

SOAH DOCKET NO. 582-08-1700
TCEQ DOCKET NO. 2008-0091-UCR

2009 MAY -6 PM 3:08

PETITION OF RATEPAYERS § BEFORE THE STATE OFFICE
APPEALING RATES § CHIEF CLERK'S OFFICE
ESTABLISHED BY §
CLEAR BROOK CITY § OF
MUNICIPAL UTILITY §
DISTRICT § ADMINISTRATIVE HEARINGS

SOAH DOCKET NO. 582-09-1168
TCEQ DOCKET NO. 2008-1645-UCR

PETITION OF § BEFORE THE STATE OFFICE
WEST TRAVIS COUNTY § OF
MUNICIPAL UTILITY §
DISTRICT NO. 3 § ADMINISTRATIVE HEARINGS

AND

SOAH DOCKET NO. 582-08-2863
TCEQ DOCKET NO. 2008-0093-UCR

APPEAL OF THE RETAIL WATER § BEFORE THE STATE OFFICE
AND WASTEWATER RATES OF §
THE LOWER COLORADO RIVER § OF
AUTHORITY §
§ ADMINISTRATIVE HEARINGS

THE EXECUTIVE DIRECTOR'S BRIEF REGARDING
QUESTIONS TO BE CERTIFIED

TO THE HONORABLE COMMISSIONERS OF THE TCEQ:

COMES NOW the Executive Director of the Texas Commission on Environmental Quality (Commission or TCEQ) and files The Executive Director's Brief Regarding Questions to be Certified. On Friday, May 1, 2009, Administrative Law Judges Bill Newchurch, Henry Card, and Kerrie Qualtrough filed with the Commission a request seeking answers to the following six questions:

1. Is Texas Water Code section 49.2122 so inconsistent with Texas Water Code section 13.043(j) that the two statutory provisions cannot be harmonized?
2. Does Texas Water Code section 49.2122(b) create a presumption that rates set by

a district are properly established absent a showing that the district action setting the rates was arbitrary and capricious?

3. Does Texas Water Code section 49.2122(b) only create a presumption that customer classes established by the district are properly established absent a showing that the district action establishing the classes was arbitrary and capricious?
4. If the answer to Question No. 2 is YES, does Texas Water Code section 49.2122(b) require the petitioner to make an initial showing that the district's rate-setting action was arbitrary and capricious?
5. If the answer to Question No. 4 is YES, in the circumstance that there is no showing that the district action setting rates was arbitrary and capricious and the rates are therefore presumed to be "properly established," is there any further inquiry required into whether the rates themselves are valid? If so, what is the standard under which the rates themselves must be judged?
6. If the answer to Question 2 is YES, is the petitioner required to make the initial showing the district's rate setting action was arbitrary and capricious whether the rate affected is for retail service, wholesale service, or raw water?

The Executive Director agrees with the ALJs' six questions and respectfully requests that the Commission consider and respond to the questions certified by the ALJs. The ED would support one further question, which is described in Section IV, below.

I. Applicable Rule

Title 30 Texas Administrative Code Section 80.131(b) provides:

On a motion by a party or on the judge's own motion, the judge may certify a question to the commission. Certified questions may be made at any time during a proceeding, regarding commission policy, jurisdiction, or the imposition of any sanction by the judge which would substantially impair a party's ability to present its case. Policy questions for certification purposes include, but are not limited to:

- (1) the commission's interpretation of its rules and applicable statutes;
- (2) which rules or statutes are applicable to the proceeding; or
- (3) whether commission policy should be established or clarified as to a substantive or procedural issue of significance to the proceeding.

The questions submitted by the ALJs are appropriate for certification because they fall into all three categories listed in the rule: interpretation of the statute, applicability of the statute, and clarification of significant procedural issues.

II. Background

During the 80th legislative session, the legislature adopted a new statutory provision, Texas Water Code Section 49.2122(b), which became effective on September 1, 2007. This provision states:

A district is presumed to have weighed and considered appropriate factors and to have properly established charges, fees, rentals, and deposits absent a showing that the district acted arbitrarily and capriciously.

The cases referenced in the heading of this brief are the first three appeals from district rate-setting actions referred to SOAH since the new statutory provision took effect. In each of these three cases, the parties have disagreed upon the applicability and meaning of the provision. The issues were argued and briefed in all three courts, resulting in the three orders provided as attachments to the ALJs certified questions.

