SOAH DOCKET NO. 582-09-2571
TCEQ DOCKET NO. 2008-0767-UTL-E

EXECUTIVE DIRECTOR OF THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY, PETITIONER	§	**BEFORE THE STATE OFFICE**
	§	**OF**
V.	§	
AQUA UTILITIES, INC. A/K/A AQUA TEXAS, INC., RESPONDENT	§	**ADMINISTRATIVE HEARINGS**

THE EXECUTIVE DIRECTOR'S REPLY TO AQUA TEXAS' EXCEPTIONS

TO THE HONORABLE COMMISSIONERS AND ADMINISTRATIVE LAW JUDGE CRAIG BENNETT:

The Executive Director (ED) respectfully files this reply to Aqua Texas' exceptions for the Commissioners' and ALJ's consideration.

The ALJ agrees with the ED on the law—Aqua Texas cannot notice future expenses and Aqua Texas never proved the noticed surcharge in a rate proceeding. Thus, the surcharge was unauthorized as alleged in the Petition. However, the ALJ found no violation due to alleged pleadings deficiencies. The ED alleged one violation and proved one violation in this case. There were no pleading deficiencies or notice problems.

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I. Aqua Texas' assertion that there are unplead claims mischaracterizes this case.

1. Aqua Texas and the ALJ assert there are two unplead claims. One involves Aqua Texas charging an $0.85 surcharge to recover rate case expenses for the 2004 Rate Case, and the other involves Aqua Texas charging customers the $0.85 surcharge authorized in the 2002 Rate Order that were not subject to that order. Because each of the alleged unplead claims involve different circumstances they are discussed separately below. Namely, Aqua Texas charging the $0.85 surcharge to recover 2004 Rate Case expenses is the main controversy of this case from the beginning; the law does not support preventing the ED from disputing Aqua Texas' assertions. As to the $0.85 surcharge to customers not covered under the 2002 Rate Order, the ED agrees this issue did not arise until the hearing on the merits, but believes this issue is within the scope of the Petition and that Aqua Texas was given ample opportunity to defend itself; thus, there is no unfair surprise.

A. Alleged unplead claims regarding recovery of 2004 Rate Case rate case expenses.

2. This case arose because Aqua Texas claimed it could charge a surcharge to recover rate case expenses for the 2004 Rate Case based on the 2004 Notice. The ED disagreed that the surcharge was authorized—and consistent with this, the allegation is that the surcharge is unauthorized. Aqua Texas defense is that it is authorized because of the Notice. Whether or not the 2004 Notice is sufficient to authorize AT's surcharge for 2004 Rate Case rate case expenses is at the core of this case as demonstrated by the NOV[1], NOV response[2], NOE[3], NOE response[4], Petition and Aqua Texas' original answer[5]. If the 2004 Notice does not provide authorization as Aqua Texas claims, then the surcharge unauthorized as alleged.
3. Aqua Texas and the ALJ assert that the ED's point that the 2004 Notice is not clear and has language limiting it to expenses "incurred to date" is an unplead claim. The ED disagrees and believes the law supports the ED on this issue.
4. Also, notably Aqua Texas does not assert that two other reasons asserted by the ED—(1) the surcharge was never proven and (2) Aqua Texas cannot notice future expenses—are

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[1] (ED 13.)
[2] (ED 14.)
[3] (ED 15.)
[4] (AT 7)
[5] (ED B.)

unplead claims. The ALJ agreed with the ED on the legal substance of these issues. Yet, the ALJ did not find a violation. It is unclear why the ALJ did not find that these reasons support the violation. The ALJ does not discuss the fact that Aqua Texas never offered any proof of its proposed surcharge in the 2004 Rate Case in the context of a violation.[6] As for the claim that TCEQ rules prohibit Aqua Texas from noticing rates covering future expenses, the ALJ suggests that there is no violation because part of the surcharge covered expenses prior to the 2004 Notice and the ED's Petition did not cover the remaining amount of the surcharge.[7] Because the ALJ agreed with the ED on the legal substance of these issues but failed to find a violation, the ED includes them within this discussion of alleged unplead claims for recovery of 2004 Rate Case rate case expenses.

5. Looking at the language of the 2004 Notice is within this parameters of this case. All of Aqua Texas' witnesses discussed the language of the 2004 Notice (by quoting the language and asserting that it was clear) and what it meant (encompassed entire amount) in pre-filed testimony.[8] A necessary element of Aqua Texas' defense is that the 2004 Notice provided notice to customers of its intent to collect the entire surcharge (including rate case expenses incurred after the 2004 Notice). Like Aqua Texas, the ED discussed this issue in his pre-filed testimony.[9] The law does not support the position that the ED was prohibited from controverting Aqua Texas' position by also discussing language in the 2004 Notice (lack of clarity) and what it meant (contains language limiting expenses to those "incurred to date"). It is not a pleading defect to dispute the other party's assertions.

6. As with the other reasons the ED pointed out, the fact that the 2004 Notice is not clear is within the case. The ED asserted this position in pre-filed testimony without objection. If it were not within case, then the ED would have been prohibited from offering testimony to controvert Aqua Texas' testimony that the notice is clear and what its meaning was. It cannot be the case that one party can make assertions to defeat the claim, and the other party is prohibited from addressing the other party's assertions. Neither the ALJ nor Aqua Texas cite authority for this proposition. The law supports the ED.

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[6] (PFD at 31; Proposed Order at 3: Finding of Fact Nos. 6 and 7.)

[7] (PFD at 20-21.)

[8] (AT A; AT B; AT C.)

[9] (ED 3 at 13:20-23.)

7. Pleading sufficiency is about giving fair notice to the opposing party; the pleading is sufficient if fair notice is given.[10] Fair notice is given if the opposing counsel can ascertain the nature and basic issues of the controversy and the testimony that will probably be relevant.[11] Aqua Texas' original answer in this case demonstrates that Aqua Texas was on notice of the alleged unplead claims regarding recovery for 2004 Rate Case rate case expenses. Aqua Texas discusses the 2004 Notice, the language of the 2004 Notice, and how it encompasses the entire surcharge. Aqua Texas also discusses the amount of the surcharge as approximately $600,000. There is no basis for the ALJ to find that the allegation only covers the amount representing expenses incurred prior to the 2004 Notice. The ALJ agreed with the ED that TCEQ rules prohibit Aqua Texas from noticing future expenses, and there is no other authorization for the amount representing the future expenses. The ALJ found no legal authorization for charging an amount over $167,000 to recover 2004 Rate Case rate case expenses, yet found no violation for the amount over $167,000. The ALJ claims it is a pleadings problem. Yet, in Aqua Texas answer, it states the surcharge amount is well over $167,000. Aqua Texas states the surcharge is approximately $600,000—thus demonstrating that Aqua Texas was clearly on notice the allegation concerned the entire surcharge amount. This cannot be a pleadings problem, since Aqua Texas had notice of the amount at issue and pleadings are about fair notice.

8. When reviewing the sufficiency of a pleading, all allegations in the adversary pleading is construed and the parties are on notice of the claims within their own pleading; parties cannot claim lack of notice on issues in their own pleading.[12] Since Aqua Texas raised the issue of the 2004 Notice claiming it is clear and encompasses the entire surcharge, Aqua Texas cannot claim lack of notice on these issues.[13]

9. Pleadings are liberally construed in order to ascertain intent of pleader.[14] If fair notice is given to the opposing party, minor defects and technical insufficiencies will not invalidate a petition.[15] The ED's intent to claim it is an unauthorized surcharge when

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[10] *Perez v. Briercroft Service Corp.*, 809 S.W.2d 216, 218 (Tex. 1991); *Crockett v. Bell*, 909 S.W.2d 70 (Tex. App.— Houston [14th Dist.] 1995).
[11] *Brewster v. Columbia Medical Center of McKinney Subsidiary, L.P.*, 269 S.W.3d 314 (Tex. App.—Dallas 2008); *Coffey v. Johnson*, 142 S.W.3d 414 (Tex. App.—Eastland 2004).
[12] *Perez v. Briercroft Service Corp.*, 809 S.W.2d 216, 218 (Tex. 1991); *Land Title Co. of Dallas, Inc. v. F. M. Stigler, Inc.*, 609 S.W.2d 754 (Tex. 1980); *Lacy v. First Nat. Bank of Livingston, Texas*, 809 S.W.2d 362 (Tex. App.—Beaumont 1991); *Southern Ins. Co. v. Federal Service Finance Corp. of Tex.*, 370 S.W.2d 24 (Tex. Civ. App.—Austin 1963); *Lindsey v. Lindsey*, 228 S.W.2d 878 (Tex. Civ. App.—Amarillo 1950); *Bagby v. Bagby*, 186 S.W.2d 702 (Tex. Civ. App.—Amarillo 1945).
[13] *See Perez v. Briercroft Service Corp.*, 809 S.W.2d 216, 218 (Tex. 1991)
[14] *Torch Operating Co. v. Bartell*, 865 S.W.2d 552 (Tex. App.—Corpus Christi 1993); *Morales v. Texas Emp. Ins. Ass'n*, 554 S.W.2d 51 (Tex. Civ. App.—Austin 1977); *Smith v. Ortman-McCain Co.*, 537 S.W.2d 515 (Tex. Civ. App.—Austin 1976); *Hatten v. Mohr Chevrolet Co.*, 366 S.W.2d 945 (Tex. Civ. App.--Dallas 1963).
[15] *Stoner v. Thompson*, 578 S.W.2d 679, 683 (Tex.1979)

Aqua Texas charges expenses unknown at the time of the 2004 Notice is expressly stated in the NOV, NOE and pre-filed testimony in this case. Additionally, the ED provided pre-filed testimony that the surcharge was never proven and the notice language is unclear and limits expenses to those "incurred to date." It does not make sense to agree with ED on the very issue asserted in the NOV and fully litigated by the parties—that Aqua Texas cannot notice future rate case expenses—and find that is not what was alleged.

10. Every fact will be supplied in a pleading that can reasonably inferred from what is specifically plead.[16] It is reasonable to infer that the ED's position in this case is that the 2004 Notice did not provide authorization and that the ED disputes the Respondent's contentions that it does.

B. Alleged unplead claim regarding charging customers the surcharge authorized in the 2002 Rate Order

11. The issue regarding Aqua Texas charging customers improperly for the surcharge in the 2002 Rate Order arose during the evidentiary hearing. Unlike the rest of the case, this issue does not involve the $0.85 surcharge to recover 2004 Rate Case rate case expenses. Most importantly, the ED wants to distinguish this alleged unplead claim from the alleged unplead claims regarding the 2004 Rate Case rate case expenses. Unlike the alleged unplead claim regarding charging customers under the 2002 Rate Order, every issue regarding Aqua Texas' attempt to charge customers for 2004 Rate Case rate case expenses based on the 2004 Notice was fully litigated from the beginning of this case and are within the allegations in the Petition. For the reasons stated in the ED's Exceptions, the ED believes the Petition also encompasses Aqua Texas' $0.85 surcharge for rate case expenses from the 2002 Rate Order to customers not covered by that order.

