

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

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

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

PETITION OF WEST TRAVIS §
COUNTY MUNICIPAL UTILITY § BEFORE THE STATE OFFICE
DISTRICT NO. 3 FOR REVIEW OF § OF
RAW WATER RATES § ADMINISTRATIVE HEARINGS

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

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

WEST TRAVIS COUNTY MUNICIPAL UTILITY DISTRICT NO. 3
BRIEF ON CERTIFIED QUESTIONS

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TEXAS
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WEST TRAVIS COUNTY MUNICIPAL UTILITY DISTRICT NO. 3
BRIEF ON CERTIFIED QUESTIONS

TO THE HONORABLE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY:

Now comes West Travis County Municipal Utility District No. 3 (“MUD 3” or the “District”) and files this Brief on Certified Questions (“Brief”) to the Texas Commission on Environmental Quality (the “Commission” or “TCEQ”). In support hereof MUD 3 shows as follows:

I. BACKGROUND

MUD 3 filed a petition with the TCEQ in October 2008 requesting a review of an increase in contractual raw water rates charged by the Lower Colorado River Authority (“LCRA”) under two contracts (“Raw Water Petition”). The Raw Water Petition was filed under the provisions of Texas Water Code § 12.013.

After the TCEQ referred the Raw Water Petition to the State Office of Administrative Hearings (“SOAH”), Administrative Law Judge (“ALJ” or “Judge”) Qualtrough ordered the parties to submit briefs on procedural issues. These issues included whether the hearing should be conducted in a single-phase or a bifurcated hearing process, whether MUD 3 was required to prove that the rates charged by LCRA were adverse to the public interest, and which party should bear the burden of proof.

In its brief, LCRA argued that Texas Water Code § 49.2122 applied to the dispute. MUD 3 disputed the application of § 49.2122 to its Raw Water Petition and to the review of the rates charged by LCRA for raw water sold to MUD 3 pursuant to contractual agreements. In Judge Qualtrough’s response to these procedural briefs (Order No. 3), she declined to address whether § 49.2122 applied to the case, determining on other grounds that MUD 3 had the burden of proof. In her Order No. 3 Judge Qualtrough also stated the following:

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 the **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.**¹

On May 1, 2009, Judge Qualtrough, joined by two other ALJs, requested answers to certified questions (the “Request”) to the Commission regarding the application of § 49.2122. Judge Newchurch considered the applicability of § 49.2122 in a retail rate dispute in *Petition of Ratepayers Appealing Rates Established by Clear Brook City Municipal Utility District* (“Clear

¹ SOAH Docket No. 582-09-1168, TCEQ Docket No. 2008-1645-UCR, Order No. 3 at 12 (March 23, 2009) (emphasis added).

Brook City MUD”).² Judge Card also addressed the applicability of § 49.2122 in another retail rate case, which coincidentally also involves LCRA and MUD 3, namely the *Appeal of the Retail Water and Wastewater Rates of the Lower Colorado River Authority* (“LCRA Retail Rate Case”).³

On May 6, 2009, MUD 3 filed a brief opposing the Request. On May 15, 2009, the Commission’s General Counsel requested that the TCEQ Chief Clerk set the certified questions on the TCEQ agenda.

II. ANSWERS TO CERTIFIED QUESTIONS

1. **Is Texas Water Code § 49.2122 so inconsistent with Texas Water Code § 13.043(j) that the two statutory provisions cannot be harmonized?**

No. Texas Water Code § 49.2122 and Texas Water Code § 13.043(j) are not inconsistent and may be read in harmony so that both statutory provisions may be given full effect. In construing provisions of the Water Code, the Commission must apply rules of statutory construction.⁴ Rules of statutory construction require that a later statute that does not expressly repeal a former statute be read “as merely cumulative” of the prior law, even if it relates to the same subject matter.⁵ Unless two statutes are so repugnant to each other that both cannot be

² SOAH Docket No. 582-08-1700, TCEQ Docket No. 2008-0091-UCR.

³ SOAH Docket No. 582-08-2863, TCEQ Docket No. 2008-0093-UCR.

⁴ *Employees Retirement Sys. of Tex. v. Jones*, 58 S.W.3d 148, 153 (Tex. App. – Austin 2001, no pet.) (stating that even though the agency’s interpretation was entitled to “serious consideration,” the court must adhere to “certain guiding principles of statutory construction” when reviewing the statute).