In the first case, in his Order No. 6, Judge Newchurch holds that Water Code Section 49.2122 applies to a water rates appeal brought under Section 13.043(b)(4). His interpretation is that Section 49.2122(b) does not conflict with Section 13.043(j) (requiring rates to be just and reasonable), but to the extent of any conflict, Section 49.2122(b) prevails over Section 13.043(j). Thus, the appellant must first show that district acted arbitrarily and capriciously. He further holds that the provision creates a presumption that the rates are just and reasonable. He holds that Water Code Section 49.2122 conflicts with Title 30, Texas Administrative Code Section 291.12 (which relates to the burden of proof in rate proceedings)¹, and that Section 49.2122 prevails because it is later-enacted.

In the second case, in her Order No. 3, Judge Qualtrough holds that 30 TAC Section 291.12 places the burden on the appellant because it is the moving party and says that 30 TAC Section 80.17 supports this conclusion.² She holds that the appellant must show that rates are unreasonable. Finally, she declines to rule on whether the appellant must show that the district's rate-setting action was arbitrary and capricious, saying that the legislative history seems to suggest that Water Code Section 49.2122(b) applies only the process of a district's designation of classes of ratepayers, which is not the case here.

In the third case, in his Order No. 3, Judge Card holds that Water Code Section 49.2122(b) does not apply because the rate change does not affect different classes differently. Thus, he reverts to the burden of proof stated in Water Code Section 13.043(j), which requires the district to prove that its rates are just and reasonable.

¹ The full text of 30 TAC § 291.12 reads: "In any proceeding involving any proposed change of rates, the burden of proof shall be on the provider of water and sewer services to show that the proposed change, if proposed by the retail public utility, or that the existing rate, if it is proposed to reduce the rate, is just and reasonable. In any other matters or proceedings, the burden of proof is on the moving party."

² Section 80.717 provides that the burden of proof is on moving party except as specified in 30 TAC §§ 291.12 and 291.136 and in enforcement actions.

It is true that the three cases pending at SOAH are factually distinguishable. In the petition of West Travis County MUD No. 3, the MUD appeals from an action by the Lower Colorado River Authority (LCRA) affecting the rate it pays for raw water. In the case involving Clear Brook Municipal Utility District (MUD) and TCR Highland Meadow, the district's action affected a retail water service rate for one class of customers. In the final case, the City of Bee Cave and West Travis County MUDs Nos. 3 and 5 appeal from an action by the LCRA affecting a retail water service rate for all customers, not differentiating between customer classes. However, it is not the case that the different outcomes were solely due to a consistent application of the provision to different facts. The different outcomes were due in part to factual differences, but also varying interpretations of the new provision.

After reading the orders together, the ED feels that additional clarification and direction is needed as to the meaning and proper application of the provision. The ED respectfully requests that the commission take the opportunity to provide this guidance by answering the certified questions proposed.

III. Reasons the Commissioners Should Accept and Answer the Certified Questions

A. Many people, including judges and neutral parties, find the provision confusing. The Executive Director, OPIC and three Administrative Law Judges have found that the provision raises several important questions, the answers to which are unclear. In addition, interested parties on both sides (districts and one ratepayer), also request clarification. The number and variety of those who are requesting guidance suggests that the provision is indeed genuinely confusing and subject to many interpretations.

Indeed the Judges' orders demonstrate the difficulties in interpreting the provision. In his Order No. 3, Judge Card states that he "agrees with Appellants that the meaning of Section 49.2122(b) is ambiguous."³ Later, he states that the context of the provision "raise(s) questions concerning the scope and meaning of that subsection."⁴ In Judge Qualtrough's Order No. 3, she writes:

After establishing that the MUD has the burden of proof, the ALJ declines to rule at this point on whether the MUD must prove that LCRA acted arbitrarily and capriciously as purportedly required under section 49.2122 of the Texas Water Code. The legislative history cited by the MUD suggests that section 49.2122(b) applies only to the process of a district's designation of classes of ratepayers, which is not the situation presented in this proceeding. Nevertheless, under section 12.013, the MUD has to prove that the rates are unreasonable and the MUD must determine how it will prove up its case. It is up to the MUD to decide

³ SOAH Docket No. 582-08-2863, Order No. 3, p. 2.

