

SOAH DOCKET NO. 582-06-1641
TCEQ DOCKET NO. 2006-0044-UCR

APPLICATIONS OF § BEFORE THE STATE OFFICE
THE CITY OF PRINCETON §
TO AMEND CERTIFICATES OF § OF
CONVENIENCE AND NECESSITY §
IN COLLIN COUNTY, TEXAS § ADMINISTRATIVE HEARINGS

Executive Director's Exceptions to the Proposal for Decision

The Executive Director (ED) of the Texas Commission on Environmental Quality (TCEQ or Commission), by and through a representative of the Commission's Environmental Law Division, files the following exceptions to the Administrative Law Judge's (ALJ's) proposal for decision (PFD). According to the PFD, the Commission should grant Applicant City of Princeton's (City's or Princeton's) application for water and sewer certificates of convenience and necessity (CCNs) in its entirety. While the ED agrees that the City should be granted CCNs to incorporate all of the area it has requested in which it is currently serving or that is within its extraterritorial jurisdiction (ETJ), the City has fallen short of meeting its burden of proof¹ with regard to the area beyond its ETJ, which, for the sewer CCN request, comprises approximately 7,500 of the 27,000 acres requested. Princeton held the burden to show, by a preponderance of the evidence,² that it possesses the financial capability to provide continuous and adequate service for the entire area requested.³ Princeton did not meet its burden of proof in

¹ 30 TEX. ADMIN. CODE § 291.12 (West 2009).

² 30 TAC §§ 80.17, 291.12.

³ 30 TAC §291.102(a).

regard to all elements set forth in rule with respect to the entire area requested. Specifically, Princeton failed to prove its financial ability to pay for the facilities necessary to provide continuous and adequate service to the entire area, and its general financial stability. The commission is required to consider this under 30 TAC 291.102(d)(6), including specifically the adequacy of the Applicant's debt-to-equity ratio, which the ED's staff determined is inadequate to support the application. The City has failed to demonstrate its financial ability to not only obtain funding for construction of infrastructure out to the furthest reaches of its requested area, but to repay the debt incurred. The following exceptions, corrections, and other recommendations reflect this viewpoint and voice other concerns regarding the ALJ's proposed order that would implement the PFD. In support of his exceptions, the ED shows the following:

I. Overview

A. Clarification of policy regarding extraterritorial jurisdiction

In the PFD, the ALJ states that the ED's witnesses, Kamal Adhikari and Dan Smith, both testified that it is the Commission's policy to limit CCNs granted to municipalities to the boundary of the city's ETJ and that the ED asserted the Commission had a policy against certificating a municipality outside its ETJ.⁴ This slightly misstates the ED's position on this issue and requires minor clarification. It is not the Commission's position to *limit* CCNs to the boundary of a city's ETJ; rather, the ED has implemented oral guidance from the Commission to grant the city some *deference within* its ETJ.⁵ This is a fine but material distinction.

⁴ ALJ's Proposal for Decision, 24.

⁵ Testimony of Kamal Adhikari, Tr. Vol. 1, p. 89, lines 15-23.

On January 28, 2009, then-Commissioner Larry Soward expressed his opinion that city's should be given some deference as to CCNs in recognition of their need to make long-term plans for that area.⁶ At each agenda, the ED's staff listens to the Commissioners when given guidance as to the Commission's interpretation or opinions on proper implementation, and attempts to follow that guidance in similar future cases. Since that agenda, the ED's staff views cities' CCN applications with that guidance in mind, weighing the city's need to plan for adjacent areas. While "policy" might not be the correct word, as indeed it has not been written or adopted, based on Commission guidance, this is a consideration that is now incorporated into the ED's staff's review in all similar cases.

B. The ED remains concerned with Princeton's financial position, especially considering the size of the requested area and expense of sewer expansion.

The ED obtained additional information during and since the hearing on the merits that resolves his concerns regarding Princeton's source water capacity. However, while additional information presented at hearing alleviated some of the ED's concerns regarding Princeton's financial ability to serve the entire requested CCN area,⁷ it remains the ED's position that Princeton has failed to prove that it can pay for the extensive and expensive infrastructure necessary to reach the most remote areas it would be obligated to serve should it be granted the entire requested service area.

⁶ Item 1, Regular Agenda, available online at http://www.texasadmin.com/cgi-bin/tagenda.cgi?location=tnrcc&savefile=TCEQ_OM012809. Commissioner Soward stated: "When a city is attempting to do some long-range planning and to try to define an area of potential service, that we have to not only be flexible but defer to some real extent to their judgment as to what they're willing to take on as an obligation. By taking on more area, they are obligating themselves to serve this area. I think when it comes to a city...that's trying to do some long-range planning, I think we need to be a little more flexible and show a little more deference to their planning process than what we might otherwise do."

