

**SOAH DOCKET NOS. 582-08-2863
TCEQ DOCKET NOS. 2008-0093-UCR**

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**APPEAL OF THE RETAIL WATER
AND WASTEWATER RATES OF
THE LOWER COLORADO RIVER
AUTHORITY**

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BEFORE THE TEXAS CHIEF CLERKS OFFICE

COMMISSION ON

ENVIRONMENTAL QUALITY

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

**PETITION OF WEST TRAVIS
COUNTY MUNICIPAL UTILITY
DISTRICT NO. 3 FOR REVIEW OF
RAW WATER RATES**

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BEFORE THE TEXAS

COMMISSION ON

ENVIRONMENTAL QUALITY

**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 TEXAS

COMMISSION ON

ENVIRONMENTAL QUALITY

**WEST TRAVIS COUNTY MUD NOS. 3 AND 5's
BRIEF ON THE ADMINISTRATIVE LAW JUDGES'
REQUEST FOR ANSWERS TO CERTIFIED QUESTIONS**

TO THE HONORABLE COMMISSIONERS:

COME NOW Appellants West Travis County Municipal Utility District Nos. 3 and 5 (the "Districts") and file this, their Brief on the Administrative Law Judges' ("ALJs") Request for Answers to Certified Questions (the "Request"). In their Brief, the Districts will

respectfully show that (i) if the Commission finds that Section 49.2122 applies to other rate disputes beyond customer class disputes, then Section 49.2122 of the Texas Water Code is **so inconsistent** with Section 13.043(j) as to render Section 49.2122 inapplicable in this retail rate case; (ii) Section 49.2122 does **NOT** create a presumption that rates set by a district are properly established; (iii) Section 49.2122 **ONLY** creates a presumption that customer classes established by a district are properly established; (iv) **even IF** Section 49.2122 creates a presumption that the rates set by a district are properly established, then a petitioner has only to make a mere showing, provide a scintilla of evidence, that the district rate setting was arbitrary or capricious to shift the burden back to the district; (v) **even IF** the petitioner fails to show any evidence that the district action setting the rates was arbitrary or capricious, State law requires the Commission to ensure that every rate is just and reasonable, based upon costs that are reasonable and necessary for the operation of the utility as well as the cost of infrastructure that is used and useful for the delivery of service to the ratepayers; and (vi) **IF** the Commission rules that Section 49.2122 does create a presumption that rates, instead of customer classes, are properly established without a showing that the action was arbitrary or capricious, then the Commission, and other Texas regulatory agencies, would relinquish their respective authority and duties to regulate any and ALL rate setting by the 1,925 districts and the 14 river authorities in Texas, including regulation of water and wastewater rates, electrical service rates for consumers, electric transmission service rates, and communication service rates and fees as well as relinquish any authority to review and regulate ad valorem tax rates for payment of operating expenses and repayment of bonded indebtedness. In support hereof, the Districts show the following:

I.
BACKGROUND

This pending matter before the State Office of Administrative Hearings involves the appeal of a retail water and wastewater rate, not a customer class dispute. The Board of Directors of the Lower Colorado River Authority (the "LCRA") approved water and wastewater rate increases for the West Travis County Regional systems in August 2007. Within the statutory timeframe, ratepayers signed and filed petitions for an appeal of the rate increase with the Texas Commission on Environmental Quality (the "TCEQ" or the "Commission").

As the Districts have pointed out, this matter is a dispute over the unjust and unreasonable retail water and wastewater rates that the LCRA adopted. Nothing in the Districts' appeal raises any concern regarding any customer class issues, any disputes between customer classes, any customer class designations by the LCRA, or the different rates that the LCRA established between different customer classes. The Districts do not compare a residential customer's rates to the rates of LCRA's other customer classes, such as commercial or industrial customers. Instead, the Districts appealed the LCRA's retail rates under the ratemaking provisions of the Texas Water Code and the Commission's rules due to the unjust and unreasonable charges included in the LCRA's retail ratemaking for all customers, regardless of customer class. Under those provisions, both the Legislature and the Commission established that for an appeal of retail rates, the LCRA bears the burden of proof of showing that its rates are just and reasonable.

Both the LCRA and Executive Director ("E.D.") of the TCEQ asserted that Section 49.2122 applied to disputes other than those between customer classes, such as

the Districts' challenge to the LCRA's retail water and wastewater rates. Both the E.D. and LCRA argued that the ALJ should expand the scope of applicability for Section 49.2122 beyond the Legislature's intent and require the Districts to show that LCRA's action to increase retail water and wastewater rates was arbitrary and capricious.¹ However, both arguments ignore the Legislature intent for Section 49.2122 as well as the Commission's rules and practice in regard to the review of a district's retail rates.

The Districts and the City of Bee Cave asked the Administrative Law Judge to review the legislative history of Section 49.2122, which when reviewed, reveals that the entirety of this statute was intended to apply only to disputes between different customer classes in which a general law district established differing class fees discriminately. The Districts argued that the Legislature's intent was to **“allow a district to establish different fees among classes of customers** based on any factors the district considers appropriate.”² The intent of the Legislature in enacting this section was to allow districts to establish classes of customers and to charge such classes different rates, based on factors the district considers appropriate.

