

SOAH DOCKET NO. 583-09-6111
TCEQ DOCKET NO. 2009-0324-UCR

THE CITY OF KARNES CITY APPLICATION § BEFORE THE STATE OFFICE
UNDER SECTION 13.255 OF THE TEXAS §
WATER CODE FOR SINGLE CERTIFICATION § OF
OF A PORTION OF CCN NO 10570 EL OSO §
WATER SUPPLY CORPORATION (WSC) § ADMINISTRATIVE HEARINGS

**THE CITY OF KARNES CITY'S EXCEPTIONS
TO THE PROPOSAL FOR DECISION**

COMES NOW, Karnes City, Texas ("City"), respectfully files its exceptions to the proposal for decision issued on May 11, 2010 in the above-referenced matter.

The City files an exception to the ALJ's finding that the changed circumstances claimed by the City are inadequate and that the City's current ability to provide water service to "the Tract" is the only changed condition, which the City could have easily foreseen. The City would argue that the evidence it provided does constitute a material change of conditions. For instance, the Correctional Center did not exist at the time the 1994 Order was issued, and the Commission did not adopt rules to implement Texas Water Code §§ 13.255 and 13.242 until December 14, 2005, that were effective on January 5, 2006. (City's Exhibit 6, Direct Testimony of Ronald J. Freeman, at 4-5).

In addition to these material changes in circumstance, the Commission should consider the terms of the settlement agreement between the City and El Oso WSC (El Oso), including a liquidated damages provision, as these terms are incorporated into the respective Certificates of Convenience and Necessity (CCN) according to Section 13.255 (a). Not only is the City not seeking to re-litigate aspects of its Section 13.255 Application that relate to the 1994 Order, this Order was not the result of litigation but of

a settlement agreement between the City and El Oso. The terms of the executed settlement agreement are incorporated into the respective certificates of convenience and necessity of the parties to the agreement, pursuant to Section 13.255(a). The City is seeking to obtain single certification to an area that is within its corporate limits, which includes the Tract that was the subject of the 1994 Order; the uncontested area of the City's Section 13.255 application was severed and remanded to the Executive Director.

The ALJ states that the only material change in this case is "...the City is now able to meet TCEQ requirements for providing water service." This is **not** the only material change in this case. At the time the 1994 Order was issued, the Karnes Correctional Center did not exist. The fact the Correctional Center was not constructed until 1995 and is now requesting service from the City, which constitutes as a material change in circumstances. While the ALJ notes this fact in her proposal for decision, she does not consider this fact in determining whether there is a material change in circumstances. The affidavits of Waymon Berry and Larry Kolojaco provide that receiving water utility service from the City would benefit the correctional facility and nursing home in two ways, improved quality of water and lower costs. By prohibiting the City from pursuing its Section 13.255 Application for the Tract, not only will the City be adversely affected, but the Nursing Home and the Correctional Center that have requested service from the City.

Another material change in conditions includes the fact that at the time the Commission did not have rules that implemented Section 13.255. Since 1994, there have been more decisions on Section 13.255 cases. One of the contested cases that involved the interpretation of Section 13.255 is the City of Melissa and North Collin

Water Supply Corporation matter; the ALJ noted that she took official notice of this case. While the City of Melissa case does not involve an order dismissing an application with prejudice, it did involve a request for a Cease and Desist order by North Collin Water Supply Corporation. In this case, the 1994 Order involved a request for a Cease and Desist Order by El Oso. The Commission adopted Title 30 Tex. Admin. Code § 291.103(c) on December 14, 2005, to implement Texas Water Code § 13.242(c). Texas Water Code §13.242(c) provides in pertinent part that: The commission may by rule allow a municipality...to render retail water utility service without a certificate of public convenience and necessity if the municipality has given notice under Section 13.255 of this code that it intends to provide retail water service to an area...”

Section 291.103 (c) provides:

(c) Municipality Pursuant to the Texas Water Code, §13.255.

A municipality which has given notice under the Texas Water Code, §13.255 that it intends to provide retail water service to an area or customers not currently being served is not required to obtain a certificate prior to beginning to provide service if the municipality provides:

- (1) a copy of the notice required pursuant to the Texas Water Code, §13.255; and
- (2) a map showing the area affected under the Texas Water Code, §13.255 and the location of new connections in the area affected which the municipality proposes to serve.