12. In summary, Aqua Texas' surcharge to recover 2004 Rate Case rate case expenses and reliance on 2004 Notice have always been at core of case and was fully and fairly litigated by the parties. In addition, the ED believes that the allegation in the Petition also covers improperly charging customers the 2002 Rate Order surcharge. Aqua Texas' exceptions support this contention. Aqua Texas relies on the record to support its claim that there is no violation of these alleged unplead claims. Aqua Texas does not claim there is information outside the record needed for it to defend these claims and that it was

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[16] *Morales v. Texas Emp. Ins. Ass'n*, 554 S.W.2d 51 (Tex. Civ. App.—Austin 1977); *Smith v. Ortman-McCain Co.*, 537 S.W.2d 515*Smith v. Ortman-McCain Co.*, 537 S.W.2d 515 (Tex. Civ. App.—Austin 1976); *Darr Equipment Co. v. Owens*, 408 S.W.2d 566 (Tex. Civ. App.—Texarkana 1966).

unable to provide information due to unfair surprise or lack of notice. All issues were fully litigated and the record is complete.

II. Aqua Texas' assertion that there are unplead claims does not negate a violation because the violation exists for reasons distinct from the alleged unplead claims.

13. Importantly, Aqua Texas does not claim there are unplead claims regarding the ED's assertions that: (1) a notice cannot cover expenses unincurred at the time of the notice and (2) Aqua Texas never proved its noticed proposed surcharge as required. These are two of the ED's main contentions. For example, these positions are stated in the NOV, pre-filed testimony, and the ED's closing as main reasons the surcharge is unauthorized.

A. The violation is established because TCEQ rules prohibit Aqua Texas from noticing rates to cover expenses incurred after the date of the Notice.

14. There is no dispute as to the facts. Aqua Texas charged a surcharge for more than expenses incurred as of the date of the 2004 Notice. Aqua Texas has claimed from the beginning of this case that the surcharge amount is approximately $600,000 and the 2004 Notice covers all of it. Because TCEQ rules do not allow Aqua Texas to notice rates for expenses incurred after the date of the notice[17], there is no need to look at the language of the notice to determine a violation. Consequently, it is unnecessary to rely on the alleged unplead claim that the notice is unclear and contains limiting language.

15. The ALJ agrees with the ED that Aqua Texas could not notice a proposed rate for expenses incurred after the notice.[18] That is exactly what Aqua Texas said it did. There is no other basis asserted by Aqua Texas or the ALJ for the surcharge. No one asserts that this issue is outside the case; no one could claim this since it has been repeatedly asserted, including in the NOV and pre-filed testimony. Yet, the ALJ did not find a violation. The ALJ seems to claim the allegation only covers expenses incurred prior to the notice. This is contrary to all the pleadings and testimony in this case.

16. Even if there is authorization for the amount of the surcharge covering expenses incurred prior to the 2004 Notice, there is no authorization for the remaining amount of the surcharge. Aqua Texas does not claim any authorization other than the 2004 Notice. The ALJ does not claim any authorization. To find that the violation involves only the amount covering expenses Aqua incurred as of the date of the Notice is contrary to the record and law. From the NOV forward this case has been about expenses incurred after

[17] A discussion of the ED's argument that TCEQ rules do not allow notice of rates to cover unincurred expenses is discussed in section VIII.A below.
[18] (PFD at 20-21.)

the 2004 Notice. That has always been the main issue in this case. Aqua Texas acknowledges full awareness and definitely "fair notice" of this; in its original answer, Aqua Texas claims the 2004 Notice covers all of the surcharge at issue and the surcharge at issue is approximately $600,000. Since Aqua Texas and the ED agree that the entire surcharge amount is at issue, it does not make since for the ALJ to carve out $167,000 and ignore the remaining portion. There is no authorization for this surcharge, as alleged.

B. The violation is established because Aqua Texas did not prove its proposed surcharge as required by law.

17. Again, neither the ALJ nor Aqua Texas claim that this issue is outside the case. The ED has maintained throughout this case that the surcharge is unauthorized because Aqua Texas cannot rely on a notice of a proposed surcharge that it never proved.[19] The ALJ agrees that Aqua Texas did not prove the surcharge in the 2004 Notice.[20] Yet, the ALJ did not find this to support a violation. It is unclear why because the ALJ does not discuss this issue in the context of a violation. The ALJ only discusses this in regards to Aqua Texas' affirmative defense claims of res judicata and collateral estoppel.[21]

18. As the ED has maintained throughout this case, the entire proposed surcharge was never authorized because Aqua Texas never proved its proposed surcharge in the 2004 Rate Case. The ED's argument on this point is discussed in section VIII.V below. Thus, the violation exists as alleged.

19. As alleged, the $0.85 surcharge was unauthorized. Aqua Texas cannot rely on its notice because it never proved its noticed surcharge and TCEQ rules prohibit notice for expenses incurred after the notice date. The violation is established without the necessity of any reference to the alleged unplead claims.

III. Aqua Texas misstates the value of the unauthorized surcharge; Aqua Texas overcharged customers by $607,883.68 during the time period from July 2004 to February 2008.

20. The parties disagree as to the amount Aqua Texas actually charged or "billed" its customers as a rate case expense surcharge. Aqua Texas claims the ED's calculation is incorrect.[22] However, the ED's calculation is based on Aqua Texas' audited financial

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[19] (ED 3 at 20.)
[20] (PFD at 31; Proposed Order at 3: Finding of Fact Nos. 6 and 7.)
[21] (PFD at 31: ALJ discusses lack of proof of surcharge in context of res judicata defense.)
[22] (AT Closing at 46-47.)

statements. Aqua Texas' claimed errors in the ED's calculation are not true. It is Aqua Texas' calculation that contains unexplained errors.

21. While Aqua Texas terms the ED's calculation as the "billed" amount, the ED's calculation is not simply the billed or charged amount. The ED's calculation is based on how Aqua Texas accounted for the surcharge in its accounting books, and how Aqua Texas requested and obtained a rate case expense authorization as shown by the 2004 Rate Case; Aqua Texas did not request a bad debt expense charge as part of its rate case expense surcharge. It is also consistent with the amount that Aqua Texas represents until August 2009, when Aqua Texas began using different amounts and adding a bad debt expense.[23]

22. In this enforcement case, Aqua Texas is claiming that its billing and revenue accounts should be used, instead of its audited accounts, as used by the ED. However, in the 2004 Rate Case, Aqua Texas acknowledged that its expenses are tied to its audited books.[24] Aqua Texas stresses the reliability of its independently audited corporate books.[25] In this case, the ED used Aqua Texas' audited books which is how Aqua Texas accounted for its rate case expense charge. No bad debt expense charge was included in Aqua Texas' accounting books.

23. Aqua Texas billing records are not reliable and contain unexplained discrepancies. As Elsie Pascua noted in both her pre-filed testimony and at the hearing on May 25, 2011, the balance for rate case revenue for wastewater in the year 2004 was only $122.40 for the entire year.[26] This represents only 12 connections. This is not consistent with the number of wastewater connections Aqua Texas had in 2004. The number of wastewater connections as of December 31, 2003 was 10,235.[27] This one discrepancy amounts to approximately a $100,000 understatement of the billed amount which was never explained by Aqua Texas. Because of the discrepancies, ED staff did not find the billing records reliable.[28] Instead, ED staff utilized the audited accounts that Mr. Scheibelhut also represented were reliable.[29]

24. As for Aqua Texas' alleged errors in the ED's calculation, they are all based on misstatements of the ED's calculations. At hearing, Kurt Scheibelhut acknowledged that

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[23] (ED 14 at 8-9 (Sept. 21, 2007); AT 7 at 1, para 2-3 at 2, para. 4, at 3, para. 1 and 3 (Feb. 4, 2008); ED 29 (May 7, 2008); ED B at 5-6 (Jan. 8, 2009); AT 46 (Aqua Texas changes the amount and requests "collected" amount on Aug. 13, 2009).)
[24] (2004 Rate Case, Vol. 26 at 337-338, 476.)
[25] (*Id.*)
[26] (ED 3 at 25:25-34; Tr. Vol. 3 at 588:16 to 594:5, Test. of Elsie Pascua; ED 65.)
[27] (*Id.*; AT 1 at 103199.)
[28] (Tr. Vol. 3 at 599:7-18, Test. of Elsie Pascua.)
[29] (Tr. Vol. 2 at 311:17-19, at 313:6-16, at 335:7 to 337:23, at 347:13 to 348:11, Test. of Kurt Scheibelhut; Tr. Vol. 3 at 608:18 to 609:16, Test. of Elsie Pascua.)

one of Aqua Texas' alleged discrepancies was nothing more than a typo in Ms. Pascua's pre-filed testimony, and that the calculation was still valid.[30] The amounts still add up to the same amount as Ms. Pascua testified.

25. In Mr. Scheibelhut's pre-filed testimony, Mr. Scheibelhut claimed that Ms. Pascua's calculation was based on "the wrong combination" of accounts.[31] Specifically, he claimed Ms. Pascua used "revenue account" information by taking "the balance of the billed amount" and adding it to "the balance shown on account 186107".[32] This is not true, as explained by Ms. Pascua. Ms. Pascua used the same account for her entire calculation; account 186107, the deferred rate case expense account from Aqua Texas' accounting books.[33] She did not use any billing or revenue accounts or combine any accounts. At both his deposition and at the evidentiary hearing, Mr. Scheibelhut conceded this point—that Ms. Pascua did not use revenue or billing accounts, and the account she used is audited and accurate.[34] Ms. Pascua did not use a combination of accounts. She used the same account and she did not do any "double counting" as alleged.

26. The ED calculated interest in this case in accordance with industry standards—from the date the money is "borrowed" until the date it is "paid back". [35] Those dates are from October 2006[36] to September 2010[37]. In contrast, without justification, Aqua Texas calculated interest for the short timeframe of February 2007 through January 2008.[38] Kurt Scheibelhut acknowledged that the ED's method was consistent with industry standards and normal business practices.[39] Kurt Scheibelhut also acknowledged that Aqua Texas did not pay back the unauthorized surcharge until after September 2010 when it offset the unauthorized surcharge against the rate case expense surcharge in the 2008 Rate Order.[40] The ED's interest calculation is conservative in that ED staff used the low PUC rates and stopped the calculation as of the pre-file date in this case, about April 2011—before the unauthorized surcharge was returned to customers.

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[30] (Tr. Vol. 2 at 315:8-316:2, Test. of Kurt Scheibelhut.)
[31] (AT C at 35:13.)
[32] (*Id.* at 35:13-18.)
[33] (*See, e.g.*, Tr. Vol. 3 at 575:4-12, Test. of Elsie Pascua; ED 3 at 24:24-25:5.)
[34] (Tr. Vol. 2 at 344:17-346:3, 347:13-348:11.)
[35] (Tr. Vol. 3 at 595:7-24 and 596:9-11, Test. of Elsie Pascua; Tr. Vol. 2 at 317:13 to 318:3, Test. of Kurt Scheibelhut.)
[36] (ED 3 at 27:32 to 28:6; ED 39: ED calculation of interest.)
[37] (Tr. Vol. 2 at 317:1-12; *see also* Tr. Vol. 3 at 596:17-25, Test. of Elsie Pascua.)
[38] (AT 37.)
[39] (Tr. Vol. 2 at 317:13 to 318:3, Test. of Kurt Scheibelhut.)
[40] (*Id.* at 317:1-12.)

