



Control Number: 42866



Item Number: 154

Addendum StartPage: 0

**SOAH DOCKET NO. 473-14-5144.WS
PUC DOCKET NO. 42866**

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| PETITION OF TRAVIS COUNTY MUNICIPAL UTILITY DISTRICT NO. 12 APPEALING CHANGE OF WHOLESALE WATER RATES IMPLEMENTED BY WEST TRAVIS COUNTY PUBLIC UTILITY AGENCY, CITY OF BEE CAVE, TEXAS HAYS COUNTY, TEXAS AND WEST TRAVIS COUNTY MUNICIPAL UTILITY DISTRICT NO. 5 | § § § § § § § § § § | BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS |
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TCMUD 12'S INITIAL BRIEF

TABLE OF CONTENTS

| | | |
|------|---|----|
| I. | INTRODUCTION | 4 |
| II. | PARTIES | 5 |
| III. | PROCEDURAL HISTORY..... | 7 |
| IV. | GENERAL DESCRIPTION OF PROTESTED RATES | 8 |
| V. | JURISDICTION | 9 |
| VI. | THE REQUIRED PUBLIC INTEREST DETERMINATION AND ITS SCOPE | 10 |
| | A. The Requirement for an Initial Public-Interest Determination | 10 |
| | B. Public-Interest Considerations In This Case..... | 11 |
| | C. Cost of Service Analysis Is Not Relevant To Determining Whether Rates Adversely Affect The Public Interest (P.U.C. Subst. R. 24.133(b))..... | 13 |
| | 1. An examination of the seller's change to the computation of the revenue requirement or rate methodology..... | 13 |
| | 2. TCMUD 12 has not argued that WTCPUA's rates exceed its cost of service..... | 14 |
| | 3. An examination of the cost of service formulas is allowed by the rule..... | 16 |
| | 4. Commission's Order overturning SOAH Order No. 6 supports the argument that an examination of the seller's cost of service formulas are relevant to a public interest proceeding..... | 16 |

154

| | | |
|------|---|----|
| VII. | DOES THE PROTESTED RATE EVIDENCE WTCPUA'S ABUSE OF MONOPOLY POWER? (P.U.C. Subst. R. 24.133(a)(3))..... | 17 |
| A. | Is the WTCPUA a Monopoly?..... | 18 |
| | 1. Introduction: WTCPUA is a Monopoly..... | 18 |
| | 2. Definitions of Monopoly..... | 20 |
| | 3. Factors that Establish WTCPUA is a Monopolist | 22 |
| | 4. HHI Screen Supports Finding WTCPUA is a Monopoly | 25 |
| | 5. Water Utilities are Natural Monopolies and the Effect of Price Inelasticity ... | 25 |
| | 6. Conclusion: WTCPUA is a Monopoly and has Abused its Monopoly Power | 26 |
| B. | Disparate Bargaining Power of the Parties (P.U.C. SUBST. R. 24.133(a)(3)(A)).. | 27 |
| | 1. What Are TCMUD 12's Alternative Means, Alternative Costs and Problems of Obtaining Alternative Wholesale Water Services? | 27 |
| | a. Introduction: Scope of Inquiry Under P.U.C. Subst. R. 24.133(a)(3)(A).. | 27 |
| | b. Alternative to Whom? How WTCPUA Came to be TCMUD 12's Wholesale Water Services Supplier..... | 29 |
| | c. There are No Viable Alternative Providers of Wholesale Water Services for The Highlands | 32 |
| | (i) Lakeway MUD..... | 32 |
| | (ii) There is Not Another Centralized WTP..... | 34 |
| | (iii) Additional Facilities..... | 35 |
| | (iv) TCMUD 12 Could Not Avoid WTCPUA's Rates..... | 36 |
| | 2. Are There Other Disparate Bargaining Power Factors? | 37 |
| | a. Change in Connection Fee | 37 |
| | b. WTCPUA's Offer to Reduce TCMUD 12's Max Reserved Capacity | 38 |
| | c. No Opportunity for Meaningful Input re WTCPUA's Changed Rates..... | 40 |
| | (i) Change of Methodology Reflected in Form Contract Amendment | 40 |
| | (ii) No Meaningful Dialogue at Wholesale Customer Committee Meeting | 42 |
| | 3. Conclusion: If there was disparate bargaining power, does the protested rate evidence WTCPUA's abuse of monopoly power? | 43 |
| C. | Methodology for Computation of Revenue Requirement and Rate (P.U.C. SUBST. R. 24.133(a)(3)(C))..... | 44 |
| | 1. Did WTCPUA change the methodology for the computation of the revenue requirement? | 46 |
| | 2. Did WTCPUA change the methodology for the computation of the rate? | 48 |

