

SOAH DOCKET NO. 582-06-0425
TCEQ DOCKET NO. 2005-1516-UCR

APPLICATION OF TAPATIO
SPRINGS SERVICE COMPANY, INC.
TO AMEND CERTIFICATES OF
CONVENIENCE AND NECESSITY
NOS. 12122 AND 20698 IN KENDALL
COUNTY, TEXAS

§ BEFORE THE STATE OFFICE
§
§ OF
§
§ ADMINISTRATIVE HEARING

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TEXAS
COMMISSION
ON ENVIRONMENTAL
QUALITY

THE EXECUTIVE DIRECTOR'S RESPONSE TO RATEPAYERS' EXCEPTIONS

**TO THE HONORABLE WILLIAM G. NEWCHURCH, ADMINISTRATIVE LAW
JUDGE OF THE STATE OFFICE OF ADMINISTRATIVE HEARINGS:**

COMES NOW, the Executive Director ("ED") of the Texas Commission on Environmental Quality ("TCEQ" or "Commission"), by and through Jessica Luparello, staff attorney in the Commission's Environmental Law Division, pursuant to 30 TEXAS ADMINISTRATIVE CODE ("TAC") § 80.257 and 1 TAC § 155.59, and files this Response to the Ratepayers' Exceptions.

INTRODUCTION

On July 6, 2006, a hearing on the merits was held regarding the TCEQ's approval of Tapatio Springs Service Company's ("TSSC") application to amend its Certificate of Convenience and Necessity ("CCN") Numbers 12122 and 20698 to extend water and sewer service in Kendall County, Texas. On October 6, 2006, the presiding Administrative Law Judge ("ALJ") published his Proposal for Decision ("PFD") agreeing with the ED's recommendation that the Commission approve TSSC's application. On October 26, 2006, Elizabeth Martin, representative for the ratepayers ("Ratepayers"), filed Exceptions to the PFD claiming TSSC's amendment application should be denied.

REPLY

I. The TCEQ has the Statutory Authority to Approve CCN Amendments Under the Circumstances Existing in This Case.

Prior to enactment of House Bill No. 2876, the TEXAS WATER CODE (“TWC”) § 13.254(a) stated that, “The commission at any time after notice and hearing may revoke or amend **any** certificate of public convenience and necessity with the written consent of the certificate holder. . . .”¹ Ratepayers incorrectly contend that § 13.254 does not allow the TCEQ to expand a utility’s CCN into an area not already certificated to that utility.² The statute, however, vests the TCEQ with the power to amend **any** CCN. It does not, as claimed by Ratepayers, limit the TCEQ in its amendment powers to reducing or transferring service area.³

Moreover, as correctly noted by the ALJ, the TCEQ has for many years routinely granted CCN amendments expanding service area, indicating that Commission interpretation of Chapter 13 of the TWC authorizes such action.⁴ While only the legislature can delegate powers to state agencies, the legislature’s decision over many legislative terms to not disturb the TCEQ’s practice of approving CCN amendments expanding a utility’s service area beyond the boundaries of its current CCN indicates the legislature’s assent to the TCEQ’s exercise of such power.

TSSC met the § 13.254 statutory requirement of providing written consent to amendment by submitting a signed application requesting amendment to its certificate numbers 12122 and 20698. The TCEQ, therefore, has the authority to amend “any” of TSSC’s CCNs to which it

¹ TEXAS [WATER] CODE ANN. § 13.254(a) (Vernons 1997).

² Ratepayers’ Brief Filed in Response to SOAH PFD and Exceptions (hereinafter Exceptions), page 3.

³ *Id.* at 4.

⁴ PFD, page 4.

gave written consent to amendment, provided that the CCN amendment is “necessary for the service, accommodation, convenience, or safety of the public.”⁵

II. A Valid Request for Service Exists in the Requested Area.

As correctly noted by your honor, CDS International Holdings, Inc. (“CDS”), “is systematically planning an extensive residential development in the Requested Area and has requested TSSC provide the necessary utility services.”⁶ Nothing raised by Ratepayers in their Exceptions calls CDS’s request into question.