IV. There was harm to customers due to Aqua Texas' violation; a penalty and corrective action is warranted in this case.

27. Aqua Texas charged a surcharge to customers without authorization. Ultimately a surcharge for 2004 Rate Case rate case expenses was authorized in the 2008 Rate Order, to begin January 2009. However, Aqua Texas charged the unauthorized $0.85 surcharge between October 2006 and January 2008. At the time of the unauthorized surcharge, the 2008 Rate Order did not exist and what it would contain was unknown. Importantly, Aqua Texas took money from customers without authorization. Aqua Texas did not pay the customers back until September 2010, when it applied the unauthorized amount towards the authorization in the 2008 Rate Order. Consequently, for years Aqua Texas had the benefit of the customers money while the customers were deprived the use of their money. In essence, Aqua Texas received an interest free loan at the expense of its customers. It is common knowledge that there is a time value of money. There is no dispute of the facts. The customers were deprived the use of their money for years unnecessarily. For these reasons, the ED asks that Aqua Texas be required to credit customers reasonable interest to remedy the harm caused to customers.

28. The customers were also harmed by Aqua Texas' attempt to use the 2004 Notice to charge the unauthorized surcharge, in violation of TCEQ notice rules. Aqua Texas purported to notice future expenses. Addtionally, the language of the notice is vague and unclear. This was confusing to customers, as indicated by the numerous complaints received. TCEQ rules require noticed rates to be supported by the information in the application—rates cannot be based on speculation. By charging an unauthorized rate through the 2004 Notice, customers were confused and unable to evaluate the reasonableness of the noticed rate as contemplated by the rules.

29. Another harm to customers is that Aqua Texas charged customers for the 2002 Rate Order authorization who should never have been charged that surcharge.

30. An additional harm is due to Aqua Texas' attempt, through this enforcement proceeding, to charge customers a bad debt expense. It is ironic that Aqua Texas is using this very proceeding to charge customers even more and cause further harm. By charging customers an additional amount to recover bad debt expenses, customers paid a rate that they should never have paid. The bad debt expense was never part of a rate proceeding. Thus, customers were deprived the opportunity to participate in the process or contest it.

It was unilaterally determined and charged by Aqua Texas without any vetting in a rate proceeding to evaluate whether it is just and reasonable as required by the rules and statutes.

31. Customers were harmed by the surcharge because they were charged for 32 months for 2004 Rate Case rate case expenses when the 2008 Rate Order limits the surcharge to 24 months. The 24 month limitation was to protect non-settling customers from having to pay for the settling customers' portion. In the PFD, the ALJs recommended that rate case expenses be apportioned across all customers so that "If Aqua Texas has, through settlement, agreed not to recover expenses from certain customers, then that loss must be borne by it—and not the other ratepayers."[41] To accomplish this, the ALJs recommended that the monthly surcharge be per customer for a set time limit.[42] The ALJs stated:

> The surcharge amount and time period should be based on the premise that Aqua Texas is recovering its rate case expenses from all customers. That way, any rate case expenses that Aqua Texas has agreed to recover from settling parties will not be shifted to other customers, but rather will be borne by the utility.[43]

32. The ED agreed.[44] Through the unauthorized surcharge, Aqua Texas has skirted this provision. Aqua Texas acknowledged that settling customers were not going to be charged.[45] Yet, due to the unauthorized surcharge, the non-settling customers paid the entire amount and Aqua Texas did not have to bear any amount since Aqua Texas charged the entire amount over 32 months by using the unauthorized surcharge as an offset.

33. Aqua Texas cannot rely on a claim that a truism of rates is that some customers pay for others because customers come and go.[46] This does not negate the rules and statutes. Aqua Texas cannot violate the rules and statutes based on a claim that customers come and go. The statutes and rules and TCEQ policies do not conflict with the concept that customers come and go. The rules and statutes should be enforced as written.

34. Aqua Texas argues that because the 2008 Rate Order authorizes more rate case expenses than it charged through the unauthorized surcharge, there was no violation. An after the

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[41] (ED 23 at 77.)
[42] (*Id.*)
[43] (*Id.*)
[44] (2004 Rate Case, Vol. 27 at 262: ED response and exceptions to PFD.)
[45] (*Id.*, Vol. 27 at 284: AT exceptions.)
[46] (AT Exceptions at 6.)

fact authorization of a different rate is not relevant or determinative in this case. Additionally, because Aqua Texas skirted the 24 month limit in the 2008 Rate Order, it is pure speculation as to what Aqua Texas would have actually charged customers.

35. In this case, the ED is asking to assess a penalty for the Respondent's conduct in collecting an unauthorized surcharge. The ED is seeking a penalty consistent with its enforcement and penalty policies and procedures. A penalty is appropriate for this case because a violation occurred, the case was appropriately referred for enforcement and TCEQ practice is to assess penalties for cases referred for enforcement. A penalty of $2,362 is a conservative penalty.

36. The ED also requests that the Respondent be required perform corrective actions including reimbursing its customers reasonable interest for the benefit of the use of the unauthorized amount. This purpose of the corrective action is to require Aqua Texas to return to its customers the economic benefit it gained obtaining customers' money without authorization. Specifically, the ED recommends that Aqua Texas be required to return to its customers a reasonable interest amount for the time period that Aqua Texas had the alleged overcharged amount. This would prevent Aqua Texas from benefitting from the unauthorized surcharge and return that amount to the customers who were damaged by the unauthorized surcharge.

37. In the 2004 Rate Case, there are several instances in which Aqua Texas acknowledges the time value of money as it requested interest to be included in its deferred expense surcharge until the deferred expense charge was paid back to Aqua Texas.[47] Aqua Texas claimed interest was necessary in order for it to be "made whole" and to "make up for the loan it made to its customers".[48] Aqua Texas further stated that if it were not authorized to charge interest it "would deprive Aqua Texas of the time value of money" and such denial "would result in Aqua Texas not being made whole".[49] Aqua Texas requested 8.44% interest or alternatively 6.0%, which is more than ED seeks in this case.[50] The ED requests that Aqua Texas pay customers a credit of reasonable interest to make the customers whole.

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[47] (*See, e.g.*, 2004 Rate Case, Vol. 26 at 466, Vol. 28 at 9 and 239.)
[48] (*Id.*, Vol. 27 at 278.)
[49] (*Id.*, Vol. 27 at 278-279.)
[50] (*Id.*, Vol. 27 at 278.)

V. Aqua Texas' complaint about the ED's opportunity to dispute the proposed surcharge during the 2004 Rate Case is a red herring and an attempt to distract from the fact that it was Aqua Texas who had the burden to prove and obtain approval of its proposed surcharge.

38. Aqua Texas complains that the ED did not object to the noticed surcharge.[51] Aqua Texas' complaint is a red herring and an attempt to distract from the relevant issues in this case. It is also a distraction from the fact that Aqua Texas had, not just many opportunities but, the obligation to provide evidence and obtain authorization of its proposed surcharge in the 2004 Rate Case.

39. In the 2004 Rate Case, Aqua Texas had the burden to prove the proposed surcharge, not the ED.[52] The fact that the ED did not object to the proposed surcharge in the 2004 Rate Case did not affect Aqua Texas' burden. Aqua Texas chose not to offer proof of the proposed surcharge or seek authorization of it during the 2004 Rate Case. Aqua Texas sought a different surcharge consistent with TCEQ practice—to be recovered after authorized by the Commission. The ED had no reason to object to a surcharge for which there was no evidence and that Aqua Texas did not seek authorization for during the 2004 Rate Case.

40. Aqua Texas' own argument applies at least as much to it as to the ED since Aqua Texas was the party with the burden of proof and in the 2004 Rate Case hearing it requested a rate case expense surcharge different than it proposed. It knew at least in February 2007 that its proposed surcharge would not be authorized since it never offered any evidence of it or asked for such a surcharge in the 2004 Rate Case hearings.[53]

41. The ED did not realize the surcharge existed until June 2007, which was after the hearings in the 2004 Rate Case. At the 2004 Rate Case hearings, Aqua Texas did not offer any evidence of its proposed surcharge or seek authorization of it. Thus, it was already established, by the time the ED discovered the surcharge, that Aqua Texas was charging a surcharge without authorization and was not seeking authorization of it. It was reasonable for the ED to issue the NOV and attempt to resolve this issue outside the 2004 Rate Case. By issuing the NOV while the 2004 Rate Case was still ongoing, Aqua Texas had an opportunity to resolve the matter outside the 2004 Rate Case or raise the issue in the rate case—since Aqua Texas knew the ED's position before the final order in

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[51] (*See, e.g.*, AT exceptions at 10-11.)
[52] TEX. WATER CODE § 13.184(c); 30 TEX. ADMIN. CODE §§ 291.12 and 291.25(b).
[53] The 2004 Rate Case evidentiary hearing on rate case expenses was February 16 and 19, 2007.

the 2004 Rate Case. Despite there being an NOV issued about the surcharge, Aqua Texas still did not seek authorization of it in the 2004 Rate Case.

42. It was also understandable that the ED did not discover the surcharge until June 2007, after the TCEQ began receiving complaints about it. It was certainly not due to lack of diligence. In the 2004 Rate Case, Aqua Texas' witness, Mr. Charles Loy, found the ED's staff's review of the Aqua Texas 2004 Rate Case application and data to be "the most thorough review he has seen in 20 years of rate cases."[54] There are several factors that led to the ED not being aware of the unauthorized surcharge until June 2007.

43. One factor was that Aqua Texas' 2004 Rate Case application and 2004 Notice was complicated and the proposed surcharge in the 2004 Notice was not clear. Aqua Texas' application was in a different format than the TCEQ form, and during the 2004 Rate Case, the ED had to ask Aqua Texas to provide the information in TCEQ format for evaluation.[55] The application is several inches thick.[56] The body of the application contained no information about the surcharge; the surcharge was only in the notices attached to the application.[57] The proposed surcharge was not included in the page listing all the "proposed rates and fees" and comparison of existing and proposed rates; these pages include late check fees, tap fees, deposit amounts, the proposed phased and unphased rates but do not include the proposed surcharge.[58] Aqua Texas' proposed tariffs did not contain the proposed surcharge.[59]

44. Aqua Texas' 2004 Notice was the most complicated and longest notice the TCEQ had ever received.[60] The proposed surcharge alone started for different customers at different dates, depending on whether a customer was covered under the 2002 Rate Order. These different start dates were not identified in the Notice. It was unclear what rate case expenses were included in the Notice. Aqua Texas claims that the Notice covered rate case expenses incurred prior to 2002, rate case expenses incurred in preparation of the 2004 Rate Case application, and future rate case expenses unknown at the time of the notice.

45. If the 2004 proposed surcharge were clear and readily apparent, ED staff would have noticed it—as well as the ALJs, customers, and Commission. Nobody did. In the 2004

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[54] (2004 Rate Case, Vol. 26 at 480.)
[55] (*See, e.g.*, ED 23 at 6: PFD states that essentially a different set of data reviewed by the ED than was provided in the application.)
[56] (AT 1.)
[57] (*Id.*)
[58] (*See, e.g.*, AT 1 at 103251-103252.)
[59] (*See, e.g.*, *id.* at 103397-103419.)
[60] (Tr. Vol. 3 at 495:17-24, Test. of Tammy Benter; *see also* Tr. Vol. 1 at 24:6-7 and 13-16, customer Roger Lampman refers to noticed surcharge as being at the "next to last page in that book we got.")

Rate Case, the ED, Aqua Texas, the ALJs, and the Commission all agreed that the rate case expense surcharge would be $2.50 per month for a limit of 24 months.[61] The ALJs proposed and the ED and Aqua Texas ultimately agreed that the surcharge would be for a specific time so as not to overly burden non-settling customers.[62] The calculation for the surcharge was the total amount of 2004 Rate Case rate case expenses of $2,739,966.41 divided by the number of active connections of 45,871 divided by 24 months, which equals 2.49.[63] The calculation was based on the total amount of expenses divided by 24 months. The proposed surcharge was not considered; this calculation would make no sense if the ALJs, ED or Commission knew about the unauthorized surcharge.