In his Order No. 3, Judge Henry Card agreed with the Districts, ruling that Section 49.2122(b) “does not require Appellants to prove that LCRA acted arbitrarily and

¹ See LCRA's Initial Briefing on the Applicability of Texas Water Code §49.2122 at 6, Appeal of the Retail Water and Wastewater Rates of the Lower Colorado River Authority, SOAH DOCKET NO. 582-08-286, TCEQ DOCKET NO. 2008-0093-UCR (March 6, 2009)(hereinafter “LCRA INITIAL BRIEF”); E.D.'s Initial Brief at 2, Appeal of the Retail Water and Wastewater Rates of the Lower Colorado River Authority, SOAH DOCKET NO. 582-08-286, TCEQ DOCKET NO. 2008-0093-UCR (March 6, 2009)(hereinafter “E.D.'s INITIAL BRIEF”)

² House Comm. on Natural Resources, Bill Analysis, Tex. H.B. 2301, 80th Leg., R.S. (2007), attached as Exhibit “A.”

capriciously in establishing the rates that are the subject of this appeal.³ Regarding Section 49.2122(b), Judge Card noted the following:

. . . it exists in the context of a section that pertains to the establishment of customer classes. Its reference to “charges, fees, rentals and deposits” is identical to the language in subsection (a) [of Section 49.2122], which explicitly governs differences among customer classes. . . . The legislative history, set out in Appellants’ briefs, supports the narrower interpretation they espouse.⁴

He then concluded that the LCRA, just as any other utility in a rate appeal before the Commission, must bear the burden of proof that its rates are just and reasonable.⁵ Judge Card’s ruling on the inapplicability of Section 49.2122 in this rate appeal recognized that the dispute at hand is not a customer class dispute, but is merely a typical rate dispute between a retail public utility provider and its ratepaying customers.

On May 1, 2009, Judge Card, along with Judges Newchurch and Qualtrough, requested that the Commission answer certified questions regarding the applicability of Section 49.2122 (the “Request”). In Judge Newchurch’s matter, the owner of an apartment complex, TCR, appealed the rates for sewer and water service charged by Clear Brook City Municipal Utility District because CBCMUD established different charges, fees, rentals, or deposits between different **classes of customers**. Specifically, CBCMUD established a different water and wastewater rate for apartment complexes than the water and wastewater rates charged to other residential customers. In his Order No. 6, Judge William G. Newchurch applied the presumption in Section 49.2122 in

³ See Order No. 3 at 3, Appeal of the Retail Water and Wastewater Rates of the Lower Colorado River Authority, SOAH DOCKET NO. 582-08-286, TCEQ DOCKET NO. 2008-0093-UCR (March 26, 2009)(hereinafter “Order No. 3”)

⁴ Order No. 3, at 2-3.

⁵ *Id.* at 3.

declaring that CBCMUD had weighed and applied all appropriate factors in setting different rates between different customer classes, thus placing the burden of proof on TCR to show that CBCMUD acted arbitrarily and capriciously in setting different charges for different classes of customers.⁶

In Judge Qualtrough's matter, West Travis Co. MUD No. 3 ("MUD 3") filed a petition under the Commission's General Powers and Duties Relating to Water Rights found in Chapter 12 of the Water Code, not the Water Rates and Services provisions of Chapter 13. More specifically, MUD 3 appealed under Section 12.013, which allows the Commission to review and fix rates for water rights using "any reasonable basis for fixing rates as may be determined by the commission to be appropriate under the circumstances of the case being reviewed." Judge Kerrie Jo Qualtrough pointed out in her ruling that the MUD 3 matter was neither a retail rate case nor a matter involving the resale of water to third parties. Therefore, Judge Qualtrough ruled that the burden of proof in the MUD 3 matter rested squarely upon MUD 3 under the Commission's existing rules,⁷ and she did not rule on the applicability of Section 49.2122.

On May 6, 2009, the Districts filed their Response to the ALJ's Request for Answers to the Certified Questions. On May 15, 2009, the Commission's General Counsel, Les Trobman, requested that the TCEQ Chief Clerk set the certified questions for consideration during a future public meeting of the Commission.

⁶ *Petition of Ratepayers Appealing Rates Established by Clear Brook City Municipal Utility District*, SOAH Docket No. 582-08-1700, Order No. 6 at 7 (Oct. 22, 2008).

⁷ See 30 TEX. ADMIN. CODE § 291.12.

II.
ANSWERS TO ALJS' CERTIFIED 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?

Regardless how the Commission answers this question, Section 49.2122 does not apply in a ratepayers' appeal of retail water and wastewater rates. If the Commission answers that it cannot harmonize these Water Code Sections (i.e., there is a direct conflict between these sections), then the applicability provision of Chapter 49 will prohibit the application of Section 49.2122 to any appeal filed under Section 13.043, as Section 49.2122 will be in direct conflict with Section 13.043. For the Commission to answer that these Water Code Sections are harmonious, then it must rule that Section 49.2122 applies to a subject matter other than an appeal of retail rates to avoid a direct conflict with Section 13.043. Section 49.2122 cannot apply in an appeal of retail water and wastewater rates brought by petitioners under Section 13.043. Either way the Commission answers the question, the question is moot in regard to a retail rate appeal.

a. YES, these Water Code Sections are so inconsistent the Commission cannot harmonize these sections.