| | |
|--|----|
| a. The WTCPUA did change the methodology for the computation of the rate..... | 48 |
| b. The origins of the change in methodology. | 50 |
| c. The change in methodology as described by the proposed contract amendment..... | 53 |
| d. The change in methodology as described by the proposed contract amendment is applied to all wholesale customers not just the wholesale customers that amended their contracts with the WTCPUA. | 58 |
| e. The new methodology in the contract amendment was used to calculate TCMUD 12's monthly charge and volumetric charge. | 59 |
| 3. Conclusion: If there was a change in the methodology for the computation of the revenue requirement or rate, does the Protested Rate evidence WTCPUA's abuse of monopoly power? | 62 |
| VIII. TRANSCRIPTION COSTS | 65 |
| IX. CONCLUSION AND PRAYER | 66 |

ATTACHMENT A - TCMUD 12's Annual Minimum Bill (2014-2048)

ATTACHMENT B - Procedural History

ATTACHMENT C - Annual Minimum Bill Calculations

ATTACHMENT D - Transcript Cost Breakdown

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| PETITION OF TRAVIS COUNTY | § | BEFORE THE STATE OFFICE |
| MUNICIPAL UTILITY DISTRICT NO. | § | |
| 12 APPEALING CHANGE OF | § | |
| WHOLESALE WATER RATES | § | |
| IMPLEMENTED BY WEST | § | |
| TRAVIS COUNTY PUBLIC UTILITY | § | OF |
| AGENCY, CITY OF BEE CAVE, TEXAS | § | |
| HAYS COUNTY, TEXAS AND WEST | § | |
| TRAVIS COUNTY MUNICIPAL | § | |
| UTILITY DISTRICT NO. 5 | § | ADMINISTRATIVE HEARINGS |

TCMUD 12'S INITIAL BRIEF

TO THE HONORABLE WILLIAM G. NEWCHURCH:

I. INTRODUCTION

WTCPUA's actions in setting wholesale water service rates¹ charged to TCMUD 12 beginning on January 1, 2014 evidence abuse of monopoly power which is contrary to the Public Interest. By exercising its disparately greater bargaining power and changing the methodology for the computation of both the revenue requirement and rates, WTCPUA has harmed TCMUD 12 by depriving the wholesale purchaser of the benefit of the rights obtained under the LCRA Wholesale Water Services Agreement.² When LCRA sold the West Travis County Water System to WTCPUA, and TCMUD 12 consented to the transfer of its Wholesale Water Services Agreement to WTCPUA pursuant to the Transfer Agreement, WTCPUA stepped into the shoes of the "monopolistic" LCRA, and became the monopolistic provider of wholesale water services that allows TCMUD 12 to provide retail water service to The Highlands.³ WTCPUA's actions therefore affect not only TCMUD 12, but all of the end-user customers in The Highlands whose

¹ Specifically, the Monthly Charge and the Volume Rate.

² TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 13:8-9.

³ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 15:11-13; Tr. at 39-40 (The Highlands is all of TCMUD 12 & 13 and 152 lots in TCMUD 11.)

only source of potable water is the West Travis County Water System, now operated by WTCPUA.

