

# State Office of Administrative Hearings



Cathleen Parsley  
Chief Administrative Law Judge

April 13, 2010

Les Trobman, General Counsel  
Texas Commission on Environmental Quality  
P.O. Box 13087  
Austin Texas 78711-3087

**Re: SOAH Docket No. 582-09-2557; TCEQ Docket No. 2009-0048-UCR; In Re: Appeal of Multi-County Water Supply Corporation to Review the Wholesale Water Rate Increase Imposed by the City of Hamilton, Certificate of Convenience and Necessity No. 11525, and Request for Interim Rates in Cooke County; Application No. 36280-M**

Dear Mr. Trobman:

The above-referenced matter will be considered by the Texas Commission on Environmental Quality on a date and time to be determined by the Chief Clerk's Office in Room 201S of Building E, 12118 N. Interstate 35, Austin, Texas.

Enclosed are copies of the Proposal for Decision and Order that have been recommended to the Commission for approval. Any party may file exceptions or briefs by filing the documents with the Chief Clerk of the Texas Commission on Environmental Quality no later than May 3, 2010. Any replies to exceptions or briefs must be filed in the same manner no later than May 13, 2010.

This matter has been designated **TCEQ Docket No. 2009-0048-UCR; SOAH Docket No. 582-09-2557**. All documents to be filed must clearly reference these assigned docket numbers. All exceptions, briefs and replies along with certification of service to the above parties shall be filed with the Chief Clerk of the TCEQ electronically at <http://www10.tceq.state.tx.us/epic/efilings/> or by filing an original and seven copies with the Chief Clerk of the TCEQ. Failure to provide copies may be grounds for withholding consideration of the pleadings.

Sincerely,

A handwritten signature in black ink, appearing to read "Travis Vickery".

Travis Vickery  
Administrative Law Judge

TV:ls  
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cc: Mailing List

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**AGENCY:** Environmental Quality, Texas Commission on (TCEQ)

**STYLE/CASE:** MULTI-COUNTY WATER SUPPLY CORP

**SOAH DOCKET NUMBER:** 582-09-2557

**REFERRING AGENCY CASE:** 2009-0048-UCR

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**STATE OFFICE OF ADMINISTRATIVE  
HEARINGS**

**ADMINISTRATIVE LAW JUDGE  
ALJ TRAVIS VICKERY**

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CITY OF HAMILTON

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xc: Docket Clerk, State Office of Administrative Hearings

**SOAH DOCKET NO. 582-09-2557  
TCEQ DOCKET NO. 2009-0048-UCR**

<b>APPEAL OF MULTI-COUNTY WATER</b>	<b>§</b>	<b>BEFORE THE STATE OFFICE</b>
<b>SUPPLY CORPORATION TO REVIEW</b>	<b>§</b>	
<b>THE WHOLESALE WATER RATE</b>	<b>§</b>	
<b>INCREASE IMPOSED BY THE CITY</b>	<b>§</b>	
<b>OF HAMILTON, CERTIFICATE OF</b>	<b>§</b>	<b>OF</b>
<b>CONVENIENCE AND NECESSITY</b>	<b>§</b>	
<b>NO. 11525, AND REQUEST FOR</b>	<b>§</b>	
<b>INTERIM RATES IN COOKE</b>	<b>§</b>	
<b>COUNTY; APPLICATION NO. 36280-M</b>	<b>§</b>	<b>ADMINISTRATIVE HEARINGS</b>

**PROPOSAL FOR DECISION**

**I. INTRODUCTION**

Multi-County Water Supply Corporation (MCW) appealed the wholesale water rate increase adopted by the City of Hamilton (City). MCW contends that the increase is adverse to the public interest. The City and the Executive Director (ED) of the Texas Commission on Environmental Quality (Commission) disagree and argue that MCW's appeal should be denied. The Administrative Law Judge (ALJ) concludes that the wholesale water rate increase is not adverse to the public interest. The ALJ recommends that MCW's appeal be denied.

**II. SUMMARY**

This matter involves a water rate dispute between the City and MCW. These parties have had an ongoing contractual relationship since they entered into a water supply contract in 1989 (Contract). In short, the City has been purchasing water from its source, Upper Leon River Municipal Water District (Upper Leon), for some time and then reselling that water to MCW pursuant to the Contract. Although there have been a few rate increases over the years, the increase at issue in this matter was originally noticed in 2008. At that time, Upper Leon increased the rate paid by the City by fourteen cents per one thousand gallons, which the City then sought to pass-through to MCW. MCW appealed and this proceeding resulted.

### III. PROCEDURAL HISTORY AND JURISDICTION

On December 11, 2008, MCW filed a petition with the Commission appealing an increase in the wholesale water rates charged by the City. On January 14, 2009, the petition was referred to the State Office of Administrative Hearings (SOAH). On May 5, 2009, ALJ Travis Vickery conducted a preliminary hearing and the following parties appeared: MCW, the City, and the ED. Notice and jurisdictional documents were admitted at the preliminary hearing and the parties agreed to a procedural schedule. Based on the notice and jurisdictional documents admitted at the preliminary hearing, the ALJ concluded that the Commission has jurisdiction to consider and act on MCW's appeal pursuant to TEX. WATER CODE ANN. (Water Code) § 13.043(f).

On November 5, 2009, ALJ Travis Vickery convened a hearing on the merits, attended by MCW, the City, and the ED. The hearing was completed that day, and two sets of post-hearing briefing were submitted by the parties. Pursuant to Order No. 8, the record closed on February 12, 2010.

### IV. BACKGROUND<sup>1</sup>

#### A. The City's Water System

Currently, the City purchases treated water from Upper Leon, which it then re-sells to retail customers and MCW. The City has purchased water from Upper Leon since 1964. Up until 1991, the City purchased raw water from Upper Leon that was transported in the Leon River after being released from Lake Proctor. The City diverted the raw water from the Leon River and treated it in its own water treatment plant.<sup>2</sup>

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<sup>1</sup> The ALJ used the City's background section from the City's Initial Brief for this section.

<sup>2</sup> City of Hamilton (COH) Ex. 37 at 2-3.

In the late 1980's, the City, MCW, Upper Leon and the Farmers Home Administration (FHA) began discussing a new water project for the City and MCW. Instead of using the Leon River to transport water, the project contemplated transporting raw water through a 36-mile pipeline from Upper Leon to the City, where it would be treated at the City's treatment facility.<sup>3</sup> Construction of the pipeline was to be financed through public bonds sold by the City, and backed by FHA.<sup>4</sup>

At the same time, MCW was acquiring funds to install and improve its own infrastructure. A large portion of the water to be transported through the pipeline was to be supplied to MCW by the City. As a result, the City designed the pipeline with a capacity sufficient to supply the City and MCW. Although the larger line would be more expensive to construct, the FHA was willing to back the bonds because the City guaranteed sufficient water sales revenue to service the debt.<sup>5</sup>

The City was able to guarantee sufficient revenue because all water supplied to its citizens would come from Upper Leon through the pipeline. In addition, the City and MCW were to enter into the Contract, which would include a provision requiring MCW to purchase all water exclusively from the City – thus guaranteeing a minimum level of revenue to service the pipeline debt. Until that time, MCW did not have a source of water to supply its members, and the project would provide it with a reliable source. As a result, the City and MCW entered into the Contract in 1989.<sup>6</sup>

The FHA reviewed and approved the Contract and required that the letter of conditions issued by FHA be amended to comport with the Contract. As a result, so long as rates are high enough, the volume of water transported through the pipeline is sufficient to allow the City to recover its costs and pay off the debt on the pipeline. That debt is still being paid down and will

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<sup>3</sup> The FHA is a federal agency that Congress authorized to provide financing in rural areas for water and wastewater facilities, among other things.