⁵ *Jones v. Sharyland Ind. Sch. Dist.*, 239 S.W.2d 216, 218 (Tex. Civ. App. – San Antonio 1951, no writ).

maintained, they will be construed to give effect to both, if possible.⁶ Even if two laws are repugnant, a construction will be sought that will harmonize them and give effect to each.⁷

According to these rules of statutory construction, Texas Water Code §§ 49.2122 and 13.043 should be interpreted in such a way so that both are given effect, if possible. Section 49.2122 relates only to the designation of customer classes, the allocation of costs to the designated classes, and the burden to be borne by anyone challenging such designation and allocation. In contrast, § 13.043 is broad and encompasses the exercise of the Commission's appellate jurisdiction. It requires 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. Rates shall not be unreasonably preferential, prejudicial, or discriminatory, but shall be sufficient, equitable, and consistent in application to each class of customers.”***⁸

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.***⁹ 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.¹⁰ Section 13.043(j), adopted in 1989,¹¹ was fully integrated into the laws and

⁶ *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)).

⁷ *Cole v. State*, 170 S.W. 1036, 1037 (Tex. 1914); *Gordon v. Lake*, 356 S.W.2d 138, 139 (Tex. 1962).

⁸ Tex. Water Code Ann. § 13.043(j) (Vernon 2008) (emphasis added).

⁹ *Allen Sales and Servicenter, Inc. v. Ryan*, 525 S.W.2d 863, 866 (Tex. 1975).

¹⁰ *Mass. Indemnity & Life Ins. Co. v. Tex. State Brd. of Ins.*, 685 S.W.2d 104, 109 (Tex. App. – Austin 1985, no writ.)

¹¹ 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)).

regulations regarding the review of water rates at the time that § 49.2122 was enacted in 2007. The legislature is thus presumed to have been familiar with § 13.043(j) when enacting § 49.2122. Unless “clearly indicated” to the contrary, the adoption of § 49.2122 is subject to the current rate review structure under § 13.043(j).¹² Thus, it should be presumed that the legislature intended that § 49.2122 was not to be in conflict with § 13.043(j), but rather read in harmony with the law existing at the time of enactment.

These two statutory provisions address different rate situations and are not in conflict; each provision may stand on its own in application to these differing situations. Although other parties assert that §§ 49.2122 and 13.043(j) address the same types of rate cases and are contradictory to each other, such an interpretation is strained and violates the requirement that statutory provisions be read to harmonize. Because it is possible to read these two statutes in harmony, a court (and the Commission) must do so.¹³ Nothing indicates that § 49.2122 is intended to usurp the current process of reviewing retail water rates or that it is meant to apply to a review of raw water rates. Rather, the clear language of the section reveals that it is intended to address the designation of customer classes by districts and the allocation of costs to these classes.

Question No. 1 is actually the ultimate question that should not be reached unless and until the Commission answers the other certified questions in a manner that creates the possibility of an inconsistency between the two statutory provisions. For example, Question No. 2 inquires whether § 49.2122 creates a presumption that district rates are properly established. Unless such a presumption is created, the applicability of § 13.043 should not be

¹² See *Allen Sales and Servicer, Inc. v. Ryan*, 525 S.W.2d 863, 866 (Tex. 1975).

¹³ *Cole v. State*, 170 S.W. 1036, 1037 (Tex. 1914); *Gordon v. Lake*, 356 S.W.2d 138, 139 (Tex. 1962).

questioned. Indeed, this Question No. 1 *cannot* be answered until the Commission determines how it will construe the provisions of § 49.2122.

Every rate case that has been tried at SOAH and presented to the Commission for final determination has always focused on the ultimate answers to the inevitable questions that arise in a ratemaking scenario: (1) are the rates just and reasonable? (2) do the rates treat customer classes fairly and in a non-discriminatory fashion? (3) do the rates treat the utility fairly and preserve its financial integrity? Nothing in § 49.2122 provides justification for the Commission in the exercise of its appellate jurisdiction over retail rates to avoid these questions. Such avoidance would be contrary to the duty imposed on the Commission under § 13.043(j) to ensure that *every* rate is just and reasonable.

2. Does Texas Water Code § 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. Every utility that sets rates, and every regulatory authority that reviews a utility's rates, always starts the rate-setting process with an examination of what it costs the utility to provide the utility service, *i.e.*, the utility's cost of service must be determined. The next logical and usual step is to determine the utility's revenue requirement, *i.e.*, what amount of revenue does a utility need in order to cover its expenses and earn a reasonable return on its investment. Only after the utility's revenue requirement is established are rates designed to recover this revenue requirement.