46. Another factor that impacted the ED's awareness of the proposed surcharge was that Aqua Texas represented to ED staff that rate case expenses were a part of cost of service. Aqua Texas' application was not in the same format as the TCEQ application form. When ED staff requested that the information in Aqua Texas' application be provided in the same format as the TCEQ application form, Aqua Texas provided information that rate case expenses had been included in cost of service.[64] If Aqua Texas had included its rate case expenses in cost of service, then it would necessarily have not included rate case expenses as a surcharge, so the ED had no reason to believe Aqua Texas was charging a proposed surcharge.

47. Another factor is that Aqua Texas did not offer any evidence of the proposed surcharge in the 2004 Rate Case or seek approval of it. If Aqua Texas were charging a surcharge or intended to, then it had an obligation to prove the reasonableness of it and obtain authorization. Aqua Texas' failure to raise the proposed surcharge in 2004 Rate Case proceeding further contributed to the ED's lack of awareness.

VI. The PFD does not contain impermissible advisory opinions.

48. Aqua Texas claims that the PFD contains impermissible advisory opinions.[65] The ED disagrees. The concept of impermissible advisory opinions comes from the requirement that judicial courts render decisions on actual justiciable controversies and not provide merely advisory opinions that do not bind the parties.[66] The requirement arises out of

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[61] (ED 9 at 21; 2004 Rate Case, Vol. 28 at 289-290.)
[62] (*Id.*; ED 23 at 77.)
[63] (2004 Rate Case, Vol. 28 at 289-290; ED 9 at 21.)
[64] (*See, e.g.*, ED 44 at 3; Tr. Vol. 1 at 211:10-213:6, Test. of Elsie Pascua.)
[65] (AT Exceptions at 2-3.)
[66] *See, e.g.*, *Tex. Assoc. of Bus. v. Tex. Air Control Bd.*, 852 S.W.2d 440, 444-445 (Tex. 1993).

the separation of powers doctrine.[67] Namely, the purview of the judicial branch is to decide real controversies that bind the parties to the action; providing merely advisory opinions encroaches on the executive branch.[68]

49. Aqua Texas references two cases on impermissible advisory opinions. Both cases involve the trial court's subject-matter jurisdiction to decide the lawsuit. One involves a plaintiff's standing to sue and the other involves the mootness doctrine. In *Tex. Assoc. of Bus. v. Tex. Air Control Bd.*,[69] the issue was whether the plaintiff, Texas Association of Business, had standing to sue on behalf of its members. If not, the Court reasoned, there was no jurisdiction and no justiciable controversy; any opinion would be merely advisory and not bind the parties. In *Bexar Metropolitan Water Dist. v. City of Bulverde*,[70] the defendant argued that the trial court lacked subject-matter jurisdiction because the issue between the parties was moot; therefore, any decision rendered by the court would be merely advisory. Neither of the cases cited by Aqua Texas involve administrative cases or claims of pleading deficiencies.

50. The underpinnings preventing courts from providing advisory opinions are not present in administrative law PFDs. A PFD does not purport to be a final order binding the parties; it is a recommendation to the Commission, which is the body that issues the final order binding the parties. Additionally, SOAH and the Commission are part of the executive branch, not the judiciary, so the separation of powers issue does not apply. As such, it makes sense for the PFD to provide all information relevant for the Commission to make a fully informed decision.

51. In this case, subject-matter jurisdiction exists, the parties have an actual controversy, and one of the issues is the scope of the Petition. The parties disagree both on the scope of the Petition and whether a violation exists. Ultimately, the Commission will make a decision about the scope of the Petition and whether there is a violation. The Commission's determination will bind the parties, and as such, a justiciable controversy exists. Since these are relevant issues, it is reasonable, if not prudent, for the ALJ to discuss these issues fully in the PFD. Moreover, the ALJ does not recommend advisory findings of fact or conclusions of law in his Proposed Order, which he proposes to be the final order in this case. Because the prohibition on advisory opinions does not apply to the ALJ and PFDs, a PFD contains an informative recommendation to the Commission,

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[67] *Id.*
[68] *Id.*
[69] *Id.*
[70] 234 S.W.3d 126, 131 (Tex. App.-Austin 2007, no pet.).

and because the ALJ does not recommend any advisory opinions in the Proposed Order, the ED does not agree that any of the PFD should be stricken as an impermissible advisory opinion.

VII. Aqua Texas' reliance on 30 TEX. ADMIN. CODE § 80.29 is misplaced and the issue is irrelevant since there are no pleadings deficiencies.

52. Aqua Texas' claim that 30 TEX. ADMIN. CODE § 80.29 precludes a remand in this case is a misstatement of the law.[71] Remands as well as pleading amendments are within the discretion of the Commission and ALJ. However, the issue is not relevant since there are no pleadings deficiencies in this case.

53. 30 TEX. ADMIN. CODE § 80.29 does not prohibit the Commission from remanding this case to allow the ED to amend its petition. Section 80.29(a) states:

> (a) Up to seven days before the hearing, parties to an enforcement action may file supplemental or amended pleadings, so long as those pleadings do not operate as an unfair surprise to the opposite party. ***Amendments after that time will be at the discretion of the judge and may constitute grounds for a continuance.***

Thus, amendments after seven days before hearing are not prohibited; they are at the discretion of the ALJ.[72] While the ED is not advocating remand, it is within the Commission and ALJ's discretion to remand and allow amendments as deemed appropriate.

54. The ED's position is that there is no need to remand because there are no unplead claims. The ED maintains that Aqua Texas' $0.85 surcharge to recover 2004 Rate Case rate case expenses is not only within the allegation in the Petition, this surcharge is at the core of this case. Further, Aqua Texas had fair notice this and of all reasons the ED maintains that Aqua Texas reliance on the 2004 Notice is misplaced, especially since Aqua Texas raised these issues. As such, there are no unplead claims as to the surcharge for 2004 Rate Case rate case expenses. Regarding the $0.85 surcharge charged to all customers for the 2002 Rate Case surcharge, this did arise during the hearing due to admissions by the Respondent. The ED maintains that this misuse of the surcharge is also within the allegation; Aqua Texas cannot claim surprise since the hearing was recessed and Aqua Texas was given an opportunity to defend against this issue. Because

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[71] (AT Exceptions at 3.)

[72] Aqua Texas attempts to distinguish 30 TEX. ADMIN. CODE § 80.29(a) with 30 TEX. ADMIN. CODE § 70.102, claiming section 70.102 allows amendments while section 80.29 does not. (AT Exceptions at 3, n.2.) Such a distinction does not exist on this issue because section 70.102(c) contains almost the same provision regarding amendments as section 80.29(a); both allow amendment after seven days before hearing, within the discretion of the ALJ.

there are no pleadings deficiencies, there does not need to be a remand and this issue is irrelevant.

VIII. The Respondent's claim that the 2004 Notice authorized the surcharge is without merit.

55. Section 13.187 of the Water Code allows utilities to notice rate changes 60 days before the effective date of the proposed change. Under this section, utilities may charge the proposed rate before any affirmative approval by the TCEQ.[73] Because utilities are allowed to charge the proposed rate before the proposed rate is authorized, there are specific requirements about what can be included in a proposed rate. The Respondent's proposed rate case expense surcharge, including speculative, future and unknown expenses does not comply with the rules. Noticing proposed rate case expenses that have not been incurred at the time of the notice is contrary to the regulatory scheme and TCEQ practice is to not allow them.[74]

56. If a utility notices a proposed rate and there is a contested case hearing on the proposed rate, the utility has the burden to plead and prove the proposed rate. It is still only proposed, not authorized, until the utility proves the proposed rate as required and obtains authorization of it. In the 2004 Rate Case, Aqua Texas did not offer any proof of its proposed surcharge and its proposed surcharge was not authorized.

A. TCEQ rules and regulations do not allow notice of rate case expenses unknown and not incurred at the time of filing of the notice.

57. Aqua Texas claims that the 2004 Notice covers rate case expenses that Aqua Texas had not incurred at the time it filed the notice. However, utilities are required to include in noticed rates, only components, such as expenses, that are known, supported by documentation, and realized. Utilities are not allowed to notice speculative, unknown, unincurred, and unsupportable rates.

i. Proposing a rate case expense surcharge in a proposed rate change is inconsistent with the rules on rate case expenses.

58. Rate case expenses are expenses incurred as a result of a rate change application under 30 TEX. ADMIN. CODE § 291.28(7). They are authorized at the discretion of the Commission for recovery, after they are incurred. They generally consist of the amount

[73] TEX. WATER CODE § 13.187(a); (*see* ED 3 at 11:18-20.)
[74] (Tr. Vol. 3 at 498:24 to 499:1, Test. of Tammy Benter.)

of reasonable attorney's fees, consultant fees, and other expenses incurred as a result of a rate proceeding.

59. Rate case expenses are usually authorized by the Commission and then charged to each utility customer through a surcharge for a specific period of time.[75] The only exception is for rate case expenses necessary for the preparation of filing the proposed rate change application because those expenses are known and measurable at the time the application is filed. There is a line item in the expenses section of the application for a rate change to include rate case expenses incurred preparing the rate change application.[76]

60. The primary rule provisions governing rate case expenses can be found in 30 TEX. ADMIN. CODE § 291.28. According to section 291.28, rate case expenses are authorized at the discretion of the Commission, by Commission action in conjunction with a rate hearing.[77] This was the approach Aqua Texas took at the 2004 Rate Case evidentiary hearing and in briefing; this is not consistent with the 2004 Notice.

61. The title of section 291.28, the rule containing the authorization of rate case expenses, is "Action on Notice of Rate Change Pursuant to Texas Water Code § 13.187(b)".[78] All the provisions within this rule describe actions the Commission has the discretion to do.[79] All of the provisions in this section come under the statement, "The commission may conduct a public hearing on any application."[80] This section, section 291.28, identifies action the Commission can take during the hearing process.[81] Authorizing recovery of rate case expenses is one such action.[82] 30 TEX. ADMIN. CODE § 291.28(7) gives the Commission the discretion to allow recovery of incurred rate case expenses.

62. Rules 291.28(8) and 291.28(9) set out specific conditions that must be met before rate case expenses can be authorized. For example, the proposed rate cannot be higher by a certain percentage than the just and reasonable rate determined by the Commission, and it cannot be less than or equal to a proposed settlement. In order to determine if the conditions exist, no rate case expenses can be authorized until the rate is authorized or in conjunction with the rate authorization.

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[75] (*See, e.g.*, ED 3 at 5:17-23.)
[76] (*Id.*)
[77] (*See* Tr. Vol. 3 at 511:1-5, Test. of Tammy Benter.)
[78] 30 TEX. ADMIN. CODE § 291.28.
[79] *Id.*
[80] *Id.*
[81] *Id.*
[82] 30 TEX. ADMIN. CODE § 291.28(7).

ii. Unknown future expenses are not "allowable expenses" in a proposed rate change.