Regarding the applicability of the provisions found in Chapter 49, Section 49.002 states the following:

Sec. 49.002. APPLICABILITY. (a) 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.

(b) This chapter does not apply to a district governed by Chapter 36 unless a special law creating the district or amending the law creating the district states that this chapter applies to that district.⁸

Both the LCRA and Executive Director (“E.D.”) of the TCEQ assert that Section 49.2122 applies to disputes other than those between customer classes, such as the Districts’ ratepayer challenge to the LCRA’s retail water and wastewater rates. Both the E.D. and LCRA argue that the ALJ, and now the Commission, should expand the scope of applicability for Section 49.2122 beyond the Legislature’s intent and 1) require the Districts to carry the burden of proof in the retail rate case and 2) for the Commission to ignore the duty imposed by the Legislature and presume that LCRA’s rates are properly established unless the Districts show LCRA’s action to increase retail water and wastewater rates was arbitrary or capricious.⁹ However, both arguments are contrary to intent of the Texas Legislature. Both the E.D. and the LCRA also ignore the Commission’s rules and practice in regard to the review of a district’s retail rates. More important in answering these certified questions, the LCRA and E.D.’s interpretation of Subsection 49.2122(b) would cause a direct conflict with Section 13.043(j). Thus, the applicability provision for Chapter 49, Section 49.002, would render Subsection 49.2122 inapplicable to a rate appeal filed under Section 13.043 due to that direct conflict, and, thus, render the ALJ’s questions moot.

⁸ Tex. Water Code § 49.002 (Vernon 2008)(emphasis added).

⁹ See LCRA’s Initial Briefing on the Applicability of Texas Water Code §49.2122 at 6, Appeal of the Retail Water and Wastewater Rates of the Lower Colorado River Authority, SOAH DOCKET NO. 582-08-286, TCEQ DOCKET NO. 2008-0093-UCR (March 6, 2009)(hereinafter “LCRA INITIAL BRIEF”); E.D.’s Initial Brief at 2, Appeal of the Retail Water and Wastewater Rates of the Lower Colorado River Authority, SOAH DOCKET NO. 582-08-286, TCEQ DOCKET NO. 2008-0093-UCR (March 6, 2009)(hereinafter “E.D.’s INITIAL BRIEF”)

The Texas Legislature has imposed a statutory duty upon the Commission under Section 13.043(j), which is a direct conflict with the presumption provisions of Section 49.2122. Section 13.043(j) states the following.

In an appeal under this section, the *commission shall ensure that every rate* made, demanded, or received by any retail public utility or by any two or more retail public utilities jointly *shall be just and reasonable*. Rates shall not be unreasonably preferential, prejudicial, or discriminatory, but shall be sufficient, equitable, and consistent in the application to each class of customers. . . .¹⁰

The Commission cannot ensure that *ever rate is just and reasonable* while at the same time presuming that a district action's in setting a rate are proper without a showing that the district's action was arbitrary or capricious. By posing their questions, the ALJs assume a conflict exists between Sections 49.2122(b) and 13.043(j). If this conflict does exist, then Subsection 49.2122(b) is inapplicable to a retail rate case.

If, as the LCRA and the E.D. argue, Subsection 49.2122(b) creates a presumption that all rates, not just class designations, are properly established absent a showing that the district set the rates arbitrarily or capriciously, then Subsection 49.2122(b) is plainly in conflict with the Legislature's directive to the Commission to ensure every rate is just and reasonable. Moreover, the LCRA and E.D.'s proposed interpretation of Section 49.2122 would require a total disregard of the very specific language in Subsection 49.2122(a), which asserts that "a district may establish different charges, fees, rentals, or deposits among **classes of customers** that are based on any factor the district considers appropriate."¹¹ Subsection (b) discusses these very same "charges, fees, rentals, or

¹⁰ Tex. Water Code Ann. § 13.043 (j) (Vernon 2008)(emphasis added).

¹¹ Tex. Water Code Ann. § 49.2122 (a) (Vernon 2008)(emphasis added).

deposits” as well, and these charges, fees, rentals, or deposits are described as the same factors that a district is “presumed to have weighed and considered as appropriate” in subsection (b).¹²

Thus, for Section 49.2122 to be applicable and not in conflict with Section 13.043(j), then the Districts’ argument, that subsection (b) applies to customer class disputes only, must be correct. Section 49.2122 cannot apply to other rate disputes such as a retail rate case. If the language in Subsection 49.2122(b) is interpreted to include all rate disputes beyond the original customer class disputes discussed in subsection (a), then subsection 49.2122(b) is in conflict with Section 13.043(j) and, therefore, not applicable to this retail rate case.

b. NO, these Water Code Sections are not so inconsistent as to be harmonized IF the Commission follows the Legislature’s Intent and limits the applicability of Section 49.2122 to customer class disputes.