In this case, the nursing home had requested service from the City and the City complied with the aforementioned requirements: The City submitted its application and commenced the process of extending its water system to serve the Nursing Home, and El Oso filed a request for a cease and desist order—these circumstances are similar to that of the City of Melissa case. The City's mayor explains in his testimony (City's Exhibit 7 at 3 – 5:1-8) that the City's sole source of water came from El Oso, and the City attempted to supplement its water supply by drilling three wells; however, the City was never able to use the water from those wells. El Oso was aware that under the existing contract, the City would not be able to provide service to the nursing home and meet the Commission's standards. Although El Oso had the ability to negotiate a different contract with City, whereby the volume of water it sold to the City would be increased; El Oso was not interested in doing so, as it wanted to provide water service to the nursing home. (See DT-3) The 1994 Order required the City to cease provision of retail potable water utility service to the Tract. The 1994 Order did not contain a finding that addressed the adequacy of the City's water supply. Therefore, the adequacy of the City's water supply was not the basis for the Commission ordering the City to cease providing service to the Tract. The City would argue that the decisional law relating to Section 13.255 has changed since the 1994 Order. In the City of Melissa case, the Commission held that the City of Melissa had a legal right to serve, and was not prohibited from providing retail water utility service to customers in an area where North Collin WSC was not providing service. Whereas in this case, although the City had submitted an application and provided notice to El Oso, and no service was being provided by El Oso, the City was prohibited from providing service because it did not

hold a certificate. Today, so long as a municipality complies with Title 30, Tex. Admin. Code § 291.103(c), it can commence serving the area prior to obtaining a certificate.

Ronald J. Freeman testified that there is now more clarity on how the Commission interprets Texas Water Code Sections 13.255 and 13.242. Mr. Freeman specifically testified that, current interpretations of Sections 13.242 and 13.255 provide more clarity on two issues: (1) the calculation of damages that are due if a municipality requests single certification and (2) the timing of the city's right to provide service. (City Exhibit 6 at 4-5) "Regarding the second issue, it is now clear that a city is entitled to begin providing retail service to an area in a Section 13.255 single certification case immediately upon filing its application. In addition... it is now clear that speculative "lost revenues" is not a measure of damages if no customers are being taken from the water supply corporation that is being decertified."

"The statute did have some reference to using lost future revenues as one element of any damages calculation; but it was unclear what the phrase meant or even if it would be applied when no property of El Oso was being taken by the City. In addition, there was little or no TCEQ or court precedent on this issue." (City Exhibit 6 at 4)

Based on the foregoing, there have been material changes concerning the interpretation of Section 13.255. The Commission now has rules and precedents that interpret Section 13.255, including the calculation of "lost revenues" and a city's right to provide service under Section 13.255 prior to obtaining a certificate.

As noted in the Proposal for Decision, this case of first impression and the Commission does not have standards to determine what constitutes a material change in conditions. Therefore, the City agrees with the ALJ that since the Commission does not have said standards we need to look to case law for guidance. In *Westheimer Indep. School Dist. v. Brockett*, 567 S.W.2d 780, 787 (Tex. 1978), the Texas Supreme Court held that a "material change of conditions" should be narrowly construed, providing a basis for review in limited circumstances only. The court recognized that "there are aspects of administrative orders which must be treated with flexibility, rather than with the binding effects of *res judicata*." "To constitute a material change of conditions, the allegations must reflect that the changes have intervened since the rendition of the order and must not constitute issues which might have been raised in the prior hearing had adequate and diligent research been conducted to discover such facts."

A new cause of action between the same parties over the same issue may also be based on subsequently acquired rights. In *Marino v. State Farm Fire & Cas. Ins. Co.*, 787 S.W.2d 948 (Tex. 1990), Plaintiff Marino sued his insurance company for breach of contract for failure to pay on the policy insuring his home against loss by fire. The jury found for the homeowner and judgment was entered on the verdict. Twenty-two days later, the Texas Supreme Court recognized, for the first time, a tort action against an insurer for breach of a duty of good faith and fair dealing. Marino then filed a second suit against State Farm arising out of the destruction of his house, this time alleging a cause of action for a breach of the newly recognized duty of good faith. The trial court granted State Farm's motion for summary judgment on the ground of *res*

judicata and the Court of Appeals affirmed the summary judgment on that basis. But, the Texas Supreme Court reversed, holding that Marino's claim in the second suit was based on rights subsequently acquired and that his bad faith claim was not barred by the doctrine of res judicata.

The ALJ has erroneously concluded that the 1994 Commission Order precludes a subsequent Section 13.255 application between the same parties based on facts that did not exist but should have been foreseen at the time the order was entered. The requirement that the new application be based on unforeseen facts misstates the law. The Texas Supreme Court explained, in *City of Lubbock v. Stubbs*, 327 S.W.2d 411, 414 (Tex. 1959):

“Estoppel by judgment extends only to facts in issue as they existed at the time the judgment was rendered, and does not prevent a re-examination of the same question between the same parties, where, in the interval, the facts have changed, or **new facts have occurred** which may alter the legal rights or relations of the parties.” *Id* at 414 (emphasis supplied).

A former judgment will estop the parties from re-litigating the same issues in a subsequent suit between the same parties only where essential issues of fact have or could have been adjudicated in the former suit. *Kirby Lumber Corp. v. Southern Lumber Co.*, 192 S.W.2d 460, *affirmed* 145 Tex. 151, 196 S.W.2d 387 (1946).