63. Rate changes noticed under Section 13.187 must only include allowable expenses under 30 Tex. Admin. Code § 291.31(a) and (b). Allowable expenses must be based on a historical test year, or be known and measurable at the time of the rate change filing.[83] Rate case expenses are not based on a test year[84] or known and measurable at the time of the rate change filing. Thus, they cannot be noticed under section 13.187.[85] In fact, the rule explicitly states only allowable expenses "may be considered."[86] Since rate cases have not been incurred at the time of filing a proposed rate, they are not allowable expenses and cannot be considered.

64. Only expenses based on a test year, known and measurable expenses can be noticed pursuant to Section 13.187.[87] Rate case expenses are unknown, not measurable and speculative at the time of the rate change filing.[88] In summary, Aqua Texas did not meet the requirement that rate change filings must only include allowable expenses that are necessary and based on expenses from a test year, or that are known and measurable.

iii. TCEQ rules require all components of a proposed rate to be supported by documentation at the time of filing of the proposed rate; the Respondent's unknown rate case expenses were not supportable at the time of filing.

65. 30 TEX. ADMIN. CODE § 291.22(a) requires a utility fill out a complete application regarding the proposed rate and provide notice of the proposed rate. In this case, there was no evidence that the Respondent's proposed surcharge was part of the body of the application, other than as a part of the attached notice.[89] As such, there was no documentation in the application supporting the proposed surcharge.

66. 30 TEX. ADMIN. CODE § 291.25 specifies additional application requirements. Section 291.25(b) states:

> A utility filing for a change in rates . . . shall be prepared to go forward at a hearing on the data which has been submitted [in the application] . . .and

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[83] 30 TEX. ADMIN. CODE § 291.31(b).
[84] A test year according to section 13.002(22) of the Water Code is: The most recent 12-month period for which a representative operating data for a retail public utility are available. A utility rate filing must be based on a test year that ended less than 12 months before the date on which the utility made the rate filing. Rate case expenses by definition are not based on a historical test year, they are based on the amount incurred as a result of the rate case filing, and therefore, after the rate case filing. The nature of rate case expenses is that they are unknown at the time of the rate filing, are case specific, and impossible to estimate except through speculation. This is inconsistent with providing a rate change filing based on a test year.
[85] (Tr. Vol. 3 at 508:5-15, Test. of Tammy Benter; ED 3 at 11:24-28.)
[86] 30 TEX. ADMIN. CODE § 291.31(b).
[87] 30 Tex. Admin. Code § 291.31(b).
[88] (*See* ED 3 at 13:5-31.)
[89] (*See* AT 1.)

> sustain the burden of proof of establishing that its proposed changes are just and reasonable.

According to TCEQ rule 291.25(b), a utility must be prepared to establish that the proposed changes are just and reasonable with the information that it provides in its rate filing package. Section 291.25(g) allows modification of the rate filing package only upon a showing of good cause. This rule demonstrates that a utility cannot notice speculative and unknown future expenses in a proposed rate change, because such speculative and unknown expenses cannot be supported in the application. This rule ensures efficiencies and fairness because customers and the ED do not have to protest a proposed rate to get information supporting the rate.

iv. The rules identifying allowable surcharges do not include a rate case expense surcharge.

67. The rules regarding surcharges do not allow a utility propose a rate case expense surcharge. The definition of surcharge is:

> A surcharge is an authorized rate to collect revenues over and above the usual cost of service.[90]

According to the definition a surcharge is "authorized".[91] Because rate case expenses are speculative and unknown at the time of a rate proposal, it is also unknown if such rate case expenses are "over and above the usual cost of service" as required by the definition of surcharge. It is illogical and contrary to the regulatory scheme to interpret the rules such that expenses do not have to meet the requirements of allowable expenses as long as they are over and above, or more, than other expenses.

68. The TCEQ rule discussing surcharges in the context of a rate design is 30 TEX. ADMIN. CODE § 291.32. It identifies only two surcharges in a rate design: (1) capital improvements and (2) debt repayments.[92] Rate case expenses are not included. There are additional surcharges described in the rules that require prior written approval, which are not applicable to this case.[93] It is TCEQ practice not to allow rate case expenses in a notice of proposed rate change.[94]

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[90] 30 TEX. ADMIN. CODE § 291.21(k)(1).
[91] *Id.*
[92] 30 TEX. ADMIN. CODE § 291.32(d).
[93] 30 TEX. ADMIN. CODE § 291.21(k)(2).
[94] (Tr. Vol. 3 at 500:9 to 503:5, Test. of Tammy Benter.)

v. Proposing a rate case expense surcharges is contrary to the regulatory scheme.

69. The rules assure reliability and transparency. Utilities are monopolies, and the notice provision balances the utility's need to change rates with the customers' and the TCEQ's ability to ensure the rates are just and reasonable. The Respondent's unclear notice, which provided no amount that Aqua Texas intended to charge, which was based on speculation and included no supporting documentation, made it impossible for the TCEQ and the customers to understand and evaluate the proposed surcharge. The Respondent's attempt to use the notice provision in section 13.187 in order to charge a speculative, unsupported and unauthorized rate is misuse of this section. Aqua Texas is attempting an unauthorized rate through an improper use of the notice provision in section 13.187.[95]

70. The following additional rule requirements demonstrate that Aqua Texas' proposed surcharge is inconsistent with TCEQ rules and statutes:

- TEX. WATER CODE § 13.187(a)(2) and(a)(3) require that Aqua Texas provide a comparison of its existing water and sewer rates to its proposed rates.[96] Aqua Texas did not provide any comparison for its proposed surcharge.[97]

- TEX. WATER CODE § 13.187(c) requires a utility to submit documentation to support its expenses contained in its application. Aqua Texas did not submit any documentation of its proposed surcharge, nor could it submit any documentation of expenses that were not incurred at the time of the application.

- 30 TEX. ADMIN. CODE § 291.21(3) requires a utility to provide a tariff containing the proposed rate with a rate change application.[98] Yet, Aqua Texas' tariff did not include the proposed surcharge.[99]

B. The proposed surcharge was never authorized because Aqua Texas failed to prove the proposed surcharge in the 2004 Rate Case; a different rate case expense surcharge was authorized.

71. Aqua Texas did not obtain authorization of its proposed rate case expense surcharge. While Aqua Texas put a proposed rate case expense surcharge in the 2004 Notice, there was a contested case regarding the proposed rate in the 2004 Notice. During the contested case on the proposed rate, Aqua Texas did not offer evidence of its proposed rate case expense surcharge or seek approval of it. Aqua Texas offered no evidence of it.

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[95] (See *id.* at 509:17 to 510:25; ED 3 at 14:10-43, at 15:1-29.)
[96] *See also* 30 TEX. ADMIN. CODE § 291.22(a)(3) and (4).
[97] (*See, e.g.*, ED 30 at 8, 10.)
[98] (*See, e.g.*, AT 8 at 107288.)
[99] (*See, e.g.*, AT 1 at 103397-103405.) The tariff that was ultimately approved after the 2004 Rate Case does contain the surcharge authorized in the 2008 Rate Order.

It requested a different rate case expense surcharge. The 2008 Rate Order did not authorize the Respondent's proposed rate case expense surcharge.

72. From August 21-28, 2006, SOAH conducted a hearing on the merits on the Respondent's proposed rate.[100] This hearing did not include rate case expenses.[101] Aqua Texas did not offer evidence of its proposed rate case expense surcharge.[102]

73. On February 16 and 19, 2007, SOAH conducted a hearing in the 2004 Rate Case on rate case expenses.[103] At this rate case expense hearing, Aqua Utilities did not request authorization for its proposed rate case expense surcharge.[104] Aqua Utilities offered no evidence of the proposed surcharge that it claimed in the 2004 Notice was part of its proposed rate.[105] It offered no evidence of its proposed surcharge to continue charging $0.85 after it recovered the 2002 Rate Order's rate case expense authorization.[106] Instead, at the hearing, Aqua Texas asked for a rate case expense surcharge different than and inconsistent with the proposed surcharge in its 2004 Notice.[107]

74. Aqua Texas' attorney, Paul Terrill, testified for Aqua Texas on rate case expenses. Inconsistent with the 2004 Notice, Mr. Terrill specifically stated that when the TCEQ Commissioners determine the Respondent's reasonable and necessary expenses, then Aqua Texas seeks to recover them, over the months deemed by the Commission.[108] Kurt Scheibelhut, the Comptroller for Aqua Texas and responsible for accounting for rate case expenses during this timeframe,[109] also testified regarding rate case expenses. When he was asked how Aqua Texas wanted rate case expenses from the 2004 Rate Case to be recouped, he testified that he wanted something "similar" to the 2002 Rate Order.[110] He went on to state that he did not know how much the surcharge should be or the timeframe.[111] Inconsistent with the 2004 Notice, Mr. Scheibelhut goes on to testify that he does not know if the surcharge will be assessed to all of the customers.[112] He further testifies that he does not know why rate case expenses were not included in the proposed rate application and that he was unaware of Aqua Texas requesting any rate case

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[100] (*See, e.g.*, ED 3 at 16:35-42.)
[101] (*Id.*)
[102] (See, e.g., *id.* at 19:32-39.)
[103] (*See, e.g.*, *id.* at 17:2-4.)
[104] (*See, e.g.*, *id.* at 17:6 to 19:17; ED 15 at 41-42:Pre-filed Test. of Robert L. Laughman in the 2004 Rate Case regarding rate case expenses; ED 17 at 4-5: Pre-filed Test. of Paul M. Terrill in 2004 Rate Case regarding the method of recovery of rate case expenses.)
[105] (*See, e.g.*, *id.*; Tr. Vol. 1 at 35:12 to 36:1, Test. of customer Roger Lampman; Tr. Vol. 3 at 434:18 to 435:13, Test. of Stephen Blackhurst.)
[106] (*Id.*)
[107] (ED 17; ED 18.)
[108] (ED 17 at 4:21 to 5:3.)
[109] (*See* AT C at 3:10-11, at 6:17 to 7:9; ED 18 at 1097:13-25; Tr. Vol. 2 at 303:7-10, Test. of Kurt Scheibelhut.)
[110] (ED 18 at 1141:14-25.)
[111] (ED 17 at 1142:8-15.)
[112] (*Id.* at 1144:1-8.)

expenses for the 2004 Rate Case before March 1, 2005.[113] This is despite the fact that the 2004 Notice was submitted in approximately May 2004.[114]

75. Mr. Hugus, an Aqua Texas expert witness on rate case expenses, testified that he had "no idea" how rate case expenses would be assessed and that he understands that the process is that it is by "the recommendation of the Administrative Law Judges and the approval of the Commission."[115] When asked how Aqua Texas would like rate case expenses to be recovered, Aqua Texas offered no testimony about what it had proposed in the 2004 Notice, or that it had a proposed surcharge covering rate case expenses. Mr. Hugus testified that Aqua Texas wanted "to have back the rate case expenses in whatever method the state legal system decides."[116] In the Respondent's Proposed Findings of Fact and Conclusions of Law for the 2004 Rate Case, the Respondent requested to recover its reasonable and necessary rate case expenses through a surcharge "effective upon the adoption of this [2008 Rate] Order."[117]

76. At the evidentiary hearing, Aqua Texas testimony was consistent with the rules and TCEQ practice regarding rate case expense recovery. The Commission determines the reasonable and necessary rate case expenses and how they should be recovered. No one testified that the rate case expenses should be recovered as proposed in the 2004 Notice. It was as if the proposed surcharge in the 2004 Notice did not exist. At the evidentiary hearing, Aqua Texas offered evidence of a rate case expense surcharge consistent with TCEQ practice.