In construing provisions of State statutes, a State agency must “adhere to certain guiding principles of statutory construction.”¹³ “The rules of construction of statutes require that a subsequent statute which does not expressly repeal a former statute be construed as merely cumulative of the former statute even though it relates to the same subject matter,” unless the two statutes are “so repugnant” to each other that both cannot be maintained.¹⁴ Even if two laws are repugnant, a construction will be sought that will

¹² *Id.* §49.2122 (b)(Vernon 2008).

¹³ *Employees Retirement Sys. of Tex. v. Jones*, 58 S.W.3d 148, 153 (Tex. App. – Austin 2001, no pet.).

¹⁴ *Jones v. Sharyland Ind. Sch. Dist.*, 239 S.W.2d 216, 218 (Tex. Civ. App. – San Antonio 1951, no writ); *Bank of Tex. v. Childs*, 615 S.W.2d 810, 813 (Tex. Civ. App. – Dallas 1981, writ ref’d n.r.e.) *judgment rev’d on other grounds*, 463 U.S. 855 (1983) (citing *Standard v. Sadler*, 383 S.W.2d 391, 395 (Tex. 1964)).

harmonize them and give effect to each.¹⁵ Moreover, the rules of statutory construction specifically provide that legislative history, title, and context may be considered for the statute as a whole rather than in isolated provisions.¹⁶ New or revised statutes are presumed to be enacted by the legislature with “full knowledge of the existing condition of the law” and these new statutes are subject to existing law unless *clearly indicated to the contrary*.¹⁷ The legislature, when enacting a statute regarding a regulated activity, is presumed to be familiar with the manner in which that activity is conducted at that time.¹⁸

Section 49.2122 relates only to the designation of customer classes, the allocation of costs between the designated classes, and the burden that protesters must bear to challenge such designation and allocation. In contrast, Section 13.043 is a broad provision that grants the Commission with appellate jurisdiction over any rate proceeding, and the provision imposes a duty upon the Commission to ensure that “*every rate* made, demanded, or received by any retail public utility or by any two or more retail public utilities jointly *shall be just and reasonable*.”¹⁹

Thus, under these rules of statutory construction, the Commission must interpret Texas Water Code Sections 49.2122 and 13.043 in such a way as to make both statutes effective, if possible. Therefore, for these two sections to not conflict, Section 49.2122 must address a subject area other than the Commission’s duty to ensure every rate made

¹⁵ *Cole v. State*, 170 S.W. 1036, 1037 (Tex. 1914); *Gordon v. Lake*, 356 S.W.2d 138, 139 (Tex. 1962); *Frizzel v. Cook*, 790 S.W.2d. 41, 45 (Tex. App. – San Antonio 1990, writ denied).

¹⁶ *Ken Petroleum Corp. v. Questor Drilling Corp.*, 24 S.W.3d 344, 350 (Tex. 2000); *Morrison v. Chan*, 699 S.W.2d 205, 208 (Tex. 1985).

¹⁷ *Allen Sales and Servicer, Inc. v. Ryan*, 525 S.W.2d 863, 866 (Tex. 1975).

¹⁸ *Mass. Indemnity & Life Ins. Co. v. Tex. State Bd. of Ins.*, 685 S.W.2d 104, 109 (Tex. App. – Austin 1985, no writ.)

¹⁹ Tex. Water Code Ann. § 13.043 (j) (Vernon 2008)(emphasis added).

by a district is just and reasonable in a rate appeal filed under Section 13.043. To ensure a conflict does not exist, the Commission must find that Section 49.2122 addresses an issue more narrow than just any rate issue. The Districts and Judge Card agreed that Section 49.2122 addresses an issue more narrow than all rate disputes -- customer class disputes:

. . . [subsection b] exists in the context of a section that pertains to the establishment of customer classes. Its reference to “charges, fees, rentals and deposits” is identical to the language in subsection (a) [of Section 49.2122], which explicitly governs differences among customer classes. . . . The legislative history, set out in Appellants’ briefs, supports the narrower interpretation they espouse.²⁰

Judge Card then concluded that as Section 49.2122 did not apply to a retail rate appeal, then the LCRA, just as any other utility in a rate appeal heard under Section 13.043, must bear the burden of proof that its rates are just and reasonable, not the Districts.²¹

As noted above, the Commission may review the legislative history, title, and context of Section 49.2122 in giving effect to this later statute. In 2007, the 80th Texas Legislature adopted Section 49.2122 as part of the floor amendments to Senate Bill 3 (“SB 3”), the omnibus water bill. To ascertain the Legislature’s intent in regard to this provision, it is important to look as the source of the language for the provision. The language for this provision is the language from House Bill 2301 of the 80th Legislative Session (“HB 2301”), which was authored by State Representative Robert Talton, who was also the author of the SB 3 amendment. Although HB 2301 itself did not pass as a stand-alone bill, the exact language of HB 2301 was enacted as the amendment to SB 3

²⁰ Order No. 3, at 2-3.

²¹ *Id.* at 3.

and was codified as Section 49.2122 of the Water Code. Therefore, the legislative history of HB 2301 must be utilized to clarify and understand the Legislature's intent in adopting Section 49.2122.