<sup>4</sup> COH Ex. 37 at 2-3.

<sup>5</sup> COH Ex. 37 at 3-4.

<sup>6</sup> COH Ex. 37 at 2-7; COH Ex. 4.

not be fully repaid until 2029.<sup>7</sup> The pipeline was completed in 1991. Shortly thereafter, Upper Leon began providing raw water to the City for treatment and delivery to its customers, including MCW.<sup>8</sup>

The City and Upper Leon operated under the same water purchase contract from 1964 until 2005. On October 10, 2005, the City entered into a new contract with Upper Leon. The primary change was that the City would cease buying raw water from Upper Leon for treatment at the City's facility, and instead buy water treated by Upper Leon. The agreement also transferred the pipeline to Upper Leon. In March of 2007, the City began purchasing treated water from Upper Leon, delivered through the pipeline. This allowed the City to discontinue using its own facility. The treated water is stored by the City and distributed to roughly 1,500 retail customers and one wholesale customer, MCW.<sup>9</sup> Upper Leon serves five cities and charges one system-wide rate to each customer.<sup>10</sup>

## **B. The Contract Between the City and MCW**

In 1989, when the City and MCW entered into the Contract, the pipeline did not yet exist. The City's obligations under the Contract were expressly conditioned on "the City's ability to finance the cost of construction of a raw water pipeline from the Lake Proctor to the City of Hamilton through the sale of 1989 Revenue Bonds, the issuance of which is now pending."<sup>11</sup> To insure revenue sufficient to guarantee financing, the Contract also contained an exclusivity clause which states:

(e) During the primary term of the contract Purchaser shall not obtain water from any source other than the City unless Purchaser can show by written opinion of a

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<sup>7</sup> COH Ex. 22; COH Ex. 37 at 3-4.

<sup>8</sup> COH Ex. 37 at 2-7; COH Ex. 4.

<sup>9</sup> COH Ex. 37 at 2-5.

<sup>10</sup> COH Ex. 37 at 2-3; COH Ex. 36 at 17.

<sup>11</sup> COH Ex. 4 at 9, Clause (c).

recognized independent engineer that the City is unable to supply water and then only to the extent such supply fails to meet demand.<sup>12</sup>

It is undisputed that MCW has never procured a written opinion from an independent engineer that the City is unable to meet MCW's water needs.<sup>13</sup> Finally, although the City must demonstrate the justification for rate changes, MCW cannot adjust the rate it pays for wholesale water.<sup>14</sup> The City and MCW are still operating under the Contract today.

The Contract has been amended three times by addenda, which were negotiated and agreed to by both parties. The primary term of the Contract is 30 years from the date of initial delivery of water, which ends in 2019. In 1996, the City and MCW agreed to amend the Contract to extend the term an additional 10 years and ratify all other terms.<sup>15</sup>

There have also been a number of rate increases since the inception of the Contract. Initially, the Contract set a rate of \$2.25 per thousand gallons, and set forth the methods by which the rate could be adjusted. In 1993, the City increased the rate higher than \$2.50, on the grounds that treatment costs had gone up. MCW, however, resisted any increase. The parties negotiated and agreed that the rate would be set at \$2.50 per thousand gallons.<sup>16</sup>

In May of 2007, after the City began receiving treated water from Upper Leon pursuant to the 2005 contract, the City's costs increased and it raised the rate to \$4.46. MCW did not appeal this increase. Thereafter, on September 12, 2008, the City notified MCW that Upper Leon had increased the rate it charged the City by fourteen cents per thousand gallons, and that the City would be raising the rate to MCW by the same amount. Although the City planned for the new rate to go into effect on November 1, 2008, it did not go into effect until

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<sup>12</sup> MCW Ex. 1 at 9; Clause (C)(10)(e).

<sup>13</sup> Tr. 66.

<sup>14</sup> COH Ex. 4 at 7, Clause 5.

<sup>15</sup> COH Ex. 37 at 6, 7; MCW Ex. 1 at 5-6, Clause (C)(1).

<sup>16</sup> COH Ex. 37 at 6, 7.

September 1, 2009. After being notified of the new rate, MCWSC filed a rate appeal protesting the fourteen cent increase, and this proceeding ensued.<sup>17</sup>

## V. LEGAL BACKGROUND

MCW filed its petition under the provisions of Water Code § 13.043(f) and Chapter 291 of the Commission's rules. Water Code § 13.043(f) grants the Commission jurisdiction over a retail public utility's appeal of a change in water rates charged to the utility by a political subdivision of the state. Due to the deference to contracts found in the Texas Constitution and United States Constitution, however, the Commission's rules require a bifurcated hearing process for appeals of rates based on written contracts.<sup>18</sup> The initial hearing on an appeal is limited to a determination of whether the protested rate adversely affects the public interest.<sup>19</sup> The initial determination of whether the protested rate adversely affects the public interest cannot be based on an analysis of the seller's cost of service.<sup>20</sup>

Pursuant to 30 TAC § 291.136, as the petitioner, MCW has the burden of proof to establish that the protested rate is adverse to the public interest.<sup>21</sup> The Commission's rules establish specific factors to be considered in reaching this determination.<sup>22</sup> Specifically, the

- (a) Commission shall determine the protested rate adversely affects the public interest if after the evidentiary hearing on public interest the commission concludes at least one of the following public interest criteria have been violated:
  - (1) the protested rate impairs the seller's ability to continue to provide service, based on the seller's financial integrity and operational capability;

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<sup>17</sup> COH Ex. 37 at 7, 8; COH Ex. 7.

<sup>18</sup> *Texas Water Com'n v. City of Fort Worth*, 875 S.W. 2d 332, 335 (Tex. App. – Austin, 1994); *Federal Power Com'n v. Sierra Pacific Power Co.*, 350 U.S. 348 (1955); *Texas Register*, Vol. 19, No. 58, August 9, 1994.

<sup>19</sup> 30 TEX. ADMIN. CODE (TAC) §§ 291.131(b), 291.132, and 291.134.

<sup>20</sup> 30 TAC § 291.133(b).

<sup>21</sup> 30 TAC § 291.136.

<sup>22</sup> 30 TAC § 291.133.

- (2) the protested rate impairs the purchaser's ability to continue to provide service to its retail customers, based on the purchaser's financial integrity and operational capability;
- (3) the protested rate evidences the seller's abuse of monopoly power in its provision of water or sewer service to the purchaser. In making this inquiry, the commission shall weigh all relevant factors. The factors may include:
  - (A) the disparate bargaining power of the parties, including the purchaser's alternative means, alternative costs, environmental impact, regulatory issues, and problems of obtaining alternative water and sewer service;
  - (B) the seller's failure to reasonably demonstrate the changed conditions that are the basis for a change in rates;
  - (C) the seller changed the computation of the revenue requirement or rate from one methodology to another;
  - (D) where the seller demands the protested rate pursuant to a contract, other valuable consideration received by a party incident to the contract;
  - (E) incentives necessary to encourage regional projects or water conservation measures;
  - (F) the seller's obligation to meet federal and state wastewater discharge and drinking water standards;
  - (G) the rates charged in Texas by other sellers of water or sewer service for resale;
  - (H) the seller's rates for water or sewer service charged to its retail customers, compared to the retail rates the purchaser charges its retail customers as a result of the wholesale rate the seller demands from purchaser;
- (4) the protested rate is unreasonably preferential, prejudicial, or discriminatory, compared to the wholesale rates the seller charges other wholesale customers.<sup>23</sup>

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<sup>23</sup> 30 TAC § 291.133.