TCMUD 12 brought this appeal seeking certainty for the future of The Highlands. WTCPUA's exercise of its monopoly power based upon its disparately greater bargaining power allowed it to change the methodologies for computation of the revenue requirement and rate in a manner that, according to WTCPUA's own analysis, is intended to dramatically increase TCMUD 12's wholesale rates for the next 30 years (2015-2045). *See* Attachment A.⁴ The dramatic increases that the WTCPUA forecasts will result from the new methodology has significantly disrupted the Districts' ability to count on obtaining the benefit of the bargain reflected in the Wholesale Water Service Agreement.⁵ The Districts' goal in undertaking this very expensive and protracted appeal is straight-forward – to obtain a ruling that WTCPUA's actions in setting the 2014 wholesale water service monthly charge and volumetric rate using this new methodology violated the public interest, and then to have this Commission determine WTCPUA's cost of service, relying on the methodologies set by the Wholesale Water Services Agreement if they are found to be reasonable, with the assurance of consistency and Commission oversight for three years as afforded by PUC Subst. R. 24.135 – 24.137.

II. PARTIES

TCMUD 12 filed the Petition seeking review of WTCPUA's wholesale water services rates that became effective on January 1, 2014, on its own behalf and on behalf of TCMUDs 11 and 13 (collectively, the "Districts").⁶ Each of the Districts is a conservation and reclamation district created and functioning under Article 16, Section 59 of the Texas Constitution and Chapters 49 and 54 of the Texas Water Code. The Districts are retail public utilities under TEX.

⁴ Attachment A is WTCPUA's Response to TCMUD 12's RFP 2-3 pages WTCPUA00009767 – 9769, which is in evidence as: WTCPUA Exhibit 3 (Stowe) at 103-105 (Stowe Attachment E) and TCMUD 12 Exhibit 2 (Joyce Direct) at Exhibit JJJ-15, pp. 14-16. (On WTCPUA 00009769, the 2nd to last right column is TCMUD 12's Annual Minimum Bill by year (2014-2048); dividing that dollar amount by 12 results in the Monthly Charge. For example, the 2014 annual bill shown on WTCPUA's exhibit is \$97,690.63, which is equal to a Monthly Charge of \$8,140.89, which is exactly the Monthly Charge set by WTCPUA for TCMUD 12 in 2014. Dividing the remainder of the annual minimum bills by 12 shows that WTCPUA's new methodology was forecasted to result in Monthly Charges of \$28,547 by 2016, \$47,948 in 2018, \$93,230 in 2022, \$104,251 in 2024, etc.)

⁵ WTCPUA Exhibit No. 13, TCMUD 12 Response to WTCPUA RFI 2-4 Attachment at page 7 (3rd full paragraph) of 250 (Mr. DiQuinzio report to the TCMUD 11 Board on December 5, 2013).

⁶ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 3:6–9; and at JAD Exhibit 5 (Transfer Agreement) 4th recital.

WATER CODE § 13.002(19). Under the Districts' Memorandum of Understanding⁷ and as reflected in the Wholesale Water Services Agreement,⁸ TCMUD 12 manages the wholesale water services provided to the Districts by LCRA, and now by WTCPUA. Mr. Joe DiQuinzio's company, JadCo Management, Inc., serves as the General Manager for all three Districts.

The Districts were created after Lakeway MUD ("LMUD") agreed to exclude the area of land now known as Lakeway Rough Hollow and The Highlands subdivisions from LMUD's boundaries. The Districts were created to construct and finance water, wastewater, and drainage infrastructure to provide service to the land within their respective boundaries. The Districts are geographically identified on the Map attached to Mr. DiQuinzio's Direct Testimony as JAD Exhibit 7, which depicts Rough Hollow as the eastern portion of TCMUD 11, and The Highlands as the remainder of TCMUD 11 and all of TCMUDs 12 and 13.⁹ Pursuant to a Memorandum of Understanding, the Districts share the