitioners' complaint – “Paying for water not taken.” Annual minimum demands set in 2001 or 2006. Current annual demands far less:

Plano-26,719,809 gallons per year (2001)

21,803,047 gallons per year (2018)

\*\*Mathews & Freeland represents 2 of the non-Petitioning Members

# Appeal of NTMWD's Wholesale Rate

- Dec. 14, 2016 – Petition filed at PUC pursuant to TWC §13.043(f) (and §12.013) by Garland, Mesquite, Plano, and Richardson
- Rate set pursuant to contract – Two Phase Proceeding
- Hearing on Public Interest (First Phase)
  - Evidentiary Hearing – October 2018
  - Briefing Concluded – December 2018
  - Proposal for Decision - March 15, 2019
  - PUC Agenda – May 23, 2019
  - Parties requested time to discuss settlement
  - Dec. 13. 2019 – Petitioners ask PUC to rule

# Appeal of NTMWD's Wholesale Rate - PFD

## Finding of the ALJs - Rate Adverse to Public Interest

- The protested rate impairs Petitioners' ability to continue to provide service to its retail customers because the bond ratings of the Petitioners have been impaired (downgraded to AA- for two years) and have deferred projects. No evidence of actual impairment of service.
- The protested rate evidences an District abused its monopoly power:
  - The Petitioners lacked alternative sources of water both when the Contract was approved in 1988 and now (despite evidence showing that such alternatives existed and exist).
  - The District's change of position regarding director loyalty eliminated their input to the governance of the District.
  - The District can unilaterally adjust the Petitioners' rates and extend the term of the Contract by issuing new bonds.
  - The practical infeasibility of the Petitioners to modify the Contract due to the unanimous vote requirement.
  - The lack of incentives in the Contract to encourage water conservation.
- The rate charged by the District's to non-members is adverse to the public interest. (Five Cent Surcharge)

## Appeal of NTMWD's Wholesale Rate – Chairman Walker

- District's annual minimum allocation approach – looks like a reasonable approach for allocating fixed costs using historical peak (demand ratchet).
- District's governance structure does not look like a basis for concluding that the District abused its monopoly power.
- Need to repay bonds provides a valid need to have the contract extend for the life of the bonds.
- Questioned whether PUC could make any binding determinations regarding customer (non-member) rates because the other customers had not been given notice of this proceeding.
- Need to proceed cautiously based on the importance of this case to the issue of “regionalization” in the water industry.

# Appeal of NTMWD's Wholesale Rate

- **PUC Decision**

- Not added to any of the PUC Open Meetings since the December 13, 2019, letter.
- Commissioners' goal to consider at February 27, 2020, Open Meeting.
- Debate regarding the standard Commission should apply to conclude if rates adversely affect public interest.
- Discussion at February 14, 2020, Open Meeting suggests that PUC may revisit the rules addressing wholesale appeals.

# Appeal of NTMWD's Wholesale Rate

- Calls into question capacity charges in wholesale agreements (never perfect).
- Calls into question allocation of huge fixed costs in long-term contracts – somebody has to pay (Dallas/UNRMWA – Dallas paying for water never taken).
- Potential to disrupt existing financing arrangements.
- Potential to adversely affect regionalization
  - Disincentive to build coalition to construct new major water supply projects.
  - PUC prudence review of major water supply projects.

# Wholesale Rates Charged by Certain Municipalities to a District (Texas Water Code §13.044)

## **Sec. 13.044. RATES CHARGED BY MUNICIPALITY TO CERTAIN SPECIAL DISTRICTS.**

(a) This section applies to rates charged by a municipality for water or sewer service to a district created pursuant to Article XVI, Section 59, of the Texas Constitution, or to the residents of such district, which district is located within the corporate limits or the extraterritorial jurisdiction of the municipality and the resolution, ordinance, or agreement of the municipality consenting to the creation of the district requires the district to purchase water or sewer service from the municipality.

(b) Notwithstanding the provisions of any resolution, ordinance, or agreement, a district may appeal the rates imposed by the municipality by filing a petition with the utility commission. The utility commission shall hear the appeal de novo and the municipality shall have the burden of proof to establish that the rates are just and reasonable. The utility commission shall fix the rates to be charged by the municipality and the municipality may not increase such rates without the approval of the utility commission.