These public interest factors are to be narrowly construed to give deference to the rate set pursuant to a contract.<sup>24</sup> Although the City and the ED provided argument and evidence on 30 TAC § 291.133 (1), (2) and (4), the ALJ does not address those factors because MCW did not raise these provisions. Instead, MCW based its appeal only on 30 TAC § 291.133(a)(3) alleging an abuse of monopoly power.

## VI. THE CONTRACT GRANTS THE CITY MONOPOLY POWER

In its initial briefing, the City argued that it does not possess monopoly power over MCW.<sup>25</sup> The ED and MCW argue the City does possess monopoly power, noting that under the Commission's rules, such power may be created through contract. As a result, the ALJ required additional briefing on whether the City possesses monopoly power.<sup>26</sup> The ALJ finds that under 30 TAC § 291.133(a)(3) the City possesses monopoly power over MCW.

Of the four public interest criteria found in 30 TAC § 291.133(a), MCW alleged only that the City abused monopoly power created by the Contract. One definition of a monopoly is “. . . the exclusive right (or power) to . . . control the sale of the whole supply of a particular commodity.”<sup>27</sup> It is also defined as the “power to control price or to exclude competition.”<sup>28</sup> The basic question posed by the ALJ was whether the term “monopoly power” in 30 TAC § 291.133(a)(3), may be formed by contract or is limited to a water utility's geographic monopoly. The ED notes that a geographic monopoly in the wholesale water context,<sup>29</sup> would involve the existence of a single water source from which a customer could obtain water in its

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<sup>24</sup> See generally ED Ex. BDD-2.

<sup>25</sup> City's Initial Brief at 9-10.

<sup>26</sup> See, Order No. 7. The ALJ also asked the parties to address whether the existence of monopoly power is jurisdictional, because it is so fundamental to the issues raised by 30 TAC § 291.133(a)(3). The parties agreed that the existence of monopoly power is not jurisdictional. Based on the arguments of the parties, the ALJ agrees.

<sup>27</sup> City Supplemental Brief at 3, *citing* BLACK'S LAW DICTIONARY 908 (5<sup>th</sup> ed. 1979).

<sup>28</sup> BLACK'S LAW DICTIONARY 1023 (Deluxe 7<sup>th</sup> ed. 1999)

<sup>29</sup> A geographic monopoly in a *retail* context is created through a Commission issued Certificate of Convenience and Necessity (CCN). The Texas Water Code and the TCEQ rules limit the CCN requirements to retail water service - not wholesale water service. TEX. WATER CODE § 13.242(a); 30 TEX. ADMIN. CODE § 291.101(a).

area. An exclusive contract, however, could create a monopoly, independent of the availability of other water sources, by excluding competition price controls.

It is undisputed that the City does not possess a geographic monopoly. There are several other sources of water available to MCW in the geographic area. Jack Wall, President of MCW, testified that MCW considered water supplies from Lake Belton, Gatesville, Kempner, and the possibility of drilling its own wells before it decided to obtain water from the City.<sup>30</sup>

Instead, the ED and MCW argue that the City's monopoly power was created by the Contract, because it provides the City a unilateral right to adjust its rate and limits MCW's ability to obtain water from other sources. Although the City disagrees that the Contract creates a monopoly, all the parties agree that "monopoly power" under 30 TAC § 291.133(a)(3) may be created by contract. They note that the drafters of the wholesale water appeal rules explain in the preamble that:

there are situations where a seller and a purchaser have entered into a long term agreement that later is disputed. Over time the seller exercises near monopoly power over the purchaser because many agreements allow the seller the unilateral right to adjust the rate. Moreover, the purchaser substantially has no alternatives to obtain water or sewer service because it has entered into a long term agreement with the seller. The adopted criteria focus on the actual facts which will show whether the protested rate reflects this type of agreement so much that it invokes the public interest.<sup>31</sup>

The ED and MCW argue that the Contract meets the drafter's definition of monopoly power. The ALJ agrees. The Contract has a 40 year term and grants the City a unilateral right to adjust its rate based on the components of its methodology -- MCW cannot adjust the rate it pays for wholesale water. The Contract's exclusivity clause limits MCW's ability to obtain water from other sources. So long as the City can provide all the water that MCW needs, MCW is prohibited from obtaining water elsewhere. Even if the City cannot provide all the water that MCW needs, the exclusivity clause only allows MCW to obtain its supplemental water from

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<sup>30</sup> COH Ex. 35 at 25.

<sup>31</sup> *Texas Register*, Vol. 19, No. 58 at 6228. Included in the record as ED Ex. BDD-2.

another source. MCW must still purchase all the water that the City can provide.<sup>32</sup> As a result of these provisions, the ALJ agrees with the ED and MCW that the Contract grants the City monopoly power over the provision of water service to MCW as contemplated by 30 TAC § 291.133(a)(3).

## VII. THE CITY HAS NOT ABUSED ITS MONOPOLY POWER

To show abuse of monopoly power, MCW only raised the first four factors in 30 TAC § 291.133(a)(3):

- (A) the disparate bargaining power of the parties, including the purchaser's alternative means, alternative costs, environmental impact, regulatory issues, and problems of obtaining alternative water and sewer service;
- (B) the seller's failure to reasonably demonstrate the changed conditions that are the basis for a change in rates;
- (C) the seller changed the computation of the revenue requirement or rate from one methodology to another;
- (D) where the seller demands the protested rate pursuant to a contract, other valuable consideration received by a party incident to the contract . . .<sup>33</sup>

The City and the ED provided evidence and argument on 30 TAC § 291.133(a)(3) factors E through H, arguing that 30 TAC § 291.133(a)(3) requires the Commission to weigh *all* relevant factors. The ALJ notes, however, that this provision also states that the factors *may* include 30 TAC § 291.133(a)(3)(A) through (H), but does not require the Commission to consider all of them -- unless they are relevant. The ALJ finds that the only factors relevant to this proceeding are those raised by MCW. To be clear, however, had this case been more complex, the ALJ might have found other factors relevant.

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<sup>32</sup> COH Ex. 4 at 7, 9, Third Addendum to Water Purchase Contract.

<sup>33</sup> MCW Initial Brief at 3.

**A. Disparate Bargaining Power**

The first factor to consider is whether there is disparate bargaining power between the City and MCW. MCW offered evidence on the historical relationship of the parties, contract negotiations, past rate increases, and cost of service. The ED and MCW argued that these matters were irrelevant and that the Commission's jurisdiction in this matter is limited to a consideration of the rate increase from \$4.46 to \$4.60. The ALJ generally agrees with the ED and MCW on this point. However, whether the City has disparate bargaining power over MCW is potentially an expansive inquiry, because the bargaining history of the parties may shed light on this point.

MCW argues that the exclusivity clause of the Contract resulted in disparate bargaining power to the detriment of MCW. MCW asserts that although other viable and necessary sources of water exist, the City has repeatedly refused to allow MCW out of the exclusivity clause of the Contract. In particular, MCW argues:

- The City refused to negotiate a new contract without an exclusivity provision;<sup>34</sup>
- The City's past inability to provide water at a flow-rate which complied with the TCEQ's minimum standards left MCW unable to provide service to potential new customers;<sup>35</sup>
- MCW attempted to negotiate for and purchase treated water from other sources, but could not do so due to the exclusivity provision in the Contract;<sup>36</sup>
- During drought conditions, MCW developed a water allocation through the Brazos River Authority, but was unable to use it due to the City's insistence that MCW abide by the exclusivity provision;<sup>37</sup>

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<sup>34</sup> Tr. 52-55, 182-183; COH 21, 26, 27.