As shown in the attached Bill Analysis for HB 2301, the background and purpose of the bill was to “**allow a district to establish different fees among classes of customers** based on any factors the district considers appropriate.”²² Additionally, HB 2301 was captioned as “relating to the authority of certain special districts to establish differences in rates between customer classes.”²³ The intent of the Legislature in enacting this section was to allow districts to establish different classes of customers and to charge such classes different rates, based on factors the district considered appropriate. Representative Talton intended for Section 49.2122 to simply authorize a general law water district to create customer classes for billing rates and for those customer classes to show the district acted arbitrarily before the customers could challenge the differences in rates between the classes.

Now, if you examine Section 49.2122, subsection (a) states that a “district may establish different charges, fees, rentals, or deposits **among classes of customers** that are based on any factor the district considers appropriate. . . .”²⁴ The remainder of subsection (a) lists the different types of customer classes and the different costs and revenues that

²² House Comm. on Natural Resources, Bill Analysis, Tex. H.B. 2301, 80th Leg., R.S. (2007), attached as Exhibit “A.”

²³ Tex. H.B. 2301, 80th Leg., R.S. (2007), attached as Exhibit “B.”

²⁴ Tex. Water Code Ann. §49.2122 (a) (Vernon 2008)(emphasis added).

the district may differentiate between customer classes.²⁵ Nothing in subsection (a) is inconsistent with the Legislature's intent.

Subsection (b) then states that for establishing the different charges, fees, rentals, and deposits, the district is presumed to have weighed and considered the appropriate factors, barring a showing that the district acted arbitrarily and capriciously. Subsection (b) is merely describing the charges, fees, rentals, and deposits discussed in subsection (a). However, if the Commission was to take subsection (b) out of context, ignoring the remainder of Section 49.2122, and expand the scope of subsection (b) to the universe of all rate cases, including retail rate cases and even electrical rate cases before the Texas Public Utility Commission, then the Commission would render other portions of the Water Code superfluous, including Section 13.043.

When the entire section is read to be internally consistent, both subsections are referring to the same assessments and the consideration of the same factors, i.e., those factors used to establish customer classes and variable rates between classes. The mere absence of the phrase "customer classes" in subsection (b) does not mean that this subsection should be isolated and then broadly applied to all rate reviews that do not involve disputes on customer classifications or allocations of cost among customer classifications. The similarity in language and intent of the statute as a whole clearly indicates that subsection (b), in harmony with the entirety of Section 49.2122, relates only to customer class designations and to subsequently different rates for the classes.

²⁵ *Id.*

When Section 49.2122 is read as a whole, subsection (b) relates back to the decision of a district in developing different charges between different classes. Therefore subsection (b) is only intended to presume the appropriateness of the different charges, fees, rentals, or deposits established between each customer class by a district, not the justice and reasonableness of the costs and charges used to develop retail water and wastewater rates.

The Legislature and the Commission had fully integrated Section 13.043(j), adopted in 1989,²⁶ into the laws and regulations regarding the review of water rates at the time that the Legislature enacted Section 49.2122 in 2007. Thus, the Commission must presume that the Legislature was familiar with Section 13.043(j) and the duty it imposed upon the Commission when the Legislature enacted Section 49.2122. Unless “clearly indicated” to the contrary, the adoption of Section 49.2122 is subject to the current rate review structure under Section 13.043(j).²⁷ Thus, the Commission must presume that the Legislature intended for no conflict to exist between Sections 49.2122 and 13.043(j).

These two statutory provisions address different situations and are not in conflict. If the Commission limits the applicability to the narrow subject area of customer class designations and disputes, as the Legislature intended, then each provision may stand on its own in application to these differing situations. Nothing in SB 3 or in the legislative history indicates that the Legislature intended for Section 49.2122 to overrule the Commission’s current process of reviewing retail water rates. Clearly, the language of

²⁶ Act of May 29, 1989, 71st Leg., R.S., ch. 567, § 6, sec. 13.043(j), 1989 Tex. Gen. Laws 1887, 1888 (current version at Tex. Water Code Ann. § 13.043(j) (Vernon 2008)).

²⁷ See *Allen Sales and Servicenter, Inc. v. Ryan*, 525 S.W.2d 863, 866 (Tex. 1975).

Section 49.2122 addresses the designation of customer classes by districts and the allocation of costs to these classes. Section 49.2122 applies to nothing else.

Again, how the Commission answers this question does not matter, as Section 49.2122 cannot apply in a ratepayers' appeal of retail water and wastewater rates. If the Commission does not harmonize these Water Code Sections, then the applicability provision of Chapter 49 will prohibit the application of Section 49.2122 to any rate appeal filed under Section 13.043, as Section 49.2122 will be in direct conflict with Section 13.043. If the Commission does harmonize these sections, then the Commission must rule that Section 49.2122 applies in customer class disputes only, not in an appeal of retail water and wastewater rates brought by petitioners under Section 13.043. The question, as well as the remaining five questions, remains moot in regard to an appeal of retail rates filed under Section 13.043.

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?

NO. As stated above, if Section 49.2122(b) created such a presumption that retail rates were properly established, then that presumption would be in direct conflict with the Commission's duty to ensure that every rate made is just and reasonable. Moreover, such a presumption would circumvent the Commission's ability to review the ratemaking of a utility.