## Texas Water Code §13.044

- No two phase review
- City has burden of proof
- No deadline for filing appeal
- Can only appeal rate in effect at time petition filed (cannot challenge prior rates) – 48836
- Applies to both wholesale and retail rates – Docket No 49448
- District must be expressly required to purchase service from city as a condition of consent to creation to trigger PUC jurisdiction – Docket 49448



# City of Austin Wholesale Rate Cases

- Docket 42857 –
  - Petition filed at TCEQ in 2013
  - Order No. 3 – No Public Interest Inquiry required (no presumption of validity)
  - Final Order (2015)
    - Austin failed to meet burden of proof on its rates
    - PUC disallowed many of Austin's expenses (see later slide)
    - PUC set effective date as October 1, 2012 (Austin had to make refunds)
    - Austin prohibited from changing rate without first getting rates approved by PUC

# City of Austin Wholesale Rate Cases

- Docket 49189
  - Petition filed at PUC in 2019
  - Sought to fix deficiencies from Docket 42857
  - Petitioners sought discovery regarding WTP #4 – Prudence
  - PUC Commissioners allowed discovery
  - Austin withdrew its application

# City of Austin Wholesale Rate Cases

- PUC Disallowed Expenses
- **General Fund Transfer** – Transfers to general fund equal to 8.2% of the total revenues from all customers, including wholesale customers. The PUC disallowed because Austin failed to show how any of the “costs” associated with the transfer were useful in providing wholesale service to the Petitioners.
- **Reclaimed Water Expenses** – Transfers from AWU to the reclaimed water utility fund. Austin argued that the water customers benefited by freeing up potable water capacity for other uses. The PUC disagreed because Austin cost of service model did not offset the revenue requirement with any revenues from reclaimed water sales and because the transfers to the reclaimed water utility were not needed to provide service to the Petitioners.
- **Drainage Fee** –Transfers from AWU to the drainage utility as drainage fees. Austin argued that including these fees was appropriate because all customers benefit from watershed protection. PUC found there was no evidence regarding the reasonableness of the charges and no showing that the charges were reasonable and necessary to provide wholesale service to Petitioners.
- **Revenue Stability Reserve Fund** – Transfers to Revenue Stability Reserve Fund. The purpose of the fund is to contain 120 days of budgeted AWU operating requirements. Austin asserted that the fund benefits all customers by providing adequate liquidity to sustain a AA credit rating. The Commission disallowed the transfers as not reasonable, particularly given the size of the general fund transfer.

# Retail Rate Appeals – Appeal Process

- Scope – municipal utilities (OCL), districts, water supply and sewer service corporations. Appeal from 10% of ratepayers whose rates were changed.
- Current Process – ad hoc based on representations in petition and requests to utilities. **Goliad Case**, PUC Docket No. 47662. Watch *City of Celina*, Docket No. 49225.
- **SAWS Case**, PUC Docket No. 45786. 6,300 signatures. Weeks to confirm validity of signatures and denominator.
- Proposed rule

# Retail Rate Appeals - Issues

- ***What denominator should be used to determine 10% - all ratepayers, or class?***
  - Docket 44010 & 49367 – PUC legal recommended determination by rate class
  - Docket 49350 – PUC legal recommended looking at all ratepayers (even if rates raised for small class and lowered for large class)
- ***What rate is subject to be being changed on appeal?***
  - Woodloch - PUC held that it had jurisdiction over ICL rates. Extraordinary ruling. Contrary to legislative history and precedent.
  - PUC claimed jurisdiction based on language: “in an appeal . . . the commission shall ensure that every rate made, demanded, or received . . . shall be just and reasonable.”
  - Potential to interject uncertainty in municipal financing – most official statements recite PUC has no jurisdiction over ICL rates.
  - Review of rates not changed? Review of rates for other services?

# Questions

- Review PUC Dockets: <http://interchange.puc.state.tx.us>
- Watch the PUC in Action: <http://www.texasadmin.com/tx/puct/>