Moreover, the Non Standard Service Agreement (“Agreement”) between TSSC and CDS remains valid and enforceable despite Ratepayers’ assertion that it is null and void. The Agreement states that, “[t]his agreement shall expire and be null and void if work on the Extension does not begin within twenty-four months after approval of this Agreement” The sentence, however, concludes with, “however, if any claim or suit is filed relating to this Agreement, this Agreement shall continue in effect until such claim or suit is finally resolved.”⁷

This very suit relates to the Agreement in that it will determine whether TSSC is granted a CCN for the requested area and, consequently, whether TSSC and CDS can begin work on the Extension by extending TSSC’s water and wastewater systems into the requested area. The Agreement, by its own terms, remains valid and enforceable and continues in effect until this suit is resolved. Thus, a request for service remains as evidenced by the valid Agreement.

⁵ TEXAS [WATER] CODE ANN. § 13.246(b).

⁶ Tr. 8.

⁷ Ex. A-1, subex. 1, attch. B., page 13. The “Extension” refers to the extension of TSSC’s water and wastewater systems into the requested area totaling approximately 5,000 acres.

III. TSSC has an Adequate Water Supply to Serve Current Customers and Future Customers in the Requested Area.

TSSC has an adequate supply of water to serve current customers, as well as future customers in the requested area. Ratepayers' attempts to show otherwise are mistaken and unsupported by the record.

a. GBRA Verbal Agreement

While Ratepayers allege that GBRA has no verbal agreement with TSSC, Ratepayers failed to provide evidence in the record that, if true, supports their allegation. Ratepayers instead attempt to submit new evidence, in the form of affidavits of W.E. West, Jr. and David Welch after the record has closed.

According to TEXAS GOVERNMENT CODE § 2001.060, a contested case hearing record includes:

- (1) each pleading, motion, and intermediate ruling;
- (2) evidence received or considered;
- (3) a statement of matters officially noticed;
- (4) questions and offers of proof, objections, and rulings on them;
- (5) proposed findings and exceptions;
- (6) each decision, opinion, or report by the officer presiding at the hearing; and
- (7) all staff memoranda or data submitted to or considered by the hearing officer or members of the agency who are involved in making the decision.

While the record does include exceptions, it clearly does not include attachments to those exceptions submitted as new evidence after the record closes.

The Proposal for Decision must be based on evidence in the record.⁸ In the case at hand, no evidence in the record indicates that GBRA did not agree to amend its existing contract with TSSC to increase the amount of treated water it supplies to TSSC. Additionally, nothing in the

⁸ TEXAS [GOV'T] CODE ANN. § 2001.141 (Vernons 2006) (stating that findings of fact must be based only on evidence and matters that are officially noticed); TEXAS [GOV'T] CODE ANN. § 2001.062 (requiring that PFDs be prepared by the individual who conducted the hearing or by one who has read the record; 80 TEX. ADMIN. CODE § 80.252 (West 2006) (requiring that PRDs shall be filed by the judge who conducted the hearing or by a substitute judge who has read the record).

record indicates that finding of fact number 51, regarding the water availability from GBRA to utilities in the Kendall County area, is incorrect.

The ED has great concern regarding Ratepayers' attempt to add additional information to the record at this late date. Allowing Ratepayers to submit new evidence prejudices the parties by robbing them of an opportunity to question Mr. West and Mr. Welch regarding statements made in their affidavits. The ED, therefore, requests that your honor not allow the affidavits of Mr. West and Mr. Welch to become part of the record and deny Ratepayers' exception regarding GBRA's verbal agreements.

b. Groundwater Availability

While Ratepayers attempt to show that a potential lack of groundwater in the Hill Country PGMA, in which Kendall County lies, leaves TSSC with an inadequate supply of water, such is not the case. The ED considers multiple water sources when determining the ability of an applicant to provide adequate service. Such sources may include stored water, groundwater, surface water, and purchased water. Mr. Matkin indicated that multiple water sources will in fact be used to serve the requested area.⁹ Groundwater availability, thus, is not determinative in assessing whether TSSC has an adequate supply of water.