77. The ED's witness, Elsie Pascua, testified that rate case expenses are recovered through a monthly surcharge over a specified number of months.[118] As discussed above, the Respondent's testimony about the method for recovery of rate case expenses was consistent with the ED. The ED was not aware of the proposed surcharge at the time of the hearing.[119]

78. Consistent with the evidence at hearing, the 2008 Rate Order does not authorize the Respondent's proposed rate case expense surcharge.[120]

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[113] (*Id.* at 1147:1-7.)
[114] (Tr. Vol. 2 at 307:4-16, Test. of Kurt Scheibelhut.)
[115] (ED 18 at 1267:15-18.)
[116] (*Id.* at 1267:25 to 1268:2.) Additionally, the Respondent's attorney objected to questioning witnesses about how rate case expenses should be recouped stating: This is not factual testimony that she is eliciting. These are decisions that will be made by you guys first and then by the Commission. (ED 17 at 1144:11-14.)
[117] (ED 24 at 11, ¶ 84.)
[118] (ED 18 at 1315:3-18.)
[119] (Tr. Vol. 1 at 190:10 to 192:4, Test. of Elsie Pascua; Tr. Vol. 3 at 497:16 to 498:11, Test. of Tammy Benter.)
[120] (*Id.* at 22.)

79. When there is a contested case hearing, the subject-matter of the hearing is the proposed rate and the utility has the burden to prove the proposed rate.[121] Section 13.184(c) expressly states:

> In any proceeding involving any proposed change of rates, the burden of proof shall be on the utility to show that the proposed change . . . is just and reasonable.

Aqua Texas cannot avoid this requirement and claim that its proposed surcharge was authorized. Aqua Texas chose not to prove its proposed rate case expense surcharge. It provided evidence of a different rate case expense surcharge, one consistent with TCEQ practice. The rate that was authorized was consistent with TCEQ practice; the proposed surcharge was never authorized. Aqua Texas silence about its own proposed rate, when the rules require it to prove any proposed rate, does not equal acquiescence on the part of the Commission. Any change to a rate must be authorized by the Commission.[122]

80. Regarding rates charged during a rate proceeding that are different than the rate ultimately authorized by the Commission, section 291.29(h) provides:

> Unless otherwise agreed to by the parties to the rate proceeding, the retail public utility shall refund or credit against future bills all sums collected in excess of the rate finally ordered plus interest as determined by the commission in a reasonable number of monthly installments.

The rule expressly states that if the final rate order is different from what is charged during the interim period, the utility is not authorized to keep funds it charged as part of its proposed or interim rate. This rule demonstrates that if a utility charges, during the interim, a rate different from the one authorized, the charged rate was not authorized; the utility must refund the difference. The rules demonstrate that a proposed rate is not authorized unless the Commission approves it. By charging a proposed surcharge and offering no evidence of it in the contested case hearing on the proposed rate, there was no possibility that the proposed surcharge would be authorized.

81. Aqua Texas cannot claim a proposed surcharge was authorized during the proceeding on the proposed surcharge when Aqua Texas did not include any information in its application supporting the proposed surcharge and did not offer any evidence or get any authorization of it during the proceeding on the proposed rate. While Aqua Texas maintains that the ED or customers could have complained about the noticed surcharge, in a proposed rate change hearing, the utility has the burden to prove the proposed rate.

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[121] TEX. WATER CODE § 13.187(e), (f), and (h); 30 TEX. ADMIN. CODE § 291.12.
[122] 30 TEX. ADMIN. CODE § 291.21(a) and (b)(2).

Aqua Texas had an obligation to prove its proposed surcharge in the 2004 Rate Case.[123] Because it did not, the proposed surcharge was not considered and was not authorized. Instead, Aqua Texas requested a different rate case expense surcharge and this different surcharge was authorized.

IX. Aqua Texas' claim that expenses were incurred before surcharges were charged to customers has no bearing on the issues in this case; the rules do not allow utilities to notice unsupportable rates based on future, speculative and unknown expenses <u>at the time of filing</u> the rate change application.

82. Aqua Texas' claim that it never collected more than it incurred misstates the relevant issue regarding unincurred expenses.[124] The issue is not whether Aqua Texas' charged a particular monthly surcharge before Aqua Texas' had incurred expenses. The issue is that Aqua Texas cannot propose a rate for expenses that are unknown and unincurred at the time that the rate is proposed. Aqua Texas proposed a rate case expense surcharge and claims in this case that its proposed surcharge was for rate case expenses that Aqua Texas had not incurred at the time of the noticed surcharge. Specifically, Aqua Texas had incurred about $167,134.46[125] in 2004 Rate Case rate case expenses at the time of the Notice, but all parties agree that Aqua Texas charged over that amount for 2004 Rate Case rate case expenses through the unauthorized surcharge: Aqua Texas claims the amount is about $454,000[126] and the ED claims the amount was $607,884.68.[127]

83. Aqua Texas' assertion that it did not actually charge customers before incurring expenses is not relevant in this case. The relevant point in time is the date the notice and application were filed, not the dates the surcharges were charged. This is because a utility cannot notice unknown future expenses—expenses unincurred at the time of the notice. The fact that expenses are actually incurred at a later date does not change the speculative nature of the expense when the application was filed. This is a protection for the customers who determine whether to contest the proposed rate based on the application. If expenses are speculative, customers cannot assess whether they are fair since customers are not fortune tellers. According to Aqua Texas, it would be permissible for utilities to simply notify customers that they are going to charge rates as expenses are incurred without any specificity.

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[123] TEX. WATER CODE § 13.184(c); 30 TEX. ADMIN. CODE §§ 291.12 and 291.25(b).
[124] (AT Exceptions at 6-7.)
[125] (Tr. Vol. 2 at 308:7-309:6, Test. of Kurt Scheibelhut.)
[126] (*Id.*)
[127] (ED 3 at 26:1-7.)

X. Aqua Texas' reference to its fourth phase of its proposed phased-in rates is inaccurate and immaterial.

84. Aqua Texas suggests that as a good faith effort to resolve this dispute, Aqua Texas did not implement the fourth phase of its noticed rates.[128] This is not an accurate rendition of the facts or law. In the 2004 Rate Case proceeding, Aqua Texas knew it was not going to obtain a rate as high as its fourth phase and according to rule, would have to pay it back. Aqua Texas notifies the ALJs that "in light of the PFD's recommendation of an unphased final rate" Aqua Texas did not implement its fourth phase.[129] Aqua Texas goes on to ask that if its phased rates are ultimately approved, Aqua Texas requests "an adjustment to recover the difference between the third and fourth tier rates during the pendency of the Commission's decision."[130] Aqua Texas knew that according to TCEQ rules it was not entitled to the fourth phase if the final "authorized" rate was not Aqua Texas' proposed phased-in rates, and Aqua Texas knew it would recover any amount it had foregone if its phased-in rates were ultimately authorized. Aqua Texas' contention that it chose to forego its fourth phase as a good faith gesture in this case is not consistent with the record of the 2004 Rate Case. Aqua Texas knew it could recover what it could have generated from charging the final authorized rate from beginning of the rate process and that it would have to return any excess.[131] Aqua Texas gave up nothing.

85. Aqua Texas' claim that ED witness Elsie Pascua conceded that Aqua Texas decision to forego a fourth phase of its noticed rate was a good will gesture mischaracterizes Ms. Pascua's testimony. At the hearing, Aqua Texas' attorney asked her about a statement in Aqua Texas' letter dated September 21, 2007, responding to the NOV issued in this case. In the letter, Aqua Texas' states that as a good will gesture it did not implement its fourth phase of noticed rates.[132] She testified she did not know or remember whether Aqua Texas charged its fourth phase of rates.[133] She had no personal knowledge about whether it was a good will gesture and she specifically stated she did not have an opinion as to whether it was or was not.[134] The only evidence of the alleged good will gesture is the

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[128] (AT Exceptions at 7.)
[129] (2004 Rate Case, Vol. 28 at 121.)
[130] (*Id.*)
[131] (2004 Rate Case, Vol. 26 at 456 and 463: citing to TEX. WATER CODE §§ 13.043(a), 13.187(m).)
[132] (AT 14 at 2.)
[133] (Tr. Vol. 1 at 115:5 – 117:3.)
[134] (Tr. Vol. 1 at 116:16 – 117:3.)

statement in the September 21, 2007 letter[135] which contradicts the record of the 2004 Rate Case.

86. Moreover, this issue is immaterial because Aqua Texas' alleged good faith gesture is not consistent with the good faith efforts policy of the Commission as stated in the Commission Penalty Policy. Good faith, according to the Penalty Policy, requires a respondent to stop the violation and take necessary actions to correct the violation.[136] In this case, at the time of the alleged good faith gesture, Aqua Texas continued to charge the unauthorized surcharge.[137] There is no good faith consideration given when a respondent continues to engage in the activity constituting the violation.

XI. Aqua Texas' claim that the surcharge was authorized when its application was declared administratively complete is not accurate.

87. Aqua Texas suggests that when its application was declared administratively complete, the noticed surcharge was authorized.[138] Merely submitting an administratively complete rate proposal is not equivalent to authorization of the proposed rate. The rules distinguish between a utility's proposed rate and the final rate authorized by the Commission. By its very term, a propose rate is "proposed" and is not a final rate authorized by the Commission. The rules and statutes demonstrate that an administratively complete application of a proposed rate is not an authorized rate.

88. A determination of whether an application is administratively complete is determined within 10 days of the filing of the application.[139] It is strictly a determination that the forms are filled out and the filing fee is paid. It is not a technical review; ten days is insufficient time for a technical review. The application is not considered filed until a determination that it is administratively complete is made.[140] This is the beginning of the rate change process.[141] In a discussion of rate case expenses at its August 31, 2011 agenda meeting, the Commissioners noted that there is no technical review by staff before a rate hearing; a determination of administratively complete is not a technical review.[142]

89. 30 TEX. ADMIN. CODE § 291.25 discusses rate change applications and the rate change process when there is a contested case hearing. 30 TEX. ADMIN. CODE § 291.25(a)

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[135] (AT 14 at 2.)
[136] (ED 11 at 13; TCEQ 2002 Penalty Policy.)
[137] (AT 14 at 8-9.)
[138] (AT Exceptions at 5.)
[139] 30 TEX. ADMIN. CODE § 291.8(a).
[140] *Id.*
[141] *See* 30 TEX. ADMIN. CODE § 291.25(a).
[142] *See* http://www.texasadmin.com/agenda.php?confid=TCEQ_OM083111&dir=tnrcc : Aug. 31, 2011 agenda, Item 1 regarding Texas Landing Utilities; TCEQ Docket No. 2007-1867-UCR; SOAH Docket No. 582-08-1023.

specifies that filing an application is the initiation of the rate change process, not the authorization. 30 TEX. ADMIN. CODE § 291.25(b) and TEX. WATER CODE § 13.184(c) both state that the burden of proof is on the utility to prove any "proposed change" is just and reasonable.[143] 30 TEX. ADMIN. CODE § 291.25(c) further clarifies that the proposed rate is a "rate change request" and a "proposed rate change" which can be subject to a hearing, as in the 2004 Rate Case. After the hearing, the Commission determines whether the proposed rate is authorized. These rules and statutes demonstrate that the proposed rate, even after it has been declared administratively complete, is still "proposed" until the utility meets its burden of proof and the rate is authorized by the Commission.