⁴ Id. at 2-3.

whether it must also prove that LCRA was arbitrary and capricious to overcome the presumption found in section 49.2122(b), should its analysis of the legislative history later be found in error.⁵

In his Order No. 6, Judge Newchurch explains that between the time of the prehearing teleconference in which the application of the provision was discussed and the issuance of his order, he “changed his thinking” regarding the burden imposed by section 49.2122(b).⁶ The ED points out these portions of the orders to show that even those most capable of interpreting statutes seem to have had some uncertainty and difficulty with this one. This conclusion is borne out by their request to you to answer certified questions.

B. To answer these questions definitively at this point will undoubtedly assist parties and the courts in many future cases. These are only the first three cases in which the new provision has played a role. All three were contested. All three required briefing and/or teleconferences, and orders related to how the provision would be interpreted and applied. The fact that these are just the first three cases, coupled with the number of supporters of this request, support the prediction that this provision will play a significant role in district rate appeals to come. One interpretation of the provision is that it applies to all appeals from all district rate-setting actions. Thus, without these answers, we could continue to struggle with this provision in each of the many appeals from a district rate-setting action that are filed each year.

C. Knowing the answers to these questions will contribute to judicial economy and save the commission's time. The certainty gained by having the commission's viewpoint will save SOAH's time in wrestling with these issues in each new case, reduce the likelihood of appeals based on a claim that the provision was misinterpreted or misapplied, and may even reduce the number of appeals from district rate-setting actions that are brought before the agency in the first place.

D. The commission should provide the regulated community with an adequate level of certainty regarding how its statutes will be applied in a potential contested case, not only for the sake of judicial economy, but also as a matter of service to the regulated community. A regulated entity needs to know how high the hurdle is before it sets out to clear it. Prevailing in a contested case often entails incurring legal and other expenses. A regulated entity must first understand its burden in order to weigh the costs and benefits of pursuing the case.

It is the ED's opinion that the current parties as well as other members of the regulated community who will use this statute in the future would benefit from clarification from the final decision-making body. That the first three cases directly implicating this statutory provision were referred to SOAH as contested matters and required special consideration of numerous questions related to the provision, indicates that the provision is problematic. Clear direction would decrease the likelihood of future

⁵ SOAH Docket No. 582-09-1168, Order No. 3, p. 12.

⁶ SOAH Docket No. 582-08-1700, Order No. 6, p. 2.

contested cases and appeals related to disagreements over this provision, saving the courts' and commission's time.

IV. Additional Certified Questions Requested

In addition to the six questions submitted by the ALJs, some parties have indicated their intent to submit with their briefs additional questions. The ED wishes to give his position on whether the commission should answer these additional questions, in the event that they are proposed by another party:

Proposed Question 7: If Question No. 1 is answered YES, does Tex. Water Code Section 49.002(a) dictate that Tex. Water Code section 13.043(j) controls over Tex. Water Code Section 49.2122?

Proposed Question 8: If the answer to Question No. 4 is YES, what level of evidence must the petitioner produce to show that the district acted "arbitrarily and capriciously" under Tex. Water Code Section 49.2122?

The Executive Director supports the addition of Proposed Question 7. Water Code Section 49.002(a) provides:

Except as provided by Subsection (b), this chapter applies to all general and special law districts to the extent that the provisions of this chapter do not directly conflict with a provision in any other chapter of this code or any Act creating or affecting a special law district. In the event of such conflict, the specific provisions in such other chapter or Act shall control.

This applicability provision adds another layer of uncertainty as to the proper relationship of Water Code sections 49.2122(b) and 13.043(j). If the commission determines that these two provisions conflict, this question will certainly be raised next. The Executive Director supports the addition of this certified question because it is appropriate under 30 TAC Section 80.17 in that it relates to which statutes are applicable to the proceeding and because it naturally and inevitably follows the first question certified by the ALJs.

The Executive Director does not support the addition of Proposed Question 8. Under 30 TAC Section 80.17, the level of proof required is a preponderance of the evidence. Judge Newchurch so held in his Order No. 7 (attached hereto), and because the ED agrees with the Judge's reasoning on this matter, it will not be repeated here.