Rate design has been described as an art, not a science. The goal is to design rates that generate the required amount of money and that equitably and non-discriminatorily distribute the revenue burden amongst the utility's customers. There are many ways to slice the pie and allocate the recovery of the revenue requirement. Commonly, costs are segregated between "fixed" and "variable" costs. Sometimes a demand component is added to the equation. And,

generally, customer classes are established, such as residential, commercial, and industrial, and many sub-variations thereof. The Commission's own rate filing package assists utilities in the design of their rates by providing templates for their use.

Section 49.2122 provides guidance to a district in designing its rates, and allows the district to create different classes of customers that will be charged different rates. The list of the types of customers and the characteristics shared by such customers in § 49.2122(a) adds to the guidance provided by the statute. Subsection (b) addresses the district's actions in designing its rates and potentially charging different rates to different classes of customers, and creates a presumption that the district acted properly and appropriately in that respect. This subsection does not however, create a presumption that *rates* themselves are just and reasonable. The presumption under § 49.2122 applies only to class designations for rate purposes, and not the reasonableness of the rates themselves.

Even if the statutory construction arguments addressed above, or the legislative history arguments addressed below, do not sufficiently reflect that § 49.2122(b) was meant only to apply to a review of a district's designation of customer classes and allocation of revenue requirements to those classes, public policy considerations militate against the creation of an entirely new rate review process for all rate cases, without rulemaking guidance or support from legislative history or case law.

Information is the key to an effective review of rates. The person or entity possessing such information is able to establish rates and contest rates. The provider of water service, be it a district, a municipality, or an investor-owned utility, is the only entity initially in possession of the information because it alone maintains its books and records. The provider 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) has no such access, except through the process of discovery, and has no independent ability to vouch for the reasonableness or necessity of the expenses incurred by the provider. Nor does a third party have the independent ability to demonstrate that the provider's plant is used and useful in providing the service or commodity. Thus, it is the provider who is *always* charged with bringing forth the books and records upon which the rate is based, and who is *always* responsible for demonstrating that the rates are just and reasonable and non-discriminatory.

Even in instances where a presumption of reasonableness exists, the provider must still present a *prima facie* case that its rates are just and reasonable. For example, the Railroad Commission of Texas has a substantive rule that provides a presumption of reasonableness and necessity for the expenses and investment of a gas utility that keeps its books and records in accordance with Commission rules.¹⁴ Such a presumption exists until an entity challenging the rates can demonstrate that either the books and records are not accurate, the plant is not used or useful, or in other respects demonstrate that the rates are inaccurately or inappropriately calculated.

As the legislative Talking Points referenced below indicate, § 49.2122 was intended to codify existing law governing the ability of a district to establish different rate classes. It was not intended to change the manner in which rate reviews are processed by the Commission or SOAH. Any interpretation of § 49.2122 as a *new requirement*, or as a *change* in the Commission's prevailing practice of reviewing rate cases and placing the burden of proof, would be unreasonable, erroneous, and contrary to legislative intent. If such were the intent, then certainly the Commission would have determined in a rulemaking subsequent to the adoption of

¹⁴ 16 Tex. Admin. Code § 7.503 (2002) (Tex. R.R. Comm'n., Evidentiary Treatment of Uncontroverted Books and Records of Gas Utilities). (Copy attached at Tab A.)

§ 49.2122 that henceforth, in any rate case involving a district, no rate could be challenged under any provision of the Water Code, unless and until the protestant first proves the arbitrary or capricious nature of the rates. Without a doubt, this would be a *fundamental* change in ratemaking methodology in this state and under this Commission. Such a fundamental change should not be presumed to have occurred by implication associated with the adoption of a very specific, very limited statutory provision, whose own language indicates that it is self-limiting.

Section 49.2122(b) establishes a presumption that customer classes maintained by districts are properly established, but this statute does not seek to change the existing structure for reviewing water rates. Therefore, § 49.2122(b) does not create a presumption that *rates* set by a district are properly established.

3. Does Texas Water Code § 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. This question must be answered in the affirmative, as it is framed in the very language used in the statute. In further support of a “yes” answer, a review of the legislative history of § 49.2122 reveals that the entirety of this statute was intended to apply *only* to the establishment of customer classes and subsequent rates.