When establishing rates, every utility must first determine how much it costs the utility to provide service to its customers. After determining its cost of service, the utility then develops a rate design to ensure that the utility recovers sufficient revenue to offset

its cost of providing service. To review whether the cost of service and the rate design are appropriate, the regulatory authority also reviews historical data to determine if the utility's costs are appropriate and the rate design is proper.

Section 49.2122 does not address how the utility determines its cost of service or how the utility develops its rate design to ensure that the new rates cover all of the utility's costs. Rather, Section 49.2122 merely allows a district to divide its total cost of service between different classes of customers based upon factors that a district considers appropriate. Section 49.2122 does not address whether a district's costs are reasonable and necessary. Section 49.2122 does not address whether a district's infrastructure costs are used and useful for the district's customers. Section 49.2122 merely allows a district to divide its total cost of service (i.e., to slice its pie) as the district believes appropriate. What the district cannot do is arbitrarily slice the total cost between certain types of customers. The district must have a reasonable basis for assigning different slices of the cost pie to different types of customers.

Section 49.2122 does not create a presumption that the cost of service or the *rates* are just and reasonable. The presumption under Section 49.2122 applies only to class designations for rate purposes, and not the reasonableness of the rates themselves.

To review ratemaking effectively, the regulatory authority must possess the utility's cost and revenue information. The possessor of such information is able to establish rates and contest rates. Initially, the retail utility, be it a district, a municipality, or an investor-owned utility, is the only entity in possession of the information needed to determine whether the cost of service and the rate design is just and reasonable, because

the utility alone maintains its books and records. The utility is the only entity that can attest to the truth and accuracy of the information contained in those books and records. A third party (be it a ratepayer protesting such rates or the Commission reviewing such rates) lacks access to this information, except through the discovery process. The third party also lacks any independent ability to vouch for the reasonableness or necessity of the expenses that utility incurred. Only the utility, not the third party, has the ability to demonstrate that the utility's infrastructure is used and useful in providing the service to the customers. Thus, the utility is *always* charged with bringing forth the books and records upon which the rate is based, and the utility is *always* responsible for demonstrating that the rates are just and reasonable and non-discriminatory.

Even if the legislative history and statutory construction did not so clearly reflect that Section 49.2122(b) was meant to apply specifically to a review of a general law district's designation of customer classes and allocation of revenue requirements to those classes, public policy considerations weigh heavily against the creation of an entirely new retail rate review process for all rate cases, especially without rulemaking guidance or support from legislative history or case law.

Section 49.2122(b) does not create a presumption that *rates* set by a district are properly established. Section 49.2122(b) only creates a presumption that a district's designation of customer classes is proper, absent the protester's showing that the district acted arbitrarily or capriciously in designating those customer classes.

3. Does Texas Water Code Section 49.2122(b) only create a presumption that customer classes established by a district are properly established absent a showing that the district action establishing the classes was arbitrary and capricious?

YES. As shown in the above review of the legislative history of Section 49.2122, the entirety of this statute was intended to apply to the establishment of customer classes only. If subsection (b) created a presumption that applied beyond the establishment of customer classes, then the presumption in subsection (b) would be in direct conflict with the Commission's duty found in Section 13.043.

As stated previously, the Legislature adopted Section 49.2122 as part of the floor amendments to SB 3. In offering his amendment, Representative Talton clarified the intent of the language as shown in the following transcript excerpt:

SPEAKER OF THE HOUSE: Following the amendment to the amendment, clerk will read the amendment.

CLERK: Amendment to the amendment by Talton.

TALTON: Thank you, Mr. Speaker. **Members this just allows the districts, the water districts to do classes for billing rates.** I believe it's acceptable to the author. Move adoption.

SPEAKER: Members, Mr. Talton sends up an amendment to the amendment. The amendment is accepted by the author. Is there objection? The Chair hears none. The amendment is adopted.²⁸

This transcript clearly indicates that Representative Talton intended to allow water districts to only establish different customer classes. The Texas Legislature approved this

²⁸ Debate on Tex. S.B. 3 on the Floor of the House of Representatives, 80th Leg., R.S. (May 22, 2007) available at Chamber Archived Broadcasts <http://www.house.state.tx.us/media/chamber/80.htm>, starting at approximately 3 hours, 49 minutes into the archived recording.

amendment based on this straightforward explanation and did not intend in the adoption of this amendment to create a new procedural system to review water rates assessed by districts.

When Section 49.2122 is read to be internally consistent, both subsections (a) and (b) are referring to the same assessments and the consideration of the same factors, i.e., those factors used to establish customer classes and variable rates between classes. The mere absence of the phrase “customer classes” in subsection (b) does not mean that this subsection should be isolated and then broadly applied to all rate reviews that do not involve disputes on customer classifications or allocations of cost among customer classifications. The similarity in language and intent of the statute as a whole clearly indicates that subsection (b), in harmony with the entirety of Section 49.2122, relates only to customer class designations and to subsequently different rates for the classes.