V. Conclusion

The Executive Director respectfully requests that the commission take up and consider and provide answers to questions 1 – 6 presented by the Honorable Administrative Law Judges. If another party proposes Question 7, above, the ED supports the addition of that question.

Respectfully submitted,

Texas Commission on Environmental
Quality

Mark Vickery
Executive Director

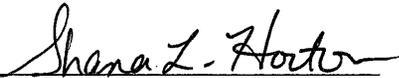
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CERTIFICATE OF SERVICE

I hereby certify that on the 6th day of May, 2009, the foregoing *Executive Director's Brief Regarding Questions to be Certified* was filed with the Chief Clerk of the Texas Commission on Environmental Quality and that a true and correct copy was forwarded to each of the parties listed on the attached mailing list by the method indicated.


Shana L. Horton

TEXAS
COMMISSION
ON ENVIRONMENTAL
QUALITY
2009 MAY - 6 PM 3: 08
CHIEF CLERKS OFFICE

MAILING LIST
SOAH Docket Nos. 582-08-1700, 582-08-2863, and 582-09-1168

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**SOAH DOCKET NO. 582-08-1700
TCEQ DOCKET NO. 2008-0091-UCR**

**PETITION OF RATEPAYERS
APPEALING RATES ESTABLISHED
BY CLEAR BROOK CITY
MUNICIPAL UTILITY DISTRICT**

§
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§

**BEFORE THE STATE OFFICE
OF
ADMINISTRATIVE HEARINGS**

**ORDER NO. 7
DENYING MOTION TO RECONSIDER ORDER NO. 6,
DENYING MOTIONS CONCERNING LEVEL OF REQUIRED EVIDENCE,
AND
GRANTING MOTION TO EXTEND DEADLINE TO PROPOSE REVISED SCHEDULE**

I. MOTION TO RECONSIDER

On October 23, 2008, TCR Highland Meadow Limited Partnership (TCR) filed a motion asking the Administrative Law Judge (ALJ) to reconsider a portion of Order No. 6. TCR asked that a hearing be set on its motion and argues that:

- Clear Brook City Municipal Utility District (Clear Brook), not TCR, should be required to prefile and present its direct case first;
- Clear Brook has the burden of proving its rates are just and reasonable; and
- TCR need only provide more than a scintilla of evidence that Clear Brook acted arbitrarily and capriciously in setting the rates in dispute.

On October 27, 2008, Clear Brook filed a response and asked the ALJ to hold a hearing and deny TCR's motion to reconsider and instead rule that:

- TCR must show that Clear Brook acted arbitrarily and capriciously in the adopting the rate order, and
- To meet that burden, TCR must show that there is no more than a scintilla of evidence to support Clear Brook's rate order.

When contacted by the ALJ's Assistant, the Executive Director (ED) and the Office of Public Interest Counsel (OPIC) indicated that they would not be filing responses to the motion to reconsider. The ALJ sees no reason to hold a hearing on TCR's motion, since it concerns issues of law, which the parties have thoroughly briefed. The motions for a hearing are denied.

Additionally, TCR's motion to reconsider Order No. 6 is denied. The ALJ sees no error in the portion of the Order about which TCR complains. The ALJ still concludes that TCR has the initial burden of proof and should prefile and present its direct case first because Water Code § 49.2122(b):

- creates a presumption that Clear Brook's rates are just and reasonable;
- assigns to TCR the burden of proving that Clear Brook acted arbitrarily and capricious, which is synonymous with unjustly and unreasonably, in weighing and considering appropriate factors and properly establishing rates;
- is a later enacted statute that conflicts with 30 TEX. ADMIN. CODE (TAC) § 291.12, concerning burden of proof, and Water Code § 49.2122(b) prevails;
- does not, nor does Water Code § 49.2122(a), conflict with Water Code § 13.043(j), which requires Clear Brook's rates to be just, reasonable, *etc.*; and
- relieves Clear Brook of the burden of proving that its rates are just and reasonable, which it would otherwise have under Water Code § 13.043(j) and 30 TAC §291.12, until TCR first shows that Clear Brook acted arbitrarily and capriciously.