<sup>35</sup> Tr. 30-31, 80-81, 95-96.

<sup>36</sup> Tr. 111-112.

<sup>37</sup> MCW Ex. 13; Tr. 117-118.

- The City attempted to force MCW to enter into a new contract with unacceptable provisions requiring MCW to become a Special Utility District and including a higher take or pay provision;<sup>38</sup> and
- After MCW rejected the new contract, the City increased MCW's rate from \$2.50 per thousand gallons to \$4.46.<sup>39</sup>

The ED and the City argue that no disparate bargaining power exists. They note that MCW entered freely and knowingly into the Contract and the exclusivity clause. Furthermore, the exclusivity clause allows for the development of other sources for water, which MCW has never properly invoked.<sup>40</sup> Both parties also argue that this inquiry is beyond the scope of this proceeding because it essentially involves arguments over the performance of a contract.<sup>41</sup> While the ALJ is cognizant that the public interest factors are to be narrowly construed, giving deference to the Contract, this proceeding is not aimed at resolving contractual issues but rather to review them for evidence of disparate bargaining power and abuse of monopoly power.<sup>42</sup>

As noted by Staff, a "disparity of bargaining power exists when one party has no real choice in accepting the terms of the agreement. Conversely, disparity in bargaining power does not exist where a claimant has freedom of choice in entering into the agreement."<sup>43</sup> Although this authority focuses on entering into an agreement, the ALJ finds that there are three potential ways in which disparate bargaining power could be found to exist in this proceeding. First, the Contract could have been entered into as a result of disparate bargaining power – *i.e.*, if the City had a true monopoly on the water supply for MCW's geographic area, which it did not. Second, once MCW entered into the Contract, disparate bargaining power may have resulted from the exclusivity provision itself – forbidding MCW to buy water elsewhere. Third, the rate increase

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<sup>38</sup> COH Ex. 5 at 11; Tr. 177.

<sup>39</sup> MCW Ex. 23.

<sup>40</sup> COH Ex. 37 at 10-11.

<sup>41</sup> Tr. 267.

<sup>42</sup> ED Ex. BDD-2.

<sup>43</sup> *Dillee v. Sisters of Charity of Incarnate Word Health Care Sys.*, 912 S.W. 2d 307, 309 (Tex. App.-Houston [14<sup>th</sup> Dist.] 1995); *Allright, Inc. v. Elledge*, 515 S.W. 2d 266, 267 (Tex. 1974).

could be evidence of disparate bargaining power. As explained below, however, the ALJ finds that:

- There was no disparate bargaining power in entering into the Contract;
- The 2008 rate increase was not the result of disparate bargaining power; and
- To the extent that the exclusivity provision arguably created limited disparate bargaining power, the City has not abused such power.

**1. There was No Disparate Bargaining Power at the Inception of the Contract**

The ALJ finds that MCW was not coerced into the Contract as a result of disparate bargaining power. Before signing the Contract in 1989, MCW had several different sources from which to obtain water, including Lake Belton, Gatesville, Kempner Water Supply, and the option to drill wells. MCW was represented by counsel in its negotiations with the City, and drafts of the Contract were reviewed and discussed at MCW board meetings.<sup>44</sup> Bill Aston, MCW's expert witness, admitted that capacity issues and problems with sourcing water existed from the inception of the Contract.<sup>45</sup> MCW entered into the Contract, including the exclusivity provision, of its own free will after consideration including the advice of an attorney and with full knowledge that other sources were available. There was no disparate bargaining power at the inception of the Contract.

**2. The Rate Increase was Not the Result of Disparate Bargaining Power**

Nor was there disparate bargaining power associated with the rate increase that forms the basis for MCW's appeal. The City's fourteen cent rate increase was simply a pass-through increase based on an identical fourteen cent increase charged to the City by Upper Leon. Although this matter is discussed in greater detail below, the ALJ finds that this pass-through increase was not the result of disparate bargaining power.

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<sup>44</sup> COH Ex. 35 at 25, 86, 89; Tr. 74.

<sup>45</sup> Tr. 143-147.

**3. To the Extent the Contract Creates Limited Disparate Bargaining Power, the City has Not Abused Such Power**

As for the Contract itself, the ALJ finds that the certain provisions arguably create limited disparate bargaining power. Although MCW freely agreed to it, the exclusivity clause requires MCW to buy its water from the City for a 30 year period. Another clause grants the City the unilateral right to adjust its rates. If this were the entirety of the matter then the ALJ would agree that limited disparate bargaining power exists, especially where there is a need for more water than the City can provide. There is, however, a very important caveat to the clause which allows MCW to develop other water sources to the extent that the City lacks the ability to provide. The exclusivity provision states:

(e) During the primary term of the contract Purchaser shall not obtain water from any source other than the City unless Purchaser can show by written opinion of a recognized independent engineer that the City is unable to supply water and then only to the extent such supply fails to meet demand.<sup>46</sup>

Clearly, MCW has the option to seek supplemental water sources, so long as it provides the written opinion of an engineer. It is undisputed that MCW has never secured or produced such an opinion. As a result, MCW has failed to meet a condition precedent to a contractual right that forms the basis for its argument that disparate bargaining power exists. To the extent that the exclusivity provision created disparate bargaining power, that power is limited.

The ALJ finds it unnecessary to analyze the course of negotiations between the parties, because the primary complaint of MCW is that the City will not release it from the exclusivity provision. This claim, however, is not borne out by the evidence. For example, in October of 2002, the City determined that it would permit MCW to develop alternate sources of water, because the City could not meet MCW's requests for additional capacity. Thereafter, the parties attempted to renegotiate the Contract to facilitate MCW's need. By letter dated August 19, 2004, however, MCW notified the City that it no longer needed the additional capacity, because the Commission granted a variance request. In the letter, MCW also asked the City to take MCW's

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<sup>46</sup> MCW Ex. 1 at 9; Clause (C)(10)(e).

future needs into account during the City's negotiations with Upper Leon regarding future water supplies. The City Administrator, Bill Funderburk, interpreted this to mean that MCW expected the City to satisfy its future water needs. Finally, the City notes that it has offered to allow MCW to develop alternate sources of water on a number of occasions – which MCW has acknowledged.<sup>47</sup>

Although the ALJ finds that the City negotiated with MCW in good faith and attempted to allow MCW to develop alternate sources in the past, the City also clearly considers MCW to be an important water customer from which a minimum revenue stream is necessary as a result of debt for the pipeline. The testimony of Mr. Funderburk best captures the City's need for either a sole-source provision or guaranteed minimum revenue stream from MCW:

The take or pay provision is critical to the City, because the City continues to be obligated to repay the debt on the pipeline that transports the water from Upper Leon. That pipeline was installed for the benefit of both Multi-County and the City, and it was anticipated that both entities would help pay off the debt. Since the pipeline was built, Multi-County has used at least 40% of the water that has been delivered through it. The sole-source provision in the contract is one way of ensuring that revenues are sufficient to cover the portion of the debt that benefits Multi-County. However . . . the City has been and remains willing to re-negotiate the water supply contract to remove the sole-source provision, as long [as] terms creating a minimum guaranteed amount of revenue are also part of a new contract.<sup>48</sup>

This summary of the City's position reflects one of the original reasons for entering into the Contract, and the City's continuing need for a minimum amount of revenue from MCW. Regardless of negotiations, the City's position is reasonable – not an exploitation of disparate bargaining power. Under any other circumstance, requiring a party to stand by its contractual obligations would not be considered disparate bargaining power. In this instance, however, the parties have contractually agreed to enter into a monopoly, as envisioned by the drafters of 30 TAC § 291.133. To the limited extent that the City possesses disparate bargaining power, it has

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<sup>47</sup> COH Ex. 37 at 7, 10-13; COH Exs. 6, 21, 24, 26.