Moreover, Ratepayers complain that the ED did not check whether TSSC could pump groundwater, and in what amount, from the aquifer managed by the Hill County PGMA. In the case at hand, the ED's staff relied on representations made by TSSC regarding groundwater sources. Nothing in the record indicates that such reliance was misplaced. In fact, Ratepayers themselves indicate that 1,087 acre feet of unallocated groundwater exists in Kendall County.¹⁰

⁹ Prefiled of Mr. Matkin at 4, lines 36-43 (indicating that wells and storage facilities will be constructed in the proposed development and that, at times, GBRA water will be supplemented with such water).

¹⁰ Exceptions, page 7. 4,591 acre feet of total supply minus 3,504 acre feet of already allocated water equals 1,087 acre feet of unallocated water.

Finally, Ratepayers request that the ALJ incorporate into his findings of fact that the amount of water to be extracted from the Hill County PGMA by TSSC exceeds the Texas Water Development Board's ("TWDB") estimate of unallocated water for Kendall County.¹¹ However, as indicated by Ratepayers themselves, this statement is unsupported by the record. Assuming that TSSC uses 1,020 acre feet of groundwater in Kendall County, and 3,504 acre feet of groundwater in Kendall County is already allocated, that totals 4,524 acre feet of allocated groundwater in Kendall County.¹² The TWDB established the total county supply of groundwater at 4,591 acre feet.¹³ Using the numbers Ratepayers used, there would remain 66 acre feet of groundwater available in Kendall County making Ratepayer's requested finding of fact wholly untenable.

c. Worse Case Scenario

Finally, assuming a worse case scenario in which GBRA made no verbal agreements with TSSC and in which an inadequate supply of groundwater exists, TSSC is still not in danger of having an inadequate water supply. As noted by your honor, the Agreement requires CDS to obtain all of the water needed to serve the requested area. Should CDS fall short of its obligations, TSSC could enforce the provision of the Agreement requiring CDS to obtain all necessary water and deny service to further CDS development in the requested area.¹⁴ Additionally, if CDS could not obtain enough water to serve all 1,700 proposed connections, the requested area could still be developed with fewer connections for which an adequate supply of water exists.¹⁵

¹¹ *Id.* at 8.

¹² Exceptions, page 7.

¹³ Exceptions, page 7 (citing Ex. A-1, subsec. 2, 4-75, Table 4-14, total Kendall County Supply).

¹⁴ Tr. 13.

¹⁵ See Findings of Fact No. 41.

Because the record shows that GRBA made verbal agreements with TSSC regarding water availability, because the record shows that unallocated groundwater exists in Kendall County, and because the Agreement does not require TSSC to serve customers in the requested area that CDS fails to secure water for, the ED requests that your honor not amend the PFD or findings of fact on these grounds.

IV. TSSC has Sufficient Financial Capability to Serve Current Customers and Future Customers in the Requested Area.

TSSC has sufficient financial capability to serve current and future customers. Ratepayers attack TSSC's financial capability primarily based on numbers calculated using facts contrary to the record. Namely, Ratepayers' calculations are primarily based on their assumption that TSSC has not paid the debt owed to Clyde B. Smith in the amount of \$905,146. This assumption is not supported by the record.

a. Debt Situation (debt-to-equity ratio)

Ratepayers rehash old arguments regarding TSSC's debt situation. TSSC, as of December 31, 2005, owed \$891,809.00 in outstanding debts.¹⁶ At the hearing on the merits on July 6, 2006, Mr. Parker testified under oath that TSSC paid the \$905,146.00 debt owed to Clyde B. Smith.¹⁷ Mr. Dan Smith testified that if TSSC satisfied the \$905,146.00 debt that TSSC's debt-to-equity ratio would improve significantly.¹⁸

The ED reiterates that nothing in the record controverts Mr. Parker's testimony. While Mr. Parker misstated his position at TSSC, he voluntarily remedied his mistake.¹⁹ To disregard all of a witness' testimony based on one misstatement, as recommended by Ratepayers, would

¹⁶ Exhibit P-5, page 3, TCEQ Annual Report of December 31, 2005.