When Section 49.2122 is read as a whole, subsection (b) relates back to the decision of a district in developing different charges between different classes. Therefore subsection (b) is only intended to presume the appropriateness of the different charges, fees, rentals, or deposits established between each customer class by a district, not the justice and reasonableness of the costs and charges used to develop retail water and wastewater rates.

Thus, Texas Water Code Section 49.2122(b) creates only a presumption that customer classes established by a 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?

As stated above, if Section 49.2122(b) created such a presumption that retail rates were properly established, then that presumption would be in direct conflict with the Commission's duty to ensure that every rate made is just and reasonable. Moreover, such a presumption would circumvent the Commission's ability to review the ratemaking process of a utility. As discussed above in response to Question No. 3, Section 49.2122(b) creates only a presumption that designated customer classes are properly established, and is not intended to presume that any rate set by a district is properly established. The answer to Question No. 2 is "no," and Question No. 4 is not applicable.

Assuming, arguendo, that the answer to Question No. 2 is yes, then the petitioner would have to make an initial showing that the district's rate setting was arbitrary or capricious. However, the burden for this initial showing cannot be high. The initial showing is neither a determination of the facts or a separate, bifurcated procedure. The petitioner's burden is to provide a scintilla of evidence, not a preponderance of the evidence, that the district acted improperly. More than a scintilla of evidence exists if the evidence "rises to a level that would enable reasonable and fair-minded people to differ in their conclusions."²⁹ Conversely, evidence that is "so weak as to do no more than create a mere surmise" is no more than a scintilla and, thus, no evidence.³⁰

²⁹ *Ford Motor Co. v. Ridgway*, 135 S.W.3d 598, 601 (Tex. 2004) (quoting *Merrell Dow Pharm., Inc. v. Havner*, 953 S.W.2d 706, 711 (Tex. 1997)).

³⁰ *Id.* (quoting *Kindred v. Con/Chem., Inc.*, 650 S.W.2d 61, 63 (Tex. 1983)).

As an example of a protester's showing, the Railroad Commission of Texas has a substantive rule that provides a presumption of reasonableness and necessity for a gas utility's expenses and investment if that gas utility keeps its books and records in accordance with Railroad Commission rules.³¹ This presumption exists until the protester shows evidence that either the books or records are not accurate, the plant is not used or useful, or the rates are inaccurately or inappropriately calculated.³²

Examples of how protesters could meet their burden that a district's rate setting was arbitrary and capricious include any of the following:

- a. The district miscalculated its costs or the revenues generated by the new rates;
- b. The district's notice of the rate increase showed a 2-step increase, but the district implemented the rate increase in 3 steps;
- c. The district failed to use proper Commission methodology for determining its costs or new rate design;
- d. The district used improper ratemaking procedures in determining its costs;
- e. The district allocated a greater percentage of its overall overhead to the retail water and wastewater utility than to other services provided by the district;
- f. The district included costs for the water and wastewater utility that are not associated with providing water and wastewater utility service to its customers;
- g. The district failed to comply with the Texas Open Meetings Act when adopting the new rates;
- h. The governing body of the district failed to have a quorum when it approved the new rates; or
- i. The district based its cost of service on projected costs instead of historical costs and known and measurable changes.

Overcoming the presumption cannot be hard if the Commission is going to retain its ability to review the ratemaking actions of a district.

³¹ 16 TEX. ADMIN. CODE § 7.503 (2002) (Tex. R.R. Comm'n., Evidentiary Treatment of Uncontroverted Books and Records of Gas Utilities).

³² *Id.*

5. **If the answer to Question No. 4 is YES, in the circumstance that there is not showing that the district action setting the 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?**

Again, assuming that the answer to Question No. 4 is yes and there is not a showing that the district action setting the rates was arbitrary or capricious, further inquiry is required under Section 13.043. Under that section of the Texas Water Code, the Commission must undertake a further inquiry regarding the validity of the district’s rates, and the Commission’s inquiry must follow the same generally-accepted ratemaking principles that have been historically applied by the Commission in rate-setting cases.

Any presumption under Section 49.2122 that rates are “properly established” only means that the district reviewed the proper information in designating its customer classes, not that the district’s total cost of service was just and reasonable. This presumption does not go so far as to presume that the district’s cost of service or revenue requirement are also correct or are factually supported.

The Legislature’s standard for determining whether rates are appropriate is the “just and reasonable” standard. The Legislature has used the reasonableness standard in at least ten (10) different provisions of the Texas Water Code, covering every instance in which the Legislature empowers the Commission or the appropriate review authority to review rates.³³ Neither Section 49.2122 nor its legislative history indicates that the Legislature intended to alter this comprehensive regulatory standard in these various provisions of the Texas Water Code. Thus, the Commission has a statutory duty to

³³ See Tex. Water Code §§12.013(a), 12.013(c), 13.001(c), 13.182(a), 13.182(b), 13.184(a), 13.184(c), 13.186(a), 13.189(a), and 13.189(b).

ensure that rates are just and reasonable, regardless of any presumption that may be afforded to the creation of customer classes by a district.

6. If the answer to Question No. 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 affect is for retail service, wholesale service, or raw water?