A. The legislative history does not support the application of § 49.2122 to all water rates assessed by districts.

The provisions of § 49.2122 are not intended to have broad application to every challenge of a district’s water rates. Instead, § 49.2122 is intended to have a narrow application and should not be broadly interpreted as a “catch-all” provision for all water rate appeals, and certainly should not have the effect of expanding the reach of Subchapter I of Chapter 291 of the Commission’s regulations to *all* rate matters.

Section 49.2122 is entitled “Establishment of Customer Classes” and provides the following:

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

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

- (A) residential;
- (B) commercial;
- (C) industrial;
- (D) apartment;
- (E) rental housing;
- (F) irrigation;
- (G) homeowner associations;
- (H) builder;
- (I) out-of-district;
- (J) nonprofit organization; and
- (K) any other type of customer as determined by the district;

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

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

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

(b) 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.¹⁵

¹⁵ Tex. Water Code Ann. § 49.2122 (Vernon 2008).

This provision of the Water Code was enacted by the 80th Legislature in 2007 as an amendment to Senate Bill 3 (“SB 3”), the omnibus water bill. The language in this amendment to SB 3 is identical to House Bill 2301 (“HB 2301”), 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 included in the enacted version of SB 3. Therefore, the legislative history of HB 2301 should be used to clarify and understand the identical language in SB 3 that enacted § 49.2122.

As shown in the attached Bill Analysis for HB 2301, the background and purpose of the bill were stated as follows:

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.¹⁶

Additionally, HB 2301 was captioned as “relating to the authority of certain special districts to establish differences in rates between customer classes.”¹⁷ 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 a district considers appropriate.

This intent is clearly shown by the adoption of the language of HB 2301 as an amendment to Amendment No. 48, which was then added to SB 3. In offering this amendment

¹⁶ House Comm. on Natural Resources, Bill Analysis, Tex. H.B. 2301, 80th Leg., R.S. (2007). (Copy attached at Tab B.)

¹⁷ Tex. H.B. 2301, 80th Leg., R.S. (2007). (Copy attached at Tab B.)

to the amendment for passage, 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.¹⁸

This portion of the transcript clearly indicates that as the author of § 49.2122, Representative Talton intended only to allow water districts to establish customer classes and have the ability to assess different rates on these different classes. The Texas Legislature approved this 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. Rather, § 49.2122 simply authorizes a water district to create customer classes for billing rates.

In the Raw Water Petition, MUD 3 did not base its complaint on customer class designations, nor did it compare its raw water rates to those of other customers. Rather, MUD 3 brought its Raw Water Petition under § 12.013 of the Texas Water Code based on its belief that the rate increase was unreasonable and unsupported by the LCRA's costs of providing these raw water services. For these reasons, the legislative history does not support the application of § 49.2122 to the Raw Water Petition.

¹⁸ 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.

B. Subsection 49.2122(b) cannot be read in isolation.

Proponents of the argument that § 49.2122(b) effects a radical re-writing of ratemaking philosophy and processes assert that § 49.2122(b) must be read in isolation from the rest of § 49.2122. The proponents argue that because this subsection does not specifically refer to “customer classes,” it therefore has a broad application to the review of *any* water rate. This strained interpretation violates the rules of statutory construction and is clearly wrong.

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.¹⁹ When construing a statute, whether it is ambiguous or not, a court may consider other matters, including the object sought to be attained, the circumstances under which the statute was enacted, the legislative history, and the title or caption.²⁰ Further, in determining the intent of a statute, the statute as a whole must be considered and not its isolated provisions, and no single provision will be given a meaning inconsistent with the other provisions “although it might be susceptible of such a construction if standing alone.”²¹

The interpretation of § 49.2122(b) urged by the LCRA and the Executive Director is not in harmony with the entirety of § 49.2122, which addresses only the establishment of customer classes and rates assessed to each class.²² The LCRA’s and Executive Director’s proposed interpretation would require a total disregard of the very specific language in § 49.2122(a), which asserts that “a district may establish different charges, fees, rentals, or deposits *among*

¹⁹ *Morrison v. Chan*, 699 S.W.2d 205, 208 (Tex. 1985).

²⁰ Tex. Gov’t Code Ann. § 311.023 (Vernon 2005); *Ken Petroleum Corp. v. Questor Drilling Corp.*, 24 S.W.3d 344, 350 (Tex. 2000).

²¹ *Morrison v. Chan*, 699 S.W.2d 205, 208 (Tex. 1985); *Barr v. Bernhard*, 562 S.W.2d 844, 849 (Tex. 1978).