<sup>48</sup> COH Ex. 37 at 13.

not abused such power by insisting on a minimum guaranteed amount of revenue from MCW; the exclusivity provision reflects the fiscal reality that led to the Contract in the first place.

Finally, well-qualified expert witnesses for the City and the ED agree that disparate bargaining power does not exist. Brian Dickey, the ED's expert, and David Yanke, the City's expert witness, reviewed and evaluated all of the evidence and attended the hearing. These experts noted that MCW entered into the Contract willingly although other sources were present. They point out that MCW failed to avail itself of the exclusivity provision's option for developing new sources based on the opinion of an engineer. Mr. Yanke also noted that the City and MCW are mutually dependent on each other for water and revenue stream, and that despite this, the City's 1996 proposed draft of an amended contract did not include a sole-source provision.<sup>49</sup> As a result, both experts agree that disparate bargaining power does not exist.

Although the ALJ finds that provisions in the Contract resulted in limited disparate bargaining power favoring the City, the ALJ finds that the City has not abused that power.

## **B. The Rate Increase Resulted from Demonstrated Changed Conditions**

The next factor to consider in determining an abuse of monopoly power is whether the City has reasonably demonstrated the changed conditions which necessitated the 2008 rate increase.<sup>50</sup> In its September 12, 2008 letter to MCW, the City explained that the fourteen cent rate increase stemmed from a corresponding fourteen cent rate increase from Upper Leon for treated water. MCW made a number of arguments to counter this evidence, including a review of the City's operating and maintenance expenses (O&M) before the 2008 rate increase. The ALJ finds that the City reasonably demonstrated changed conditions by referencing the rate increase from Upper Leon.

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<sup>49</sup> ED Ex. 1 at 2, 3, 5; COH Ex. 1; COH Ex. 36 at 1-8; Tr. 143-147, 253-255, 258, 260-263, 267.

<sup>50</sup> 30 TAC § 291.133(a)(3)(B).

MCW argues that the City failed to demonstrate changed conditions, because it has not provided information regarding its O&M for 2008 – after it began receiving treated water from Upper Leon. MCW notes that for the 2008 rate increase, the City only provided information regarding one element of the City’s rate formula, the fourteen cent increase in treated water.<sup>51</sup> By comparison, MCW argues that the City provided O&M expense information for its 2006 rate increase. The gist of MCW’s argument is that the City’s O&M expenses are far less now that it buys treated water directly from Upper Leon.

The City and the ED argue that the evidence supporting the rate increase is far simpler than implied by the arguments of MCW. They also note that MCW’s arguments are based on an impermissible cost of service analysis.<sup>52</sup> The City and the ED contend that the City need only have informed MCW of the reasons for the rate change, and the City met this requirement by the issuance of its September 12, 2008 letter to MCW, which stated that the:

[The fourteen cent increase] is based upon the same increase to the City from Upper Leon River Municipal Water District.<sup>53</sup>

Consistent with the letter, Mr. Funderburk, Mr. Yanke, and Mr. Dickey testified that Upper Leon increased the cost of treated water by fourteen cents and the City simply passed through this increase by the exact same amount. Ms. Rice also acknowledged that the 2008 increase was simply a pass-through from Upper Leon.<sup>54</sup>

The ALJ agrees with the City and the ED. The City provided ample evidence that the increase was simply a pass-through of Upper Leon’s fourteen cent increase for treated water. The Commission has previously found that an increase in expenses is a changed condition that justifies a rate increase.<sup>55</sup> Furthermore, prior rate increases are not at issue here. The 2008

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<sup>51</sup> MCW Ex. 26; Tr. 221-222.

<sup>52</sup> 30 TAC § 291.133(b)

<sup>53</sup> MCW Ex. 26.

<sup>54</sup> COH Ex. 7; COH Ex. 36 at 9; COH Ex. 37 at 7-8; ED Ex. 1 at 5-6; Tr. 75-76, 189-190, 263.

<sup>55</sup> An Order Denying the City of McAllen's Appeal of the Wholesale Rate Increase of Hidalgo County Water Control and Improvement District No. 3, SOAH Docket No. 582-02-2470, TCEQ Docket No. 2001-1583-UCR

increase is the basis of MCW's appeal and is the only increase relevant to this proceeding. Furthermore, matters dealing with the cost of service are expressly excluded from consideration by 30 TAC § 291.133(b). Although MCW's O&M expenses may have dropped when it began buying treated water instead of raw water, the price of the treated water includes Upper Leon's O&M expenses. The City and MCW would have to pay for O&M through rates, whether the O&M originates from the City or Upper Leon. The ALJ finds that the City demonstrated changed conditions which resulted in the fourteen cent rate increase to MCW and MCW failed to meet its burden of proof on this factor.

### **C. The City's Methodology Did Not Change**

The next factor to consider in determining an abuse of monopoly power is whether the City changed its methodology used in the computation of the revenue requirement or rate.<sup>56</sup> The evidence reflects that the fourteen cent rate increase was a change in one of the three components of the City's methodology, not the methodology itself. The ALJ concludes that the City's methodology did not change.

MCW argues that the City changed its revenue requirement from one methodology to another. MCW notes that the City's rate is composed of three elements, the cost of water, debt service, and O&M expenses.<sup>57</sup> According to MCW, the 2008 rate increase only described an increase in the cost of water by fourteen cents, but fails to mention the other two factors that the City admits form components in its rate structure. MCW also argues that the City failed to properly calculate a reduction in O&M expenses that resulted when the City stopped treating water and began purchasing treated water from Upper Leon. As a result, MCW challenges the methodology used by the City in the 2008 rate increase.

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(Apr. 23, 2003) (Finding of Fact Nos. 35-41). The ALJ takes official notice of this Commission Order. Any objection should be filed as an exception to this PFD. *See*, PFD at COH-A at 16.

<sup>56</sup> 30 TAC § 291.133(a)(3)(c).

<sup>57</sup> COH Ex. 37 at 9; Tr. 215.

First, the ED and the City argue that the City simply passed through a rate increase from Upper Leon to MCW.<sup>58</sup> Mr. Funderburk, the City Administrator responsible for determining the necessity of rate increases, testified that the methodology for calculating rate increases has always remained the same.<sup>59</sup> The only difference between the rates before and after the 2008 increase was fourteen cents added onto the cost of treated water. The ALJ agrees.