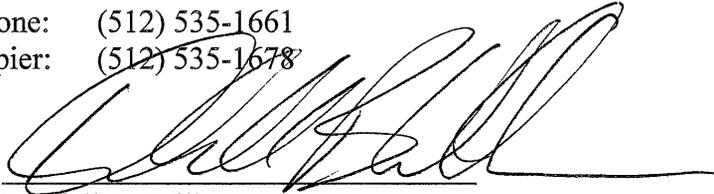
Assuming that the answer to Question No. 2 is yes, then any petitioner challenging any rate adopted by a district will have to make a showing that the district's rate-setting action was arbitrary and capricious. The implications to answering Question No. 2 as yes are enormous and affect many more services than just water and wastewater services. By answering Question No. 2 as yes, then the Commission will open the proverbial Pandora's box, creating a situation in which ratepayers of a district or river authority that receives services other than water and wastewater service will have to make an initial showing to challenge any rate adopted by a district. These rates include charges for electrical service, electric transmission service, communication services, park fees, and ad valorem taxes. Moreover, by answering Question No. 2 as yes, the Commission relinquishes its jurisdiction over 1,925 district and 14 river authorities. Furthermore, by answering Question No. 2 as yes, the Commission usurps the authority of other agencies responsible for reviewing a district's adoption of other types of rates and negates other statutes beyond those in the Texas Water Code.

**IV.
CONCLUSION**

For all of the reasons provided above, the District respectfully requests that the certified questions be answered as set forth herein.

Respectfully submitted,

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COUNTY MUD NOS. 3 and 5**

CERTIFICATE OF SERVICE

This is to certify that the undersigned sent a true and correct copy of the foregoing Districts' Brief on the ALJs' Request for Answers to Certified Questions in accordance with the applicable agency rules, as noted below, on this 12th day of June 2009 to the following parties:

The Honorable Henry D. Card, William G. Newchurch, and Kerrie J. Qualtrough,
Administrative Law Judges

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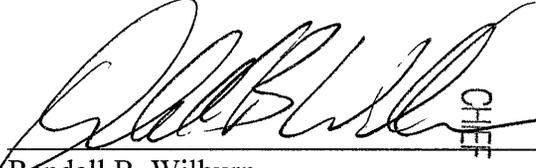
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TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

BILL ANALYSIS

H.B. 2301
By: Talton
Natural Resources
Committee Report (Unamended)

BACKGROUND AND PURPOSE

Currently, the water rate structure is unfairly different for apartment complexes versus single family residences. The fair establishment of water rates ensures that all of the district's customers pay an equitable share of the expenses for the services provided by the district.

~~HB 2301 would allow a district to establish different fees among classes of customers based on any factors the district considers appropriate.~~

RULEMAKING AUTHORITY

It is the committee's opinion that this bill does not expressly grant any additional rulemaking authority to a state officer, department, agency, or institution.

ANALYSIS

SECTION 1. Subchapter H, Chapter 49, Water Code is amended by adding Section 49.2122:

- a) Adds that a district may establish different charges, fees, rentals, or deposits among classes of customers that are based on any factor the district considers appropriate.
- b) Presumes that a district has weighed and considered appropriate factors and has properly established charges, fees, rentals, and deposits absent a showing that the district acted arbitrarily and capriciously.

EFFECTIVE DATE

Upon passage, or, if the Act does not receive the necessary vote, the Act takes effect September 1, 2007.

A BILL TO BE ENTITLED

AN ACT

1
2 relating to the authority of certain special districts to establish
3 differences in rates between customer classes.

4 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF TEXAS:

5 SECTION 1. Subchapter H, Chapter 49, Water Code, is amended
6 by adding Section 49.2122 to read as follows:

7 Sec. 49.2122. ESTABLISHMENT OF CUSTOMER CLASSES. (a)

8 Notwithstanding any other law, a district may establish different
9 charges, fees, rentals, or deposits among classes of customers that
10 are based on any factor the district considers appropriate,
11 including:

12 (1) the similarity of the type of customer to other
13 customers in the class, including:

14 (A) residential;

15 (B) commercial;

16 (C) industrial;

17 (D) apartment;

18 (E) rental housing;

19 (F) irrigation;

20 (G) homeowner associations;

21 (H) builder;

22 (I) out-of-district;

23 (J) nonprofit organization; and

24 (K) any other type of customer as determined by

1 the district;

2 (2) the type of services provided to the customer
3 class;

4 (3) the cost of facilities, operations, and
5 administrative services to provide service to a particular class of
6 customer, including additional costs to the district for security,
7 recreational facilities, or fire protection paid from other
8 revenues; and

9 (4) the total revenues, including ad valorem tax
10 revenues and connection fees, received by the district from a class
11 of customers relative to the cost of service to the class of
12 customers.

13 (b) A district is presumed to have weighed and considered
14 appropriate factors and to have properly established charges, fees,
15 rentals, and deposits absent a showing that the district acted
16 arbitrarily and capriciously.

17 SECTION 2. This Act takes effect immediately if it receives
18 a vote of two-thirds of all the members elected to each house, as
19 provided by Section 39, Article III, Texas Constitution. If this
20 Act does not receive the vote necessary for immediate effect, this
21 Act takes effect September 1, 2007.