⁷ For example, the fact that some recent major expenditures were undertaken in anticipation of service area growth.

A CCN creates an obligation for a city to provide service within the area when it is requested. Princeton's financial records show that it is not in a position to fund the infrastructure construction that would be required. The evidence showed that the City has recently exhausted a substantial portion of its credit capacity to provide capital for present operations and there is no evidence of estimation of the total cost to provide service to the entire area requested, nor arrangement for additional capital. The ED's greatest concern remains the cost that would be involved in 27,000 acres of wastewater area that Princeton would be required to serve if its application is granted in full. Its debt service coverage ratio (DSC) and debt-to-equity ratio raise a bright red flag regarding financial ability.

DSC is a ratio, the numerator of which is a combination of all available cash flow sources, and the denominator of which is the principal and interest that must be paid in the next year to service debts. This ratio must be 1:1 to cover the required debt service in the next year.⁸ According to Princeton's September 2008 audit, the ratio is negative, meaning that Princeton does not have enough cash available to service its debt in the next year. Princeton's current DSC reflects negatively on its ability to repay its debts already incurred, much less acquire and pay to service new debts incurred to expand its system past its ETJ. The debt-to-equity ratio is how much money is borrowed and must be repaid divided by the amount of equity, or net worth. Whereas Princeton's ratio was between 0.75:1 and 0.85:1 in the past, it has recently surged to 2.08:1. This was the result of a recent increase in bonded debt and certificates of obligation of 265%. The Commission is required to consider this ratio in determining whether or not to grant

⁸ Transcript of Hearing at 79, lines 4-5.

CCN area. In this case, the debt-to-equity ratio does not support such a large increase in area, especially as to the requested sewer CCN.

Princeton relies in part on its ability to raise property taxes: it has a maximum tax rate of \$2.50 and is at roughly 70 cents at present. Of course, this cushion is somewhat specious, in that the market in the area would not support a tax increase up to \$2.50. The true cap is what the market will bear in a time when growth of the City is slowing. The ED remains unconvinced that this is as great a source of revenue as claimed by the City in support of its financial position. The DSC ratio and the debt-equity ratio (which the ED must consider, by rule) are much better indicators of the City's financial ability to pay for the facilities necessary to provide continuous and adequate service, as required under Rule 291.102.

II. Exceptions and Proposed Revised Findings, Conclusions and Ordering Provisions

A. Findings of Fact 148 and 150

The ED respectfully disagrees with these findings because they are not supported by the preponderance of the evidence. The City presented substantial evidence, as outlined by the ALJ in the PFD, of its ability to obtain financing through various vehicles. Even assuming that the City is able to obtain adequate financing, there is scant evidence in the record regarding how the debts incurred will actually be repaid. Two possible revenue sources for repaying the debt are tax dollars and utility rates. If tax dollars are used, those within the city limits who pay city taxes will be subsidizing the development of infrastructure for those outside the city limits. The City and the ALJ noted that if property taxes are raised too high, it could be more than the regional housing market will bear. If rates are used, the outside-city users may have to pay unreasonably high

rates or connection fees to cover the considerable debt that will have to be undertaken to extend service to them. The evidence shows that the City's growth has slowed considerably, raising the question of whether there will be enough ratepayers to spread out the cost.

Finding of Fact 148 currently reads: Princeton is currently financially stable and can meet short-term and long-term obligations.

The ED suggests that Finding of Fact 148 be revised to read:

Princeton has failed to show by a preponderance of the evidence that it will be able to meet short-term and long-term obligations if it is obligated to serve the entire requested service area.

Finding of Fact 150 reads: Princeton has the financial capability to provide continuous and adequate service to the requested area and remain financially stable.

The ED suggests that Finding of Fact 150 be revised to read:

Princeton has not proven that it is financially capable of providing continuous and adequate service to the entire requested area and to remain financially stable.

Additional Findings of Fact are necessary to conclude that Princeton can remain financially stable if it is obligated to serve the entire requested area. In Finding of Fact 149, the ALJ finds that Princeton is able to obtain financing to build the infrastructure. In Finding of Fact 150, she finds that it has the ability to serve the area and remain financially stable. There is a necessary finding of fact missing between these two: the *ALJ needs to be able to find that Princeton has the ability not only to take out the loans,*

but to pay them back. Due to the cost of extending service to the outer reaches and the heavy debt load the City is already under, even if the City obtains financing, it has not shown how it will service any additional debt. There is not enough evidence in the record for the ALJ to make this conclusion, which is necessary to come to the final conclusion, that Princeton can remain financially stable.