90. 30 TEX. ADMIN. CODE § 291.28(3) discusses the rate change approval process when there is no hearing. It explains that that if the ED does not request a hearing within 120 days after the proposed rate, then the ED reviews the application for compliance, and if there is compliance, the ED approves the "proposed tariff".[144] This clarifies that a determination of administratively completeness is not a technical review and not authorization. There is either a hearing process in which the Commission determines authorization, or there is a technical review after a determination that there is no hearing, and the ED determines if the proposed rate is approved. The proposed rate is not authorized before one of these processes is complete.

91. TEX. WATER CODE § 13.187, which is one of the statutes that Aqua Texas relies on for authorization of the proposed rate, provides additional distinctions between a proposed rate and the approved rate. TEX. WATER CODE § 13.187(i) distinguishes between the proposed rate and the final authorized rate; this section provides the option of an escrow account during the pendency of the proceeding and requires refunds if the rates collected during the proceeding are in excess of the ordered rate. TEX. WATER CODE § 13.187(l) authorizes the option of interim rates "until a final determination is made on the proposed rate." TEX. WATER CODE § 13.187(e), (f), (h), (k), (m), and (n) also distinguish between the proposed rate and authorized rate and provide remedies for when the proposed rate exceeds the authorized rate.

92. The statutes and rules also provide that if the authorized rate is different than the rate charged by the utility during the rate process, an adjustment must be made to either refund the customers if the charged rate is higher, or for the utility to collect the

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[143] *See also* 30 TEX. ADMIN. CODE § 291.12.
[144] 30 TEX. ADMIN. CODE § 291.28(3); *see also* 30 TEX. ADMIN. CODE § 291.28(5) which distinguishes the "proposed rate" from the rate the Commission "sets".

difference if the charged rate is lower.[145] These rules and statutes exemplify that the proposed rate is not authorized, because adjustments have to be made to square up the proposed rate with the authorized rate. In the 2004 Rate Case an adjustment was not made regarding the proposed surcharge because Aqua Texas did not offer evidence that it was charging the surcharge or request authorization of it. So, it was not addressed.

93. Consistent with the rules requiring adjustments if rates charged during the interim differ from the authorized rate, in the 2004 Rate Case the PFD addresses potential under-collection by Aqua Texas. Aqua Texas proposed and charged phased-in rates with a deferred expense asset added to the base rate or alternatively, as a surcharge.[146] The ALJs did not recommend phased-in rates, and recommended that "any under-collection be recovered through a surcharge"[147] or alternatively through a surcharge implemented to recover the deferred expenses.[148] Consistent with the rules, the ALJs went on to acknowledge that over- or under-recovery must be addressed when rates charged during the rate proceeding are different that the rate ultimately authorized.[149] If proposed rates were always authorized when an application was determined administratively complete, there would be no need for over- or under-collection adjustments.

XII. Aqua Texas' claim that this enforcement case is barred as a matter of law is without merit.

94. Aqua Texas claims the 2004 Rate Case bars this case. Yet the 2004 Rate Case supports the ED in this case. The ED agrees with the ALJ that this case is not barred as a matter of law. Neither res judicata, collateral estoppel nor the filed-rate doctrine bars this case.

A. The Respondent's assertion that this case involves issues and claims determined in the 2004 Rate Case is without merit; this enforcement case involves allegations that the Respondent's actions are contrary and outside the authorizations in the 2002 and 2008 Rate Orders.

95. Throughout the Respondent's exceptions, the Respondent relies on the flawed assumption that this case involves the same issues and claims as the 2004 Rate Case. The Respondent claims that because the 2008 Rate Order disposes of the issue of the authorized rate case expenses for the 2004 Rate Case, the ED cannot bring this enforcement action. But the allegation in this enforcement case is that the Respondent has acted outside of what was authorized in the 2008 Rate Order, as well as the 2002

[145] TEX. WATER CODE § 13.187(i) and (m); and 30 TEX. ADMIN. CODE § 291.29(h) and (i).
[146] (*See* ED 23 at 57.)
[147] (*Id.* at 54.)
[148] (*Id.* at 57.)
[149] (*Id.* at 58, para. 2.)

Rate Order. In other words, the unauthorized surcharge was not authorized in the 2004 Rate Case.

96. The 2008 Rate Order determined the authorized rate case expenses for the 2004 Rate Case. This enforcement case involves an allegation that the Respondent has charged unauthorized amounts—not authorized in the 2008 Rate Order, or the 2002 Rate Order. This case involves an allegation that the Respondent acted contrary to the authorizations in the 2002 and 2008 Rate Orders.

97. The Commission has express authority to enforce orders, and to initiate an enforcement case when it determines that a regulated entity has violated the statutes, rules and Commission orders.[150] That is the allegation in this case. The ED is not attempting to retry any claims or issues decided; the ED is alleging that the Respondent has not acted in accordance with the decided issues and claims in the 2002 and 2008 Rate Orders. That is precisely within the Commission's authority. The ED alleges that the surcharge is not authorized by statute, rule, the 2002 or the 2008 Rate Orders. The Respondent did not raise its proposed surcharge, request authorization of it, or offer any evidence of it at the 2004 Rate Case; in fact, the Respondent's evidence and briefing was inconsistent with the proposed surcharge. It failed to offer evidence and seek authorization of the proposed surcharge in the 2004 Rate Case, and is now asking to use the 2004 Rate Case as a shield.

98. The discussions between the ED and the Respondent about the surcharge, i.e. the NOV, the Respondent's letter in response, and the NOE, occurred outside the rate case. The NOV is the initiation of an enforcement case, not part of a rate case. The discussions by both parties were outside the record, and occurred after the hearings in the 2004 Rate Case because this issue was not a part of the 2004 Rate Case. The Respondent cannot fail to provide evidence of the proposed surcharge and now claim that this issue was litigated against the ED.

B. The ED's actions in the 2004 Rate Case do not prohibit this enforcement case; Aqua Texas was required to prove its proposed surcharge.

99. It is the burden of the Respondent to prove the rate case expense surcharge.[151] It is the Respondent who did not prove the proposed surcharge in the 2004 Rate Case, or obtain

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[150] TEX. WATER CODE § 13.4151(a).
[151] TEX. WATER CODE § 13.184(c); 30 TEX. ADMIN. CODE §§ 291.12 and 291.25(b).

authorization of it in the 2008 Rate Order. The Respondent additionally claims the ED had an obligation to object to the 2004 Notice and/or did not sufficiently raise the issue of the proposed surcharge in the 2004 Rate Case. The ED did not have an obligation to object to this notice.

100. The Respondent is attempting to flip the regulatory scheme on its head by claiming the ED was required to file an objection to an unclear notice, and because he did not, this alleviated the Respondent's burden of proof in that proceeding, and in addition, precludes the ED from filing an enforcement case for unauthorized charges. Courts will not impose additional hurdles and obligations beyond what is explicitly provided for in the statutes authorizing state agencies to proceed with enforcement actions.[152] There is no obligation in the statutes requiring the ED to object to a notice in a rate proceeding before initiating an enforcement action alleging an unauthorized charge in violation of section 13.135 of the Water Code.[153]

101. Aqua Utilities claims after the PFD no one objected to the proposed surcharge. Yet the PFD did not authorize the proposed surcharge, so there was no reason to object after the PFD. Further, the Respondent had requested the effective date of the surcharge to be the effective date of the order. The only party who needed to request authorization of the proposed surcharge was the Respondent.

102. The ED followed the law and proper procedure regarding asserting its position in both the 2004 Rate Case and through enforcement. In addition to testifying and briefing the issue in the 2004 Rate Case, the ED followed proper enforcement procedure and has acted within its enforcement authority. The ED issued an NOV, NOE, and ultimately filed the petition in this case. It was Aqua Utilities who responded to the NOV by stating it wanted to put the customers in the same position as if the proposed surcharge had not been charged, and after the NOE, Aqua Texas ceased charging this surcharge.[154]

103. The ED complied with authority in both the rate case and this enforcement case. The ED did raise the proper methodology of recovery for rate case expenses in the 2004 Rate Case, and the ED has followed proper enforcement mechanisms based on its enforcement authority. The ED offered testimony in the rate expense case hearing, and issued an NOV (which led to this enforcement case). The Respondent stopped the

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[152] *See, e.g., Tex. Natural Res. Conservation Comm'n v. Lakeshore Util. Co., Inc.*, 164 S.W.3d 368, 378-79 (Tex. 2005) (holding that a Commission order was no prerequisite for the attorney general to initiate an enforcement action, since it is not a requirement in statutes).
[153] *See* TEX. WATER CODE § 13.4151.
[154] (ED 14 at 9; AT 7 at 1.)

surcharge and the Commission issued the 2008 Rate Order consistent with the ED's witness testimony. The ED had no reason to do anything more in the 2004 Rate Case.

C. The Respondent's claims of res judicata and collateral estoppel have no merit.

104. The preclusion doctrines of res judicata and collateral estoppel bar the relitigation of claims or issues that have been finally adjudicated or that should have been adjudicated in a prior action.[155] The general principal is that a party may not dispute a right, question or fact distinctly put in issue and directly determined by a final judgment in a prior suit between the same parties as a ground of recovery or defense in a later suit between the same parties.[156]

105. There are two principal categories: (1) claim preclusion (known as res judicata); and (2) issue preclusion (known as collateral estoppel).[157] For res judicata, or claim preclusion, to apply, a party must establish the following elements: (1) a prior final judgment on the merits by a court of competent jurisdiction; (2) the same parties or those in privity with them; and (3) a second action based on the same claims as were raised or should have been raised in the first action.[158] Collateral estoppel, or issue preclusion, is more narrowly defined than claim preclusion.[159] For collateral estoppel to apply, a party must establish: (1) the facts sought to be litigated in the second action were fully and fairly litigated in the first litigation; (2) those facts were essential to the judgment in the first action; and (3) the parties were cast as adversaries in the first action.[160]

i. Res judicata and collateral estoppel do not apply because there are no adverse issues or claims against the ED in the 2004 Rate Case.

106. In this case, the ED agrees with all of the findings of fact and conclusions of law in both the 2002 Rate Order and the 2008 Rate Order. No claim or issue is contrary to the ED's enforcement case. Because the 2004 Rate Case does not involve any issues or claims contrary to the issues and claims of the ED in this enforcement order, neither res judicata nor collateral estoppel applies. The prior rate cases were not contrary to the ED in this case because neither order authorizes the unauthorized surcharge. If anything,

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[155] *Igal v. Brightstar Info. Tech. Group, Inc.*, 250 S.W.3d 78, 86 (Tex. 2008); *Barr v. Resolution Trust Corp.*, 837 S.W.2d 627, 628-629 (Tex. 1992).
[156] *Tricon Tool & Supply, Inc. v. Thurmann*, 226 S.W.3d 494, 511 (Tex. App.—Houston[1st Dist.] 2006, pet. denied).
[157] *Barr v. Resolution Trust Corp.*, 837 S.W.2d at 628-629; *Welch v. Hrabar*, 110 S.W.3.d at 606.
[158] *Igal v. Brightstar Info. Tech. Group, Inc.*, 250 S.W.3d at 86-87; *Welch v. Hrabar*, 110 S.W.3.d at 606.
[159] *Welch v. Hrabar*, 110 S.W.3.d 601, 606.
[160] *Id.* Res judicata and collateral estoppel do apply to the relitigation of claims previously determined by an administrative agency. *Igal v. Brightstar Info. Tech. Group, Inc.*, 250 S.W.3d at 86-87; *Tricon Tool & Supply, Inc. v. Thurmann*, 226 S.W.3d 494 at 511. When an administrative agency is acting in a judicial capacity, resolves disputed issues properly before it, and the parties had an opportunity to litigate the issues, res judicata bars relitigation of claims previously finally determined by the administrative agency. *Id.*

the 2002 Rate Order and the 2008 Rate Order, according to their plain language, demonstrate that the Respondent's surcharge was unauthorized. Agency's orders are to be interpreted in accordance with their plain language.[161]

ii. Res judicata and collateral estoppel do not apply in this proceeding because there was no subject-matter jurisdiction for the ALJ in the 2004 Rate Case to adjudicate this enforcement case.