The ED and the City argue that instead of focusing on the City's methodology, MCW's arguments relate to cost fluctuations within the three separate components of the City's methodology. A change in conditions, however, is not a change in methodology. Mr. Yanke testified that a change in methodology would be "reflective of a change in the basis or approach for determining the revenue requirement or allocation of costs."<sup>60</sup> As noted by Staff, such a change would be the addition or subtraction of a major cost component of the three categories that make up the City's methodology. Yet, Ms. Rice describes a change in conditions when she testified that MCW contests "a demonstrable increase or decrease in the cost of three of those items, which was a cost of water, any increase or decrease in the cost of bonds, or any increase or decrease in O&M."<sup>61</sup> These are all fluctuations within components of the City's methodology, not the methodology itself. The ALJ agrees with the City and the ED that the fourteen cent pass-through increase was a change in conditions, not methodology, because a "change in conditions is reflective of a change within one or more components of the revenue requirement."<sup>62</sup>

The City also argues that a determination of whether there has been a change in methodology requires expert testimony. However, the ED and the City point out that MCW's focus on a change in conditions reflects the fact that its arguments are based on an impermissible and unreliable cost of service analysis performed by MCW's expert, Mr. Aston.<sup>63</sup> The City and the ED point out that Mr. Aston admitted his testimony relates to developing a proper rate

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<sup>58</sup> Tr. 76, 189-190; ED Ex. 1 at 6.

<sup>59</sup> COH Ex. 37 at 8.

<sup>60</sup> COH Ex. 36 at 11.

<sup>61</sup> Tr. 109.

<sup>62</sup> COH Ex. 36 at 11.

<sup>63</sup> ED Ex. 1 at 6.

instead of a change in methodology.<sup>64</sup> As a result, the ALJ finds that Mr. Aston's testimony is irrelevant to a public interest determination under 30 TAC § 291.133(a).<sup>65</sup>

Even if his testimony was relevant to a public interest determination, Mr. Aston also admitted that:

- He was not a rate consultant;
- His opinions were based on a prior rate increase, which was not the subject of MCW's appeal;
- He could not name the methodology used by the City before or after the rate increase;
- He did not know whether the methodology had changed;
- He could not name any methodology other than the cash method, although he was aware that others exist;
- He had not reviewed the AWWA Manual in roughly ten years and did not know whether it was a methodology; and
- His testimony and exhibits were not evidence of a change in methodology.<sup>66</sup>

The City further notes that Mr. Aston's testimony was not reliable due to a series of mistakes and erroneous assumptions. Because the ALJ is not considering his analysis, those errors do not warrant discussion beyond the ALJ's finding that Mr. Aston's testimony is unreliable due to these errors.<sup>67</sup> Although the ALJ agrees that Mr. Aston's testimony is unreliable, it will not be struck from the record as requested by the City.<sup>68</sup>

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<sup>64</sup> *Id.*; Tr. 121, 122, 162.

<sup>65</sup> 30 TAC § 291.133(b).

<sup>66</sup> Tr. 121-127, 132-133, 142, 162.

<sup>67</sup> *See* Tr. 128-142, 153-160; COH Ex. 13.

<sup>68</sup> City's Initial Brief at 18.

The City offered the testimony of its expert, Mr. Yanke, who possesses expertise in rate-setting and methodologies. According to Mr. Yanke, all three components of the City's methodology have remained the same, with fluctuations within the three components. Mr. Yanke reviewed the relevant evidence in this matter and agreed with Mr. Funderburk that there had been no change in the City's methodology.<sup>69</sup> The ALJ agrees and also finds that MCW failed to meet its burden of proof on this matter. In fact, MCW did not offer any evidence to support its contention that the City altered its methodology.

**D. There Was No Other Valuable Consideration Received by a Party Incident to the Contract**

Another factor to consider when determining whether an abuse of bargaining power exists is whether a party incident to the contract received other valuable consideration.<sup>70</sup> The ALJ finds that no such consideration was received.

MCW argues that when the City transferred the pipeline to Upper Leon without receiving cash consideration, other valuable consideration was received by the City. MCW notes that a principal goal of the Contract was to enable financing the cost of the pipeline from Lake Proctor to the City. MCW also complains that the City transferred the pipeline to Upper Leon, but retained the debt. According to MCW, when the pipeline was transferred, there should have been a corresponding reduction in obligation for the debt of the pipeline – and in the rate charged by the City. Without a reduction in its obligations associated with the pipeline, MCW's consideration for entering into the Contract has been lost.<sup>71</sup> MCW argues that the City's ability to transfer the pipeline to Upper Leon without input from MCW is evidence of disparate bargaining power.

The City and the ED argue that the pipeline transfer is irrelevant to the determination of whether other consideration was received, because the transfer occurred between Upper Leon

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<sup>69</sup> COH Ex. 36 at 10, 11; COH Ex. 37 at 8, 9; Tr. 215-223, 235-238, 257.

<sup>70</sup> 30 TAC § 291.133(a)(3)(D).

<sup>71</sup> Tr. 97, 107, 108, 195, 201; MCW Ex. 30 at 6.

and the City. As Mr. Yanke testified, the point of this factor is to “capture any non-rate related benefits exchanged between the parties to the contract.”<sup>72</sup> He testified that MCW misunderstood this factor, which was intended to account for situations where a seller receives benefits other than revenue from the buyer, which ultimately reduces the revenue requirement.<sup>73</sup> Thus, the City and the ED argue that this factor does not involve an analysis of any agreements other than the Contract. The ALJ agrees.

As for MCW’s argument that the transfer of the pipeline should have included a transfer of the debt, the ALJ disagrees. The City and the ED argue that the pipeline debt should remain in rates recovered from MCW because financing the pipeline was a primary point of the Contract. As a result, it makes no difference whether debt retirement is included in rates charged MCW directly by the City or by Upper Leon to the City and then passed-through to MCW. Pipeline debt retirement should be and was included in rates paid by MCW.<sup>74</sup> As noted by the ED, the fact that the debt for the pipeline was not transferred to Upper Leon is evidence that no other valuable consideration was received by a party incident to the contract. Furthermore, the ED’s witness, Mr. Dickey, testified that MCW’s argument that the pipeline debt should have been removed from rates requires a cost of service analysis.<sup>75</sup> The ALJ agrees with the City and the ED, and finds that MCW failed to meet its burden of proof on this factor.

### VIII. ALLOCATION OF TRANSCRIPT COSTS

At a preliminary hearing, the ALJ ordered MCW to pay all court reporter and transcript costs, subject to a reallocation among the parties at the conclusion of the case. Pursuant to 30 TAC § 80.23, the City moved to permanently allocate transcription costs to MCW. The City notes that its participation in this proceeding was compulsory and defensive. It argues that this appeal should not have been filed by MCW, that there was little justification for bringing this

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<sup>72</sup> COH Ex. 36 at 18.

<sup>73</sup> *Id.*

<sup>74</sup> COH Ex. 36 at 18, 19.

<sup>75</sup> ED Ex. 1 at 7.

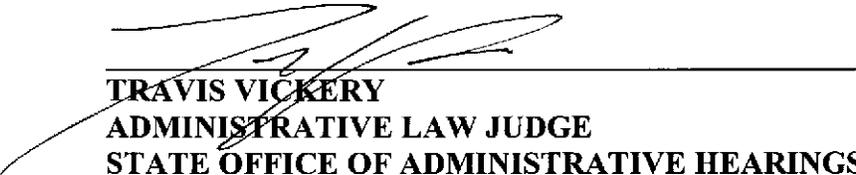
proceeding, that the evidence offered was “half-hearted,” weak, irrelevant, and yet caused the City to incur substantial amounts of attorneys’ and expert witness fees and litigation costs. In short, the City contends that this proceeding was a waste of the City’s, TCEQ’s and SOAH’s resources.

The ALJ agrees that there was little to MCW's case. To develop a complete evidentiary record and avoid any deprivation of due process, the ALJ gave MCW the benefit of the doubt in evidentiary rulings. Despite this latitude, the ALJ agrees that the majority of the evidence offered by MCW did not match the evidence required to establish the factors in 30 TAC § 291.133(a)(3). The ALJ recommends that all transcription costs be allocated to MCW.