²² See Tex. Comm’n. on Environ. Qual., *Legislative Wrap-Up Report 80th Legislature* (June 2007) at 34 available at http://www.tceq.state.tx.us/comm_exec/igr/leg80.pdf_4327637.pdf. (Copy attached at Tab C.)

classes of customers that are based on any factor the district considers appropriate.”²³ These very same “charges, fees, rentals, or deposits” are also discussed in subsection (b) as well, and they are described as the same factors that a district is “presumed to have weighed and considered appropriate” in subsection (b).²⁴

These two provisions must be read together as a statutory whole. When the entire statute is read to be internally consistent, it is evident that 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 among these 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 costs among customer classes. The similarity in language and intent of the statute as a whole clearly indicates that subsection (b), in harmony with the entirety of § 49.2122, relates *only* to customer class designations and to subsequently different rates for the classes.²⁵

Neither the statutory construction nor legislative intent supports such a broad application of subsection (b) to apply this provision to the Raw Water Petition. The character of the Raw Water Petition is not in dispute; the Petition seeks to review water rates assessed on raw water purchased for irrigation and aesthetic purposes. MUD 3 has not alleged that the rate is incorrect based on any customer class designations established by the LCRA, nor is the complaint based on any comparison of MUD 3’s raw water rate to the rates assessed other classes of LCRA customers. Rather, MUD 3 brought its Raw Water Petition under § 12.013 of the Texas Water

²³ Tex. Water Code Ann. § 49.2122(a) (Vernon 2008) (emphasis added).

²⁴ Tex. Water Code Ann. § 49.2122(b) (Vernon 2008).

²⁵ See Tex. Comm’n. on Environ. Qual., *Legislative Wrap-Up Report 80th Legislature* (June 2007) at 34 available at http://www.tceq.state.tx.us/comm_exec/igr/leg80.pdf_4327637.pdf. (Copy attached at Tab C.)

Code seeking review of the raw water rate based on MUD 3's belief that the increased rate is unreasonable and is not supported by the LCRA's costs of providing these raw water services.

4. If the answer to Question No. 2 is YES, does Texas Water Code § 49.2122(b) require the petitioner to make an initial showing that the district's rate-setting action was arbitrary and capricious?

As detailed above in response to Question No. 2, § 49.2122(b) creates a presumption only that designated customer classes are properly established, and is not extended to presume that any rate set by a district is properly established. Thus, the answer to Question No. 2 is "no" and Question No. 4 is not applicable.

However, even if Question No. 2 is answered in the affirmative by the Commission, Question No. 4 is still not applicable to the Raw Water Petition because the burden of proof in the Petition was decided based on other grounds. In Order No. 3, Judge Qualtrough appropriately declined to apply § 49.2122 to the Raw Water Petition to decide which party bears the burden of proof, instead ruling that other administrative and statutory provisions answered that question.²⁶ Thus, the burden of proof provisions under § 49.2122 are inapplicable to the Raw Water Petition and provide no benefit to its resolution.

Additionally, § 49.2122 does not apply to the Raw Water Petition because under the facts of the Petition, MUD 3 has no initial showing. The presumption, if any, under § 49.2122 applies when parties are examining the rate design, *i.e.*, the allocation of the revenue requirement among various customer classes. The Raw Water Petition does not challenge the designation of customer classes or the allocation of costs to these classes by LCRA, but rather seeks only to review the LCRA's raw water rates assessed on MUD 3 based on the LCRA's cost of service. Therefore, even if § 49.2122 could be interpreted to require an initial showing, MUD 3 would

²⁶ SOAH Docket No. 582-09-1168, TCEQ Docket No. 2008-1645-UCR, Order No. 3 at 12 (March 23, 2009).

not have to make such a showing regarding its Raw Water Petition because it is not seeking to challenge the raw water rate design nor the designation of customer classes by LCRA.

- 5. If the answer to Question No. 4 is YES, in the circumstance that there is no 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?**

As discussed above, Question No. 4 should be answered “No.” However, should the Commission decide to answer Question No. 4 in the affirmative and thus reach this Question No. 5, it is clear that the Commission must undertake a further inquiry regarding the validity of the rates charged, and such inquiry should follow the same generally-accepted ratemaking principles that have been historically applied by the Commission in rate-setting cases.

Any presumption under § 49.2122 that rates are “properly established” only means that the district reviewed the proper information in designing its rates vis-à-vis customer classes. This presumption, however, 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.