107. Res judicata and collateral estoppel do not apply in this case because there was no jurisdiction for the claims and issues in this case to be determined in the 2004 Rate Case. Neither res judicata nor collateral estoppel applies when the initial tribunal lacks subject-matter jurisdiction over the claims.[162]

108. Administrative agencies have only the powers and jurisdiction enumerated by statute.[163] Where a prescribed power is granted and the method of its exercise prescribed, the precise method set forth in the act excludes all others and must be followed.[164] In order for the ED to assert this enforcement action, he must comply with the statutes and rules regarding enforcement; he had no authority to assert an enforcement case without following the enforcement procedure mandated by statute and rule.[165]

109. The ED was required to file the petition, give the Respondent an opportunity to file an answer, wait the required number of days before referring it to SOAH, and follow the other requirements of section 13.4151 of chapter 13 of the Water Code, as well as 30 TEX. ADMIN. CODE ch. 70. The 2004 Rate Case did not provide an authorized forum or procedure to cite the Respondent for the violations in this case, to request a penalty and to request corrective actions. The only mechanism under which the ED could bring an enforcement case for the remedy of penalties is through the procedures resulting in this case. Additionally, there was no jurisdiction for the ED to assert a violation of the 2002 Rate Order in the 2004 Rate Case.

110. Because the ED did not have jurisdiction, the ALJ in the 2004 Rate Case also did not have jurisdiction to adjudicate a claim outside the TCEQ's jurisdiction.[166] Since there was no jurisdiction for the enforcement claims in 2004 Rate Case, the Respondent's res judicata and collateral estoppel claims are barred.

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[161] *See Igal v. Brightstar Info. Tech. Group, Inc.*, 250 S.W.3d at 89.
[162] *Igal v. Brightstar Info. Tech. Group, Inc.*, 250 S.W.3d at 82; *Tex. A & M Univ. Sys. v. Luxemburg*, 93 S.W.3d 410, 418 (Tex. App.—Houston[14th Dist.] 2002, pet. denied); *SWEPI, L.P. v. Camden Res., Inc.*, 139 S.W.3d 332, 340 (Tex. App.—San Antonio 2004, pet. denied).
[163] *Igal v. Brightstar Info. Tech. Group, Inc.*, 250 S.W.3d at 83; *Subaru of Am., Inc. v. David McDavid Nissan, Inc.*, 84 S.W.3d at 220.
[164] *See Bryant v. L.H. Moore Canning Co.*, 509 S.W.2d 432, 435 (Tex. Civ. App.—Corpus Christi 1974, no writ).
[165] *Id.*
[166] *See* TEX. GOV'T CODE § 2003.021(b).

111. The Respondent does not explain how an enforcement case, with specific enforcement procedures, and claims for penalties, an enforcement order which impacts compliance history, a violation of the 2002 Rate Order, and corrective action could have been heard in the 2004 Rate Case. If there is no jurisdiction for the claims in the initial proceeding, then res judicata does not apply.[167]

iii. The Respondent's claim of res judicata is without merit.

112. For res judicata, or claim preclusion, to apply, Aqua Texas must establish the following elements: (1) a prior final judgment on the merits by a court of competent jurisdiction; (2) the same parties or those in privity with them; and (3) a second action based on the same claims as were raised or should have been raised in the first action.[168] Because the claims of this enforcement case are different than the 2004 Rate Case, Aqua Texas' affirmative defense of res judicata is without merit.

113. Res judicata does not apply because the claims in this case are not the same as the claims in the 2004 Rate Case. One element the Respondent must establish in res judicata is that the claim in this enforcement action was or should have been determined in the prior rate case.[169] The claim by the ED in this enforcement case is that the Respondent charged the unauthorized surcharge in violation of 30 TEX. ADMIN. CODE § 291.21(a), TEX. WATER CODE § 13.135, and the 2002 Rate Order. The claims in the 2004 Rate Case most related to this case are whether the Respondent incurred reasonable and necessary rate case expenses, the amount of such expenses, whether the Respondent should recover these expenses, and the mechanism of such recovery. These are different claims, not the same claims. The ED could not have raised an enforcement claim unrelated to the 2004 Rate Case in the 2004 Rate Case. Further the ED could not have raised a claim for penalties in the 2004 Rate Case. Whether the Respondent's surcharge was unauthorized is not a claim that was or could have been litigated in the 2004 Rate Case.[170]

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[167] *Igal v. Brightstar Info. Tech. Group, Inc.*, 250 S.W.3d at 82; *Tex. A & M Univ. Sys. v. Luxemburg*, 93 S.W.3d 410, 418 (Tex. App.—Houston[14th Dist.] 2002, pet. denied); *SWEPI, L.P. v. Camden Res., Inc.*, 139 S.W.3d 332, 340 (Tex. App.—San Antonio 2004, pet. denied).
[168] *Igal v. Brightstar Info. Tech. Group, Inc.*, 250 S.W.3d at 86-87; *Welch v. Hrabar*, 110 S.W.3.d at 606.
[169] *Igal v. Brightstar Info. Tech. Group, Inc.*, 250 S.W.3d at 86-87.
[170] *Welch v. Hrabar*, 110 S.W.3.d at 606.

iv. The Respondent's claim of collateral estoppel is without merit.

114. Collateral estoppel is narrower than res judicata and bars relitigation of essential and identical issues of fact actually litigated in a prior proceeding.[171] Collateral estoppel prevents relitigation of particular issues already resolved in a prior suit.[172] Collateral estoppel only extends to those issues of fact or law that were expressly or necessarily determined in the prior action; it does not extend to those matters which might have been, but were not, raised and adjudicated in the first action.[173] The issue decided in the prior action must be identical to the issue in the pending action.[174] There were no actual, essential and identical issues of fact decided in the 2004 Rate Case contrary to the ED in this enforcement case.

115. The Respondent claims there is issue preclusion because the ED did not sufficiently raise the issue in the 2004 Rate Case. This assertion is contrary to the facts. At the hearing the Respondent did not offer any testimony about how the Commission should authorize payments. The Respondent did not testify regarding the proposed surcharge, and instead requested the entire amount of its rate case expenses, with no offset. The Respondent never requested authorization of its proposed surcharge, never offered evidence of the proposed surcharge, and never asked for an offset in the amount of the proposed surcharge. Furthermore, the Respondent asked for a rate case expenses surcharge to be effective on the date of the 2008 Rate Case Order. This was similar to the ED's testimony. Consistent with the ED witness's testimony, as well as the Respondent's testimony and briefing, the Commission ordered a $2.50 surcharge for 24 months effective January 1, 2009. Because the 2008 Rate Order authorized recovery of rate case expenses consistent with the ED witness's testimony, the ED had no reason to take further action in the 2004 Rate Case. To the extent there were more facts that could have been discussed, these were not necessary facts and do not meet the criteria for collateral estoppel.[175]

116. The issue in this case is that the Respondent assessed a surcharge without authorization, inconsistent with the 2008 Rate Order, inconsistent with the Respondent's own position in the 2004 Rate Case, and not in compliance with rules and statutes. The issue of reasonable and necessary rate case expenses incurred and to be recovered was litigated.

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[171] *Coalition of Cities for Affordable Util. Rates v. Pub. Util. Comm'n of Tex.*, 798 S.W.2d 560, 562-63 (Tex. 1990); *Welch v. Hrabar*, 110 S.W.3.d at 607.
[172] *Barr v. Resolution Trust Corp.*, 837 S.W.2d at 628.
[173] *SWEPI, L.P. v. Camden Resources, Inc.*, 139 S.W.3d at 339.
[174] *Id.*
[175] *Coalition of Cities for Affordable Util. Rates v. Pub. Util. Comm'n of Tex.*, 798 S.W.2d at 562-63; *Welch v. Hrabar*, 110 S.W.3.d at 607; *Barr v. Resolution Trust Corp.*, 837 S.W.2d at 628; *SWEPI, L.P. v. Camden Resources, Inc.*, 139 S.W.3d at 339.

The method of recovery was also litigated. The problem is that the Respondent's actions in collecting the Extended Surcharge were without authority and inconsistent with how the rate case expenses were authorized in the 2008 Rate Order.

117. Moreover, the Respondent misstates the standard for collateral estoppel. The Respondent states that the ED had opportunity to litigate the surcharge issue. The ED disputes this, but even so, this is not the standard for collateral estoppel. The standard is that the issue in this enforcement case must be an essential, identical and actually fully litigated issue as an issue in the 2004 Rate Case, and determined contrary to the ED.[176]

118. The issue, of whether the surcharge was unauthorized and in violation of rule, statute, and Commission order, was not litigated in the 2004 Rate Case. The Respondent took the same position as the ED in the 2004 Rate Case: that rate case expenses should be recovered after authorized in the order. The 2008 Rate Order expressly authorizes rate case expenses to be recovered after the Order. Collateral estoppel does not apply.

D. Aqua Texas misapplies the "filed-rate doctrine"; it does not apply to this case.

119. Aqua Texas asserts the filed-rate doctrine applies to this case.[177] It does not. The filed-rate doctrine applies to tariffs filed with and approved by the administrative agency.[178] The proposed surcharge in the 2004 was not contained in a tariff approved by the Commission. Noticed proposed rates are not a tariff.[179]

120. Aqua Texas also claims noticed rates are presumed reasonable.[180] This claim is contrary to TCEQ rules. TCEQ rules require utility to prove reasonableness in any hearing on proposed rate; there is no presumption.[181]

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[176] *See, e.g., Coalition of Cities for Affordable Util. Rates v. Pub. Util. Comm'n of Tex.*, 798 S.W.2d 560, 562-63 (Tex. 1990).
[177] (AT Exceptions at 13-14.)
[178] *Southwestern Elec. Power Co. v. Grant*, 73 S.W.3d 211, 216 (Tex. 2002.)
[179] *See, e.g.*, 30 TEX. ADMIN. CODE § 291.21.
[180] (AT Exceptions at 14.)
[181] TEX. WATER CODE § 13.184(c); 30 TEX. ADMIN. CODE §§ 291.12 and 291.25(b).

XIII. Conclusion

For these reasons, the ED respectfully requests the ALJ recommend and the Commission adopt the ED's exceptions.

Respectfully submitted,

Texas Commission on Environmental Quality

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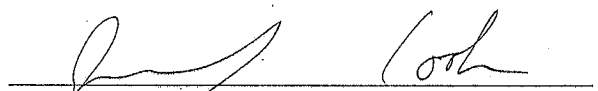

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CERTIFICATE OF SERVICE

I certify that on January 23, 2012, the foregoing original document and seven (7) copies were filed with the Chief Clerk of the Texas Commission on Environmental Quality. Additionally the document was electronically filed with the Chief Clerk.

I further certify that on this day a true and correct copy of the foregoing document was served to the following:

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