### IX. CONCLUSION

The ALJ finds that the City did not abuse its monopoly power in the provision of water service to MCW. The ALJ concludes that the City's 2008 wholesale water rate increase is not adverse to the public interest. The ALJ recommends that MCW's appeal be denied.

**SIGNED April 13, 2010**

  
**TRAVIS VICKERY**  
**ADMINISTRATIVE LAW JUDGE**  
**STATE OFFICE OF ADMINISTRATIVE HEARINGS**

**TEXAS COMMISSION ON ENVIRONMENTAL QUALITY**



**AN ORDER**

**Denying Multi-County Water Supply Corporation's Appeal of the Wholesale Water Rate Increase Imposed by the City of Hamilton, Certificate of Convenience and Necessity No. 11525, and Request for Interim Rates in Cooke County; Application No. 36280-M  
TCEQ Docket No. 2009-0048-UCR  
SOAH Docket No. 582-09-2557**

On \_\_\_\_\_, the Texas Commission on Environmental Quality (TCEQ or Commission) considered Multi-County Water Supply Corporation's Appeal of the Wholesale Water Rate Increase Imposed by the City of Hamilton (the Appeal). The matter was presented to the Commission with a Proposal for Decision by Travis Vickery, an Administrative Law Judge with the State Office of Administrative Hearings, who conducted a contested case hearing concerning the Appeal. After considering the ALJ's Proposal for Decision and the evidence and arguments presented, the Commission makes the following Findings of Fact and Conclusions of Law:

**I. FINDINGS OF FACT**

**Procedural Matters**

1. Multi-County Water Supply Corporation (MCW) is a Texas retail public utility that receives wholesale water service from the City of Hamilton (City).
2. The City is a Texas municipal corporation located in Hamilton County, Texas.

3. On December 11, 2008, MCW filed a petition with the Texas Commission on Environmental Quality (Commission) appealing a fourteen cent increase in the wholesale water rates charged to MCW by the City (Appeal).
4. MCW's petition was referred to the State Office of Administrative Hearings (SOAH) on January 14, 2009.
5. SOAH Administrative Law Judge (ALJ) Travis Vickery conducted a preliminary hearing in this case on May 5, 2009.
6. At the preliminary hearing, the following appeared and were identified as parties to this case: (1) MCW (represented by Kathleen Dow, attorney), (2) the City (represented by Wesley Lloyd, attorney), and (3) the Executive Director (ED) of the Commission (represented by Ron Olson, staff attorney).
7. The hearing on the merits convened on November 5, 2009, at the SOAH Hearing Facility, 300 West 15th Street, Austin, Texas, with ALJ Travis Vickery presiding.
8. All parties participated in the hearing and submitted written closing arguments. Supplemental briefing was required and the record closed on February 12, 2010.

### **Underlying Background Facts**

9. The City receives all of its water from the Upper Leon River Municipal Water District (Upper Leon) pursuant to a wholesale contract. The City has purchased water from Upper Leon since 1964.
10. Until 1991, the City purchased raw water from Upper Leon that was transported in the Leon River after being released from Lake Proctor. The City diverted the raw water from the Leon River and treated it in its own water treatment plant.

11. In the late 1980's, the City, MCW, Upper Leon and the Farmers Home Administration (FHA) began discussing a new water project for the City and MCW. Instead of using the Leon River to transport water, the project contemplated transporting raw water through a 36-mile pipeline from Upper Leon to the City, where it would be treated at the City's treatment facility. Construction of the pipeline was to be financed through public bonds sold by the City, and backed by FHA.
12. In the late 1980's, MCW was acquiring funds to install and improve its own infrastructure. A large portion of the water to be transported through the pipeline was to be supplied to MCW by the City. As a result, the City designed the pipeline with a capacity sufficient to supply the City and MCW. Although the larger line would be more expensive to construct, the FHA was willing to back the bonds because the City insured its ability to service the pipeline debt through contractual water sales revenue to MCW and its retail customers.
13. Upper Leon is a regional provider of water service and supplies water to four other cities. Upper Leon charges all five cities the same system-wide rate.
14. The City has provided wholesale water utility service to MCW since 1991, under a 1989 written contract between the City and MCW (Contract).
15. The Contract provided for an initial term of 30 years.
16. The Contract included a provision requiring MCW to buy its water exclusively from the City, unless MCW obtained a written opinion from a recognized independent engineer indicating that the City was unable to supply enough water to meet MCW's demand (Exclusivity Clause).
17. The Exclusivity Clause was necessary because the City required a minimum revenue stream from MCW to obtain financing for the construction of the water pipeline.
18. The City's obligations under the Contract were expressly conditioned on "the City's ability to finance the cost of construction of a raw water pipeline from the Lake Proctor to

the City of Hamilton through the sale of 1989 Revenue Bonds, the issuance of which is now pending.”

19. Although the City must demonstrate the justification for rate changes, MCW cannot adjust the rate it pays for wholesale water.
20. The FHA reviewed and approved the Contract and required that the letter of conditions issued by FHA be amended to comport with the Contract. As a result, so long as rates are high enough, the volume of water transported through the pipeline is sufficient to allow the City to recover its costs and pay off the debt on the pipeline.
21. The pipeline was constructed and completed in 1991, using funds that were raised by the City as a result of the bonds that were sold and backed by the FHA. The City continues to pay the debt that was incurred to build the pipeline, and the debt is not scheduled to be paid off until January of 2029.
22. The pipeline was constructed for the benefit of both the City and MCW, and of a sufficient size to be able to serve both parties. If it weren't for the need to provide service to MCW, the City could have built a smaller pipeline.
23. The City provides water service to approximately 1,500 retail connections and one wholesale customer, MCW.
24. The Contract remains in effect and has not been amended or superseded, with the exception of three addenda:
  - In 1993, the City and MCW agreed to amend the Contract and increase the rate;
  - In 1995 the City and MCW agreed to amend the Contract to provide for a daily maximum amount of usage; and
  - In 1996 the City and MCW agreed to amend the Contract to extend the term of the contract an additional 10 years until 2029, and to ratify all other terms contained in the Contract.
25. Between 1993 and 2007, the City's water rates to MCW did not change.

26. On October 10, 2005, the City entered into a new contract with Upper Leon. The primary change was that the City would cease buying raw water from Upper Leon for treatment at the City's facility, and instead buy water treated by Upper Leon. The agreement also transferred the pipeline to Upper Leon.
27. In March of 2007, the City began purchasing treated water from Upper Leon, delivered through the pipeline. This allowed the City to discontinue using its own water treatment facility.
28. The City raised MCW's rate in May of 2007 to \$4.46 per thousand gallons.
29. In September of 2008, the City was notified by Upper Leon that its rate for treated water would increase by fourteen cents, effective October 1, 2008.
30. On September 12, 2008, the City notified MCW that its rate would increase by fourteen cents, effective on November 1, 2008, and as a result of the increase from Upper Leon.

**No Disparate Bargaining Power**

31. The City possesses monopoly power over MCW through the Contract, because the Contract has a 40 year term, requires MCW to purchase only from the City, all of the water that the City can provide, and grants the City a unilateral right to adjust its rate based on the components of its methodology.
32. The City does not possess a geographic monopoly over MCW.
33. MCW had alternative water sources available when it entered into the Contract, and each time it signed an addendum to the Contract.
34. MCW currently has alternative sources of water available.
35. MCW entered into the Contract freely.