As discussed above, the establishment of customer classes is only one step, and one focus of inquiry, in setting and reviewing rates. A district’s determination to establish customer classes, if based upon the criteria contained in § 49.2122, is presumed to be proper. However, if a protestant is able to show that the district acted arbitrarily or capriciously in establishing these customer classes or in allocating costs to them, the presumption has been rebutted, and thereafter the district must show, by a preponderance of the evidence, that its customer classifications and rate design are appropriate and result in just and reasonable rates.

Proof that the legislature has intended that the ultimate standard applied to rates is for the rates to be just and reasonable is found in numerous statements to that effect in provisions of the

Texas Water Code covering every instance in which the Commission or municipalities review rates:

- §12.013(a): The Commission shall fix **reasonable rates** for the furnishing of raw or treated water for any purpose mentioned in Chapter 11 or 12 of this code.
- §12.013(c): The commission in reviewing and fixing **reasonable rates** for furnishing water under this section may use any reasonable basis for fixing rates as may be determined by the commission to be appropriate under the circumstances of the case being reviewed; provided, however, the commission may not fix a rate which a political subdivision may charge for furnishing water which is less than the amount required to meet the debt service and bond coverage requirements of that political subdivision's outstanding debt.
- §13.001(c): The purpose of this chapter is to establish a comprehensive regulatory system that is adequate to the task of regulating retail public utilities to assure rates, operations, and services that are **just and reasonable** to the consumers and to the retail public utilities.
- §13.182(a): The regulatory authority shall ensure that every rate made, demanded, or received by any utility or by any two or more utilities jointly shall be **just and reasonable**.
- §13.182(b): Rates shall not be unreasonably preferential, prejudicial, or discriminatory but shall be **sufficient, equitable, and consistent** in application to each class of consumers.
- §13.184(a): The commission may not prescribe any rate that will yield more than a **fair return** on the invested capital used and useful in rendering service to the public.
- §13.184(c): In any proceeding involving any proposed change of rates, the burden of proof shall be on the utility to show that the proposed change, if proposed by the utility, or that the existing rate, if it is proposed to reduce the rate, is **just and reasonable**.
- §13.186(a): If the regulatory authority, after reasonable notice and hearing, on its own motion or on complaint by any affected person, finds that the existing rates of any utility for any service are unreasonable or in any way in violation of any law, the regulatory authority shall determine the **just and reasonable rates**, including maximum or minimum rates, to be observed and in force, and shall fix the same by order to be served on the utility.
- §13.189(a): A water and sewer utility as to rates or services may not make or grant any **unreasonable preference** or advantage to any corporation or person

within any classification or subject any corporation or person within any classification to any *unreasonable prejudice or disadvantage*.

§13.189(b): A utility may not establish and maintain any *unreasonable differences* as to rates of service either as between localities or as between classes of service.

Nothing in § 49.2122 indicates that the legislature intended to alter this comprehensive regulatory requirement that rates be just and reasonable and that customer classes be non-discriminatory. Thus, the Commission has no authority to shirk its statutory duty to 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 affected is for retail service, wholesale service, or raw water?

No. As shown above in Question No. 2, the proper answer to Question No. 2 is "No." Regardless of the type of rate case, the provider and not the ratepayer initially bears the burden of proof in a rate review. The provider is the only entity in possession of the books and records that show the accuracy of the rates. A third-party such as the ratepayer has no access to these books and records, and has no ability to independently determine the reasonableness and necessity of the expenses incurred by the provider. Therefore, as in all rate cases, it should be the provider who first has the burden of proof to bring forward the books and records upon which the rate is based and demonstrate that such rate is just and reasonable.

However, should the Commission determine that the answer to Question No. 2 is "Yes," § 49.2122 should not apply to every rate review case, but rather should only apply to a rate review that is not authorized under another statute. For example, Texas Water Code § 12.013 allows for the review of raw water rates, as is indicated in the Raw Water Petition. Further, as detailed in Question No. 2, Chapter 13 of the Water Code also provides for the review of potable

water rates with an existing structure in place to review such rates.²⁷ To provide for a rate review under § 49.2122 when an existing statute and review structure is already in place would create confusion between parties as to which statutory rate review process is to be applied to specific cases. This confusion would no doubt create an increase in disputes before the Commission and SOAH in deciding the statutory application issues and procedures. Therefore, even if the Commission determines that § 49.2122 applies to any rate review case, such application should be limited to only those types of rates that have no current statutory mechanism for review.