¹⁷ Tr. 17, lines 6-10 and at 20, lines 20-22 and at 21, lines 1-2.

¹⁸ Tr. 110, lines 18-19, 25 and at 111, lines 1-7.

¹⁹ Tr. 18.

set a dangerous precedent and likely effectively render the sworn testimony of numerous witnesses invalid. Because TSSC paid the debt owed to Clyde B. Smith, and because Ratepayers have failed to show otherwise, the ED requests your honor not alter the PFD of findings of fact on these grounds.

b. Ratepayers Proposed Calculations

Ratepayers also attempt to calculate TSSC's shareholder equity, debt-to-equity ratio, retained earnings, and net income; however, their calculations are flawed. Ratepayers state that TSSC has negative shareholder equity of \$616,500.00, in addition to outstanding debt.²⁰ The debt Ratepayers refer to is the \$905,146.00 debt owed to Clyde B. Smith. It is precisely because of that debt, however, that TSSC has negative shareholder equity. If the debt were substantially paid, as indicated by the record, with resources separate from TSSC's balance sheet, the equity becomes positive \$288,695.00. Ratepayers instead attempt to go outside of the record, assert that the debt owed to Clyde B. Smith was not paid, and use that debt as a basis for calculating TSSC's shareholder equity.

Ratepayers also assert that TSSC's retained earnings are negative \$1,293,378.00.²¹ Without any comment on the possibility of misclassified amounts, if TSSC paid the debt owed to Clyde B. Smith, as indicated by the record, the retained earnings would have to be reduced by that amount. This leaves TSSC with negative retained earnings of \$288,183.00.²² This amount would be more than offset by the category of "Additional Paid-in Capital" which totals a positive \$634,105.00. Additionally, TSSC's cash net income for the fiscal year ending on December 21,

²⁰ Exceptions, page 10.

²¹ Exceptions, pages 10-11.

²² Beginning Retained Earnings (\$-1,293,378) - Adjusted for debt repayment (\$905,146) = Adjusted Retained Earnings (\$-288,183).

2004, is shown at \$41,773.²³ This is after covering an interest expense of \$55,314.00. If, however, the debt owed to Clyde B. Smith was paid, this interest payment would no longer exist and that amount (\$55,314.00) could be added to the net income, putting it over \$90,000.00.

In sum, Ratepayers based most, if not all, of their calculations regarding TSSC's shareholder equity, debt-to-equity ratio, retained earnings, and net income on TSSC not having satisfied the \$905,146.00 debt owed to Clyde B. Smith. The record, however, indicates this debt was paid. The ED, therefore, recommends that your honor not amend the PFD or findings of fact based on Ratepayers skewed calculations.

c. New v. Existing System

Ratepayers contend that Mr. Adhikari testified that the proposed systems will be existing systems, thereby allowing TSSC to avoid submitting information required of new, stand alone systems.²⁴ Mr. Adhikari, however, did not determine whether the proposed systems will be new, stand alone systems or part of existing systems.²⁵ Instead Mr. Adhikari indicated that he would need to see final engineering plans and specifications before making such a determination.²⁶ Because no determination was made regarding whether the proposed systems will be new, stand alone systems or part of existing systems, TSSC was not required to submit data required of new, stand alone systems, such as Item 6 on the TCEQ Amendment Application.

If it turns out that the proposed systems will not be inter-connected to the existing systems, then they will be considered new, stand alone systems. TSSC might then be required to submit documents, such as those contained in Item 6, to demonstrate that it has financial

²³ Exceptions, page 11 (citing Ex. A-1, subsec 1, attach. G).

²⁴ Exceptions, page 13.

²⁵ Tr. 134, lines 4-10.

²⁶ *Id.*

capability to operate and maintain a new water and/or sewer system. Moreover, if it is determined that the proposed systems are new, stand alone systems then TSSC must obtain a new Public Water System Identification Number ("PWS ID") from the TCEQ. At that time, the TCEQ would require TSSC to meet all the requirements for new, stand alone systems before assigning a PWS ID. TCEQ's review of the final construction drawings for new, stand alone systems serves as a check point for ensuring that these systems comply with TCEQ rules.