36. Prior to entering into the Contract, MCW was represented by counsel and was aware of capacity issues, and problems associated with the location of a source of water. MCW evaluated several alternative sources of water but decided to enter into the Contract with the City.
37. Prior to entering into the Contract, MCW's legal counsel presented drafts of the Contract at meetings of MCW's Board of Directors. The Board of Directors engaged in extensive discussions about the Contract and previous drafts.
38. MCW made requests of the City in 2003 and 2004 for additional water supply beyond what the City was obligated to provide under the Contract, and the City made good faith efforts to evaluate its ability to accommodate those requests.
39. In an August 19, 2004 letter, MCW notified the City that it no longer needed additional capacity since the Commission had granted a variance to its capacity requirement.
40. As a result of the August 19, 2004 letter, the City ceased efforts to acquire additional capacity for MCW.
41. In the August 19, 2004 letter, MCW also expressed a desire to acquire all future water from the City and requested that the City keep this in mind when discussing future water supply needs with Upper Leon.
42. MCW has never sought, acquired, or provided the City with a written opinion from a recognized independent engineer indicating that the City is unable to supply enough water to meet MCW's demand.
43. MCW has used at least 40% of the water that has been purchased from Upper Leon by the City and delivered through the pipeline.
44. MCW is an important customer to the City because the City relies on MCW for its continued financial integrity.

45. MCW relies on revenue from the sale of water to MCW to pay the debt on the pipeline.
46. The City and MCW have engaged in negotiations that would have revised the Contract and removed the sole-source provision at various times between 2002 and the present.
47. In 2006, after MCW renewed its request that it be allowed to develop alternative sources, the City proposed a draft contract to MCW that did not contain a sole-source provision, instead using a take-or-pay approach to ensuring that the City received adequate revenue to service the debt on the pipeline.
48. In January of 2007, MCW acknowledged that the City would allow MCW to use an alternative source as long as a contractual minimum amount of water was purchased each year. The City offered to negotiate the amount of the take or pay provision.
49. The City possessed no disparate bargaining power over MCW when the parties entered into the Contract.
50. The City's 2008 rate increase of fourteen cents was not the result of disparate bargaining power over MCW.
51. The City has limited disparate bargaining power compared to MCW.
52. The City has not abused any disparate bargaining power it may possess over MCW.

**The City Demonstrated Changed Conditions That Justify the Rate Increase**

53. The fourteen cent increase in the rate the City charges MCW is the direct result of Upper Leon increasing by fourteen cents the rate it charges the City.
54. The City has reasonably demonstrated changed conditions that are the basis for the 2008 change in the rate.

### **The City's Methodology for Rate-Setting Has Not Changed**

55. The City uses the cash method for calculating revenue requirements and setting rates.
56. Prior to the City's 2008 rate increase of fourteen cents, the City used the same method it used to calculate the new rate and revenue requirement.
57. In establishing the rate increase to MCW, the City did not change the computation of its revenue requirement or rate from one methodology to another.

### **No Other Valuable Consideration Received by the City**

58. The City did not receive other valuable consideration incident to the Contract.

### **No Abuse of Monopoly Power**

59. The City's 2008 rate increase of fourteen cents does not reflect an abuse of monopoly power by the City.

### **Transcript Costs**

60. At a pre-hearing conference on October 30, 2009, the ALJ ordered MCW to pay all court reporter and transcript costs, subject to a reallocation at the conclusion of the case.
61. At the pre-hearing conference, MCW had an opportunity to object to, waive its right to, or decline, having a court reporter transcribe the testimony and arguments offered at the final hearing and did not do so.
62. The City moved to permanently allocate reporter and transcript costs to MCW in its post-hearing brief.
63. A transcript of the final hearing on the merits was prepared by a certified court reporter.

64. There is no evidence in the record of any difference in the financial ability of the parties to pay the costs.
65. Both MCW and the City participated equally in the hearing.
66. As the respondent in this proceeding, the City's participation was defensive and compulsory.
67. MCW is the petitioner, the party requesting relief from the Commission, and the party that bears the burden of proof in this proceeding.
68. MCW had little basis for bringing this Appeal.
69. The majority of the evidence offered by MCW did not match the evidence required for MCW to meet its burden of proof.
70. MCW offered no evidence during the hearing, and made no argument in its post-hearing brief, that the reporter and transcript costs should be allocated to the City.

## **II. CONCLUSIONS OF LAW**

1. MCW is a retail public utility as defined in TEX. WATER CODE ANN. § 13.002(19).
2. The City is a political subdivision of the State of Texas.
3. MCW's Appeal was filed under the provisions of TEX. WATER CODE ANN. §13.043(f), and Chapter 291 of the Commission's rules.
4. MCW only contends that 30 TEX. ADMIN. CODE § 291.133(a)(3) has been violated.
5. The Commission has jurisdiction to consider and rule on MCW's Appeal pursuant to TEX. WATER CODE ANN. § 13.043.

6. SOAH has jurisdiction over matters related to the hearing in this case. SOAH ALJs have authority to conduct a hearing and issue a proposal for decision with Findings of Fact and Conclusions of Law in contested cases referred by the Commission, pursuant to TEX. GOV'T CODE ANN. ch. 2003.
7. Proper notice of the Appeal was given as required by 30 TEX. ADMIN. CODE § 291.130(a) and TEX. GOV'T CODE ANN. §§ 2001.051 and 2001.052.
8. The Commission's rules specifically require a bifurcated hearing process for appeals from rates based on written contracts. 30 TEX. ADMIN. CODE §§ 291.131(b), 291.132, and 291.134.
9. The initial hearing on an appeal is conducted for the sole purpose of determining whether the protested rate adversely affects the public interest. 30 TEX. ADMIN. CODE §§ 291.131(b), 291.132, and 291.134.
10. MCW, as petitioner, bears the burden of proof that the protested rate adversely affects the public interest. 30 TEX. ADMIN. CODE § 291.136.
11. The Commission has by rule set out the criteria for determining whether the protested rate adversely affects the public interest. 30 TEX. ADMIN. CODE § 291.133(a).
12. The determination of whether the protested rate is adverse to the public interest is not to be decided based on an analysis of the seller's cost of service. 30 TEX. ADMIN. CODE § 291.133(b).
13. MCW failed to demonstrate by a preponderance of the evidence that the City's proposed rate is adverse to the public interest.
14. The factors set forth in 30 TEX. ADMIN. CODE § 80.23(d)(1) weigh in favor of allocating reporter and transcript costs to MCW.

15. MCW should pay the costs and expenses associated with the court reporter and preparation of the transcript of the hearing.

NOW, THEREFORE, BE IT ORDERED BY THE TEXAS COMMISSION ON ENVIRONMENTAL QUALITY THAT:

1. Multi-County Water Supply Corporation's Appeal of the Wholesale Water Rate Increase of the City of Hamilton is denied.
2. Multi-County Water Supply Corporation shall pay all costs for court reporter and transcript for this case.
3. All other motions, requests for entry of specific findings of fact or conclusions of law, and any other requests for general or specific relief not expressly granted herein, are hereby denied.
4. The Chief Clerk of the Commission shall forward a copy of this Order to all parties.
5. If any provision, sentence, clause or phrase of this Order is for any reason held to be invalid, the invalidity of such shall not affect the validity of the remaining portions of the Order.
6. The effective date of this Order is the date the Order is final, as provided by 30 TEX. ADMIN. CODE § 80.273 and TEX. GOV'T CODE §2001.144.

**ISSUED:**

**TEXAS COMMISSION ON ENVIRONMENTAL QUALITY**

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**Bryan W. Shaw, Ph.D., Chairman  
For the Commission**