B. Conclusions of Law

Conclusion of Law No. 5 currently states: Princeton demonstrated that it can provide continuous service and meet other regulatory requirements for water and sewer CCNs in Collin County, Texas, as set forth in Tex. Water Code Ann. §§ 13.241, 13.244, and 13.246, as amended effective September 1, 1999, and 30 Tex. Admin. Code § 291.102, effective October 19, 2000.

The ED suggests that Conclusion of Law No. 5 be revised to read: Princeton demonstrated that it can provide continuous service and meet other regulatory requirements for water and sewer CCNs *within its ETJ and in areas in which it is currently serving* in Collin County, Texas, as set forth in Tex. Water Code Ann. §§ 13.241, 13.244, and 13.246, as amended effective September 1, 1999, and 30 Tex. Admin. Code § 291.102, effective October 19, 2000.

Conclusion of Law No. 7 currently states: Princeton should be granted water and sewer CCNs for the proposed water and sewer service areas set out in amended water and sewer service area maps admitted as evidence in the hearing on the merits on February 23 and 24, 2010, which areas comprise reduction to the requested areas included in the notice published on November 10 and 17, 2005.

The ED suggests that Conclusion of Law No. 7 be revised to read: Princeton should be granted water and sewer CCNs for the water and sewer service areas set out in amended water and sewer service area maps admitted as evidence in the hearing on the merits on February 23 and 24, 2010, which areas comprise reduction to the requested areas included in the notice published on November 10 and 17, 2005, *except for the portion of the proposed area that is outside Princeton's ETJ*.

C. Ordering Provisions

Ordering Provision No. 1 currently reads: The CCNs shall include the respective areas set out in amended water and sewer service area maps admitted as evidence in the hearing on the merits on February 23 and 24, 2010, which areas comprise reduction to the requested areas included in the notice published on November 10 and 17, 2005, except for the portion of the proposed area that is outside Princeton's ETJ.

III. Non-Substantive Corrections

- Finding of Fact (FOF) No. 7 should be revised as follows: in the second line, replace the semicolon after the word "Princeton" with a comma. In the fifth line, delete the period after the name "Gary".
- FOF No. 10 should be revised as follows: delete the first instance of the phrase "On January 11, 2007" and change "Boa Sorte L.C.C." to "Boa Sorte L.L.C.".
- FOF No. 59 should be revised to change the word "propose" to "proposed" and "on site septic facilities" to "on-site sewage facilities" (for consistency with TCEQ terminology).

- In FOF No. 66, “million gallons per day” should be inserted after “.676” and the abbreviation “mgd” should be placed in parentheses.
- In FOF No. 67, “CNN” should be replaced with “CCN”.
- In FOF No. 80, the word “area” should be inserted after “the proposed water service...”.
- In FOF No. 91, the word “waster” is a typographical error and should be replaced with the word “water”.
- FOF 98 should be revised by adding a period at the end of the sentence.
- In FOF 113, “166 percent” should be replaced with “66 percent” to accurately represent the increase in long-term outstanding debt from \$8 million to \$12.6 million.
- FOF No. 165 should be revised by adding a period at the end of the sentence.

IV. Conclusion

The ED’s analysis shows that Princeton has not met its burden of proof by satisfying the section 291.102 requirement to show that it has the financial ability to pay for the facilities necessary to provide continuous and adequate service and prove its financial stability, including the adequacy of its debt-equity ratio. The ED continues to have serious concerns regarding the feasibility of paying for expensive extension of sewer service out to the remote reaches of the requested service area. If Princeton wishes to extend to the areas outside its ETJ in the future, perhaps it will be able to demonstrate at that time that it can take on and service the debt it will have to incur for

those areas. At present, the City is over-leveraged. Therefore, the ED respectfully requests that the ALJ's proposed order be revised as recommended in these Exceptions to grant the CCNs in that portion of the requested area that is within the City's ETJ or in which it is currently serving.

Respectfully submitted,

TEXAS COMMISSION ON ENVIRONMENTAL
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CERTIFICATE OF SERVICE

I do hereby certify that on the 9th day of August, 2010, the original "Executive Director's Exceptions to the Proposal for Decision" was filed with the Chief Clerk of the Texas Commission on Environmental Quality and true and correct copies were sent by the method(s) indicated to the parties below.

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