III. CONCLUSION

The certified questions posed by the ALJs in the above dockets regarding the interpretation and application of § 49.2122 are not germane to a case such as MUD 3's Raw Water Petition because § 49.2122 is intended to apply only to the establishment of customer classes and the rates subsequently charged to such classes. Judge Qualtrough decided the burden of proof in MUD 3's Raw Water Petition on other statutory grounds, and thus rendered the answering of these certified questions unnecessary in MUD 3's Raw Water Petition docket. However, if the Commission determines that the certified questions are germane to the Raw Water Petition, the Commission should follow the rules of statutory construction and interpret § 49.2122 in harmony with, and subject to, the water rate review structure currently in place at the time of the enactment of § 49.2122. Further, to facilitate consistency with the current rate review structure, § 49.2122 should be interpreted to require that the provider retain the burden of proving that the rates charged are just and reasonable based on its cost of service.

²⁷ See Tex. Water Code Ann. § 13.043(f) (Vernon 2008).

For the above reasons, MUD 3 respectfully requests that the certified questions be answered as set forth herein.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this the 17th day of June 2009, a true and correct copy of the *West Travis County Municipal Utility District No. 3 Brief on Certified Questions* has been served on all parties of record in this proceeding by hand delivery, First Class Mail, or facsimile transmission to the persons listed below:

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16 TAC § 7.501

Source: The provisions of this § 7.501 adopted to be effective July 29, 2002, 27 TexReg 6687.

§ 7.503. Evidentiary Treatment of Uncontroverted Books and Records of Gas Utilities

(a) In any proceeding before the Commission involving a gas utility that keeps its books and records in accordance with Commission rules, the amounts shown on its books and records as well as summaries and excerpts therefrom shall be considered prima facie evidence of the amount of investment or expense reflected when introduced into evidence, and such amounts shall be presumed to have been reasonably and necessarily incurred; provided, however, that if any evidence is introduced that an investment or expense item has been unreasonably incurred, then the presumption as to that specific investment or expense item shall no longer exist and the gas utility shall have the burden of introducing probative evidence that the challenged item has been reasonably and necessarily incurred. The gas utility shall be given a reasonable opportunity to prepare and present such additional evidence relevant to the reasonableness or necessity of any item so challenged. This section shall apply to the books and records of an affiliate of a gas utility engaged in a transaction with the gas utility as described in the Texas Utilities Code, § 102.104.

(b) Nothing in this section shall prevent the examiner or any commissioner from requiring the gas utility to provide additional information to support any specific record, fact, or argument at any time, whether or not such was put in issue at the hearing.

Source: The provisions of this § 7.503 adopted to be effective July 29, 2002, 27 TexReg 6687.

§ 7.5212. Construction Work in Progress

(a) A utility may be permitted to include CWIP in its rate base only where necessary to the financial integrity of the utility. CWIP shall be deemed necessary to the financial integrity of a utility only where shown by clear and convincing evidence that its inclusion is necessary in order to maintain a sufficient financial liquidity so as to meet all capital obligations and to allow the utility to raise needed capital or is necessary to prevent the impairment of a utility's service. A mere averment or demonstration that exclusion of CWIP would result in an increase in the cost of funds to the utility or general assertions that the financial integrity of the utility would be impaired shall not be deemed sufficient to permit such inclusion.

(b) A utility permitted to include CWIP pursuant to this section shall utilize as a rate base amount the

RAILROAD COMMISSION OF TEXAS

expenditures for such projects as are reflected on its books as of the test year. The amount shall be determined in a manner consistent with the calculation of other rate base information to reflect a uniform treatment of the test year items.

Source: The provisions of this § 7.5212 adopted to be effective July 29, 2002, 27 TexReg 6687.

§ 7.5213. Allowance for Funds Used During Construction

A utility may be permitted, subject to any revenue adjustment required, to include AFC related to a project in its rate base in rate proceedings after completion of the project. If, pursuant to this section, a utility is permitted to include CWIP related to a project in its rate base, only that AFC accruing prior to such inclusion shall be permitted.

Source: The provisions of this § 7.5213 adopted to be effective July 29, 2002, 27 TexReg 6687.

§ 7.5252. Depreciation and Allocations

(a) Book depreciation and amortization for rate-making purposes shall be computed on a straight-line basis over the useful life expectancy of the item of property or facility in question.

(b) In any rate proceeding where items of plant, revenues, expenses, taxes, or reserves are shared by or are common to the service area in question and any other service area, these items shall be allocated to fairly and justly apportion them between the area in question and any other service area of the utility.