II. LEVEL OF REQUIRED PROOF

When Order No. 6 was issued only special exceptions, a discovery dispute, and a request to modify the procedural schedule—primarily to deal with burden of proof and the order of prefiling evidence—was before him. In the current pleadings, TCR and Clear Brook more specifically ask for rulings concerning the level of proof required to meet TCR's burden of proving that Clear Brook acted arbitrarily and capriciously in setting the disputed rates. The ALJ agrees that the case will be processed more efficiently if he rules on this issue at this time.

The level-of-proof dispute largely concerns scintillas, which are tiny amounts of something. Assuming for the sake of argument that it has any burden of proof, TCR claims that it must present only a bit more than a scintilla of evidence that Clear Brook acted arbitrarily and capriciously in setting the disputed rates. On the other hand, Clear Brook contends that TCR must show that there is no more than a scintilla of evidence to support Clear Brook's rate order. Both are incorrect.

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Both Parties rely on administrative law cases decided under Tex. Gov't Code § 2001.174, its statutory ancestor, similar provisions in other statutes, and similar principles developed by the courts in the absence of statutes on point. Section § 2001.174 summarize all of those and states:

If the law authorizes review of a decision in a contested case under the substantial evidence rule or if the law does not define the scope of judicial review, a court may not substitute its judgment for the judgment of the state agency on the weight of the evidence on questions committed to agency discretion but:

(1) may affirm the agency decision in whole or in part; and
(2) shall reverse or remand the case for further proceedings if substantial rights of the appellant have been prejudiced because the administrative findings, inferences, conclusions, or decisions are:

- (A) in violation of a constitutional or statutory provision;
- (B) in excess of the agency's statutory authority;
- (C) made through unlawful procedure;
- (D) affected by other error of law;
- (E) not reasonably supported by substantial evidence considering the reliable and probative evidence in the record as a whole; or
- (F) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

Thus, absent legal error, a reviewing court will almost never second-guess the weight assigned to the evidence by the agency that acted in a quasi-judicial capacity and considered the evidence presented by the parties to the dispute. The deference given to the administrative adjudicator's weighing of the evidence is enormous. As the Supreme Court of Texas summarized in *Texas Health Facilities Com. v. Charter Medical-Dallas, Inc.*, 665 S.W.2d 446, 453 (Tex. 1984):

Although substantial evidence is more than a mere scintilla, *Alamo Express, Inc. v. Union City Transfer*, 158 Tex. 234, 309 S.W.2d 815, 823 (1958), the evidence in the record actually may preponderate against the decision of the agency and nonetheless amount to substantial evidence. *Lewis v. Metropolitan Savings and Loan Association*, 550 S.W.2d 11, 13 (Tex. 1977). The true test is not whether the agency reached the correct conclusion, but whether some reasonable basis exists in the record for the action taken by the agency. *Gerst v. Nixon*, 411 S.W.2d 350, 354 (Tex. 1966). A reviewing court is not bound by the reasons given by an agency in its order, provided there is a valid basis for the action taken by the agency. *Railroad Commission v. City of Austin*, 524 S.W.2d 262, 279 (Tex. 1975). Thus, the agency's action will be sustained if the evidence is such that reasonable minds could have reached the conclusion that the agency must have reached in

order to justify its action. *Suburban Utility Corp. v. Public Utility Commission*, 652 S.W.2d 358, 364 (Tex. 1983).

The findings, inferences, conclusions, and decisions of an administrative agency are presumed to be supported by substantial evidence, and the burden is on the contestant to prove otherwise. *Imperial American Resources Fund, Inc. v. Railroad Commission*, 557 S.W.2d 280, 286 (Tex. 1977). Hence, if there is evidence to support either affirmative or negative findings on a specific matter, the decision of the agency must be upheld. *Gerst v. Goldsbury*, 434 S.W.2d 665, 667 (Tex. 1968); see also *Lewis v. Jacksonville Building and Loan Association*, 540 S.W.2d 307, 311 (Tex. 1976).

Should either TCR or Clear Brook seek judicial review of the Commission's ultimate decision in this case, Section § 2001.174 would apply. A reviewing court would defer to the Commission's weighing of the evidence.