In this case, the changes the City is relying on did not exist at time the 1994 order was entered. Neither *Brockette*, *Marino* nor any other authority requires the changes relied upon to avoid res judicata preclusion to occur not only after the former order was entered but also to have been unforeseeable. Because the ALJ imposed a requirement of foreseeability, she erroneously concluded that Karnes City's present

decertification proceeding is precluded by the 1994 Commission Order. This conclusion must be reversed and the City must be allowed to proceed.

The Corrections Center did not exist and therefore issues related to providing service to the Corrections Center could not have been raised in the prior case; the construction of the Corrections Center occurred after the rendition of the 1994 Order. In footnote 15, the ALJ notes that Bluebonnet seeks to switch its water service to the City is not a changed condition. However, the ALJ overlooks the fact that the Corrections Center is also seeking to obtain water service from the City.

Furthermore, the City files an exception to the ALJ's finding that the City's current ability to provide water service to "the Tract" is an issue that could have been foreseen. The City could not have foreseen that it would have the ability to provide service to this area. Raul H. Garcia testified in 1994, "the City had tried to develop three wells to supplement the water supply available from El Oso WSC." However, the City was not successful, "because the TNRCC refused to allow the City to blend the water from the wells with the water from El Oso."¹ When a utility drills a well there is no assurance that the well will be capable of producing an adequate amount of water that meets the Commission's standards. Thus, the City does not agree with the ALJ's finding that the City's current ability to provide water service to this area could have easily been foreseen. Only within the last two years has the City been able to secure an additional source of water.² The City now has an adequate supply of water that meets TCEQ standards and is now able to serve the Corrections Center and Nursing Home who want water service from the City. In other words, "new facts have occurred which alter the

¹ City of Karnes City Exhibit 3 at 3: 1-5.

² City of Karnes City Exhibit 3 at 3: 13-15.

legal rights and relations of the parties.” Based on the foregoing, the City has demonstrated that there are material changes in circumstances to warrant the Commission’s reconsideration of which utility should provide water service to the Tract.

The ALJ indicates in the Proposal for Decision that written settlement agreement between the City and El Oso underlies the 1994 Order. The ALJ also notes that the agreement contains a provision that the City will pay El Oso liquidated damages in the amount of \$50,000 if the City ever re-applies for single certification of the Tract. The City and El Oso contemplated that, although that Tract was being dismissed with prejudice, the City may at some future date submit an application for this Tract.³ The ALJ asserts that, the Commission in the 1994 Order did not incorporate the liquidated damage provision. However, Section 13.255 (a) provides in pertinent part that:

The agreement may provide for single or dual certification of all or part of the area, for the purchase of facilities or property, *and for such other additional terms that the parties may agree on* The executed agreement shall be filed with the commission, and *the commission, upon receipt of the agreement, shall incorporate the terms of the agreement into the respective **certificates of convenience and necessity** of the parties to the agreement.* [Emphasis added.]

Based on Section 13.255(a), all the terms of the agreement, including the liquidated damages provision, are incorporated into the respective certificates of convenience and necessity. Ronald J. Freeman testified that section 3 of the settlement agreement, the

³ City of Karnes City Exhibit 6 at 2-3.

liquidated damages provision, provides El Oso with a remedy if the City later chose to file another section 13.255 application for the Tract. (City's Exhibit 2, Testimony of Ronald J. Freeman at 2)

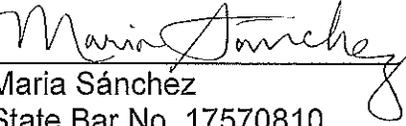
Finally, it is worth noting that the Executive Director does not oppose proceeding with the City's current Section 13.255 application for the Tract, though there are no existing Commission standards to determine what constitutes a material change in conditions. Hence, the Staff agrees with the City that the Commission has authority to review this application. (Executive Director's Brief at 5)

CONCLUSION

The City does not agree that it should be barred from pursuing its Section 13.255 application for this 60-acre tract due to the material changes in circumstances; the Correction Center did not exist at the time the 1994 Order was issued and is requesting service from the City. The City now has a source of water to provide service to the Correction Center and Nursing Home, and contrary to the ALJ's finding the City could not have easily foreseen that it would have an additional source of water. Additionally, the settlement agreement contains a liquidated damages provision that provides that the City will pay El Oso liquidated damages in the amount of \$50,000 if the City ever re-applies for single certification of the Tract. The terms of the settlement agreement, including the liquidated damages provision, are incorporated into the respective certificates of convenience and necessity according to Section 13.255(a). The City respectfully requests that the Commission issue an order that allows the City to proceed with its Section 13.255 application to obtain single certification and authorization to provide water utility service to the 60-acre tract.

Respectfully submitted,

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By: 
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CERTIFICATE OF SERVICE

I hereby certify that on the 1st day of June 2010, a true and correct copy of the City of Karnes City's Exceptions to Proposal for Decision was sent to the parties of record via fax and first class mail.


Maria Sánchez