(c) In any rate proceeding involving a gas utility that engages in both utility and nonutility activities, all items of plant, revenues, expenses, taxes, and reserves shall be allocated to fairly and justly apportion them between the utility operations and the nonutility operations. No items of plant, revenues, expenses, taxes, or reserves allocable to nonutility operations shall be included in any figures used to arrive at any rate to be charged by a gas utility for utility service, unless clearly shown to be integral to utility operations.

Source: The provisions of this § 7.5252 adopted to be effective July 29, 2002, 27 TexReg 6687.

§ 7.5414. Advertising, Contributions, and Donations

(a) Actual expenditures for advertising shall be allowed as a cost of service for ratemaking purposes provided that the total sum of such expenditures shall not exceed one-half of 1.0% of the gross receipts of the utility for utility services rendered to the public except as provided in this section.

By: Talton

H.B. No. 2301

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.

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.

Legislative Wrap-Up Report

80th Texas Legislature



Texas Commission on Environmental Quality
June 2007

Tab C

- Applies to a CCN issued to a city, regardless of when it was issued
- Applies to an application for a CCN by a city, regardless of when it was filed, and a proceeding to amend or revoke a CCN held by a city, regardless of when the proceeding was initiated.

Unique Reservoir Sites

- Designates all reservoir sites recommended in the state water plan as having unique value for the construction of a dam or reservoir. The effect of the designation is that a state agency or political subdivision may not obtain a fee title or easement that would significantly prevent the construction of the reservoir. The designation terminates on September 1, 2015 unless a project sponsor has voted to spend money to construct or file an application by that time. A Region C Study Commission is established to study and evaluate the need for Marvin Nichols Reservoir.
- These provisions are effective immediately.

Monitoring by the TWDB of the performance of a political subdivision that receives financial assistance under Subchapter K, Chapter 17

- Amends Texas Water Code, Section 13.344 by allowing political subdivisions to receive funding under Subchapter K, Chapter 17, on a temporary basis if the political subdivision requests temporary continuation of funding and TWDB makes certain determinations.
- As part of TWDB's determinations, it must consult with the offices of Attorney General, Secretary of State, and the agency to see if any of these entities has an objection to the request for temporary funding.
- The political subdivision must meet certain conditions, such as having adequate safeguards in place to prevent proliferation of colonias and committing to correct model subdivision rules deficiencies within 90 days after TWDB makes the determinations under this subsection.
- Applications by qualifying political subdivisions may not be accepted or granted after 06/01/09.
- The provisions of this section sunset on 09/01/09.

Relating to the authority of certain special districts to establish differences in rates between customer classes

- Amends Texas Water Code, Section 49.2122, by authorizing districts to set different class rates and charges, fees, rentals or deposits for these classes.
- Customer classes are based on any factor the district considers appropriate including: similarity of type of customers in each class; type of service provided; the cost of facilities, operations and administrative costs to provide service to customers in a particular class; and the total revenues and connection fees from customers in a particular class.
- The customer classes and associated charges per class are presumed to be appropriate unless it is found that the district acted arbitrarily.

Relating to the succession of the La Joya Water Supply Corporation by the Agua Special Utility District

- Renames the entity from La Joya Special Utility District (SUD) to Agua SUD.
- Modifies the provisions for transferring the responsibilities of La Joya Water Supply Corporation to Agua SUD.
- Changes the directors, provides for appointment of temporary directors by local cities and county commissioners, the manner in which new directors are elected, and also decreases the number of directors.
- Directs the receiver to dissolve the corporation.
- Requires all temporary and permanent board directors to obtain training and requires the elected treasurer to obtain special training.
- Prohibits a director of the corporation from serving as a director of the district.
- Prohibits directors from serving consecutive terms.
- Does not limit injunctive, monetary or penalty orders imposed on La Joya Water Supply Corporation or limit the liability to persons who served on the board of La Joya Water Supply Corporation.
- Metes and bounds description closed.

Edwards Aquifer Authority

- Required permitted groundwater withdrawal reductions for the Edwards Aquifer Authority (EAA) to 450,000/400,000 acre-feet are replaced by a permit cap of 572,000 acre-feet.
- EAA to adopt by rule a critical period management plan by January 1, 2008 based on percent reductions on permitted withdrawals provided in tables based upon spring flow and water levels the San Antonio and Uvalde pools of the aquifer.