That leads TCR to argue that it need only provide a bit more than a scintilla of evidence that Clear Brook acted arbitrarily and capriciously. The ALJ does not agree. While only a small amount of evidence is needed to support a decision by the Commission on judicial review, the Commission demands a higher level of proof from a movant in a case before it. 30 TAC § 80.17 provides

(a) The burden of proof is on the moving party by a **preponderance of the evidence**, except as provided in subsections (b) . . .

(b) Section 291.12 of this title (relating to Burden of Proof) governs the burden of proof in a proceeding involving a proposed change of water and sewer rates not governed by Chapter 291, Subchapter 1 of this title (relating to Wholesale Water or Sewer Service).

(Emphasis added.)

As discussed in Order No. 6, 30 TAC §291.12 places the burden of proof on "the provider of water and sewer services." However, Water Code § 49.2122 (b) preempts that rule by requiring TCR to first show that Clear Brook acted arbitrarily and capriciously. To show that, the ALJ concludes that Rule 80.17(a) applies and requires TCR to first show by a preponderance of the

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evidence that Clear Brook acted arbitrarily and capriciously. A little more than a scintilla will not do.

But Clear Brook argues that the required level of proof is even higher. It points to additional cases applying Tex. Gov't Code § 2001.174¹ and claims that they show that the courts have determined that something is not arbitrary and capricious if it is supported by substantial evidence, which need be only slightly more than a scintilla of proof. This leads Clear Brook to contend that TCR must show that there is no more than a scintilla of evidence to support the rates in dispute. The ALJ does not agree.

Clear Brook's argument rips cases out of their Texas Gov't Code § 2001.174 context. In those cases, the courts were not generally determining the meaning of arbitrary and capricious. Instead, they were determining the extent of the prohibition on a reviewing court's substituting its judgment concerning the weight of the evidence for that of the agency that acted as the neutral trier of fact and weighed the evidence. In that situation, the adjudicator is entitled to extreme deference.

Clear Brook is not entitled to that extreme deference. It did not hold a contested case and was not acting as a disinterested and impartial adjudicator when it set rates. Instead, it was acting as a seller and setting prices that it would charge TCR for service. Neither Section 2001.174 nor the long-established principles that underlie it apply in that situation. It is true that Water Code § 49.2122 creates a presumption in Clear Brook's favor, but a fair reading of that statute does not entitle Clear Brook to the same deference accorded an adjudicative agency.

¹ *Sanchez v. Tex. State Bd. of Med. Examiners*, 229 S.W.3d 498 (Tex. App. Austin 2007, no pet.); *Reliant Energy, Inc. v. PUC*, 153 S.W.3d 174 (Tex. App. Austin 2004, review denied); *Public Utility Com'n. v. Gulf States Utilities Co.*, 809 S.W.2d 201, 210 (Tex. 1991); *Gerst v. Nixon*, 411 S.W.2d 350 (Tex. 1966); *Hinkley v. Tex. State Bd. of Med. Exam'rs*, 140 S.W.3d 737 (Tex. App. Austin 2004, review denied); *Montgomery Indep. Sch. Dist. v. Davis*, 34 S.W.3d 559 (Tex. 2000); *Meador-Brady Management Corp. v. Texas Motor Vehicle Comm'n*, 833 S.W.2d 683 (Tex. App. Austin 1992), rev'd on other grounds, 866 S.W.2d 593, (Tex. 1993); and *City of El Paso v. Public Util. Comm'n*, 883 S.W.2d 179, 185 (Tex. 1994).

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The ALJ concludes that Clear Brook is presumed to have weighed and considered appropriate factors and to have properly established rates absent a showing by a preponderance of the evidence that Clear Brook acted arbitrarily and capriciously.

III. EXTENSION OF DEADLINE TO FILE REVISED SCHEDULE

10/31/2008 10:01

On October 29, 2008, TCR, with the concurrence of all parties, filed a motion to extend the October 29, 2008, deadline that Order No. 6 set for the parties to propose a revised procedural schedule. TCR asked for an extension until the ALJ ruled on TCR's motion to reconsider Order No. 6. The motion to extend is granted. The Parties shall confer and propose a new schedule by November 14, 2008.

SIGNED October 31, 2008.

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**WILLIAM G. NEWCHURCH
ADMINISTRATIVE LAW JUDGE
STATE OFFICE OF ADMINISTRATIVE HEARINGS**

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