Moreover, the ED is not substituting a letter from CDS's bank for the information required of new, stand alone systems in Item 6 of the TCEQ Amendment Application.²⁷ The ED has not made a determination on whether the proposed systems will be new, stand alone systems or part of existing systems. As such, the information in Item 6 was not required of TSSC and the ED is not substituting a letter from CDS's bank for that information.

Finally, Ratepayers correctly assert that it is TSSC's burden of proof to show adequate financial capability.²⁸ They largely did so through reliance on the Agreement requiring CDS to fund all necessary construction to serve the proposed area. Ratepayers have pointed to nothing in the record indicating that CDS cannot satisfy its obligation.²⁹ While Ratepayers imply that the Bank of America letter stating that CDS has unrestricted funds in the low seven figure amount available for use to comply with the Agreement is unreliable,³⁰ Ratepayers introduced nothing supporting their implication. Moreover, as recognized by your honor, the Agreement can be amended to add a requirement that a developer contribute financially to aid construction in the requested area,³¹ thereby not leaving TSSC to shoulder the burden alone should CDS back out of

²⁷ See Exceptions, page 14.

²⁸ *Id.* at 15.

²⁹ See Tr. 28.

³⁰ Exhibit A-1 at exhibit 4, Bank of America Letter.

³¹ Tr. 30.

the development. Nothing submitted by Ratepayers disturbs this finding. The ED, therefore, recommends that your honor not amend the PFD of findings of fact of these grounds.

V. TSSC has the Managerial and Technical Capability to Serve Current and Future Customers in the Requested Area.

TSSC demonstrated that it possesses the technical capability to serve current and future customers. As correctly noted by your honor, Mr. Parker has over fifteen years of experience managing the daily operation of TSSC, TSSC has corrected all statutory and rule violations, TSSC has satisfactorily addressed all issues raised in the latest TCEQ inspection of its facilities, and TSSC currently operates a wastewater treatment facility that exceeds the sewer demands of its customers.³² Ratepayers would have your honor overlook TSSC's good record and successful management based on what they characterize as high water loss. The ED recommends otherwise.

As noted in the PFD, nothing in the record provides a basis for comparison to determine if TSSC's water loss is in fact high when compared to similar utilities.³³ Additionally, TSSC indicated that correcting water loss is a concern and recently repaired a major leak.³⁴ If anything, TSSC's attention to its rate of water loss shows good management and technical ability. The ED requests that you honor not overlook all the positive indicators of TSSC's managerial and technical ability on the sole basis of what Ratepayers characterize as high water loss. The ED recommends that your honor not revise the PFD or findings of fact on these grounds.

VI. The ED's Staff Completed an Effective Review of TSSC's Application.

The ED's staff satisfactorily reviewed TSSC's amendment application prior to recommending approval. Ratepayers protest that the ED did not receive all requested

³² Tr. 15-16.

³³ Tr. 17.

³⁴ Tr. 39, lines 6-11 and lines 21-25.

information and due to pressure to approve applications approved TSSC's application.³⁵ This is simply not the case.

While the ED's staff did not receive all requested information, they clearly received a sufficient amount on which to recommend approval. Should this have not been the case, then staff would have recommended denial. The ED is satisfied with the information presented by TSSC supporting its application. To overturn the ED's decision, as requested by Ratepayers, when the ED itself is satisfied with responses to its own requests seems unusual.

Your honor determined that TSSC carried its burden of proof regarding the requirements for approving its application.³⁶ The ED sees no information presented by Ratepayers which disturbs this conclusion. Accordingly, the ED recommends that the PFD and findings of fact not be amended on these grounds.

VII. TSSC is a Proper Applicant for This Application.

A proper Applicant for this application is TSSC. It is TSSC which filed the amendment application. It is TSSC that will maintain and operate the system. It is TSSC, as the utility, that will have to comply with all applicable statutes and TCEQ rules regulating water and sewer utilities.

While CDS will bear the financial burden of extending TSSC's system in the requested area, possibly design the system, and supply water for the system; these facts do not mean that TSSC is an incorrect applicant for this application. In the *Bexar Met* case, the Commission and Court of Appeals allowed approval of a CCN for the City of Bulverde even though GBRA would design, construct, finance, operate, and maintain the system.³⁷ The facts of this case are similar

³⁵ Exceptions, page 8-9.

³⁶ Tr. 36.

³⁷ *Bexar Metropolitan Water Dist. v. TCEQ*, 185 S.W.3d 546 (Tex. App. – Austin 2006).

to the case at hand and, as in *Bexar Met*, TSSC's CCN should be approved notwithstanding CDS's contributions. Because TSSC is a proper applicant for this application, the ED recommends that your honor not amend the PFD of findings of fact of this basis.

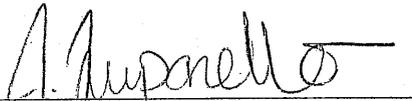
CONCLUSION AND PRAYER

WHEREFORE, PREMISES CONSIDERED, the Executive Director respectfully prays that the Administrative Law Judge deny Ratepayers' Exceptions and not amend his Proposal for Decision, Findings of Fact, or Conclusions of Law.

Respectfully Submitted,

TEXAS COMMISSION ON
ENVIRONMENT QUALITY

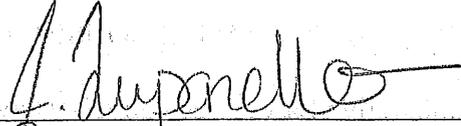
Robert Martinez, Acting Director
Environmental Law Division

by 

Jessica Luparello
State Bar of Texas No. 24035758
Environmental Law Division
P.O. Box 13087, MC 173
Austin, Texas 78711-3087
Phone: (512) 239-0608
Fax: (512) 239-0606

CERTIFICATE OF SERVICE

I hereby certify that on this 6th day of November, 2006, a true and correct copy of the foregoing document was placed into United States Mail, hand delivered, faxed, or sent by interagency mail to all persons on the attached mailing list.



Jessica Luparello
Staff Attorney
Environmental Law Division

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FOR THE STATE OFFICE
OF ADMINISTRATIVE
HEARINGS

Mike Rogan
Administrative Law Judge
State Office of Administrative Hearings
300 West Fifteenth Street
Austin, Texas 78701
(512) 475-4993
(512) 475-4994 Fax

FOR THE APPLICANT

Patrick Lindner
Attorney at Law
7550 IH-10 West, Northwest Center
Suite 800
San Antonio, Texas 78229
(210) 349-6484
(210) 349-0041 Fax

FOR THE EXECUTIVE DIRECTOR:

Kathy Humphreys-Brown
Staff Attorney
Environmental Law Division, MC 173
Texas Commission on Environmental Quality
P. O. Box 13087
Austin, Texas 78711-3087
(512) 239-3417
(512) 239-0606 Fax

Jessica Luparello
Staff Attorney
Environmental Law Division, MC 173
Texas Commission on Environmental Quality
P. O. Box 13087
Austin, Texas 78711-3087
(512) 239-0608
(512) 239-0606 Fax

FOR THE CHIEF CLERK

LaDonna Castañuela
Office of the Chief Clerk, MC 105
Texas Commission on Environmental Quality
P. O. Box 13087
Austin, Texas 78711-3087
(512) 239-3300
(512) 239-3311

FOR THE PUBLIC INTEREST COUNSEL:

Mary Alice Boehm-McKaughan
Assistant Public Interest Counsel, MC 103
Texas Commission on Environmental Quality
P. O. Box 13087
Austin, Texas 78711-3087
(512) 239-6377 Fax

FOR THE RATEPAYERS:

Elizabeth R. Martin
Attorney at Law
P. O. Box 1764
106 W. Blanco, Suite 206
Boerne, Texas 78006
(803) 816-8686
(830) 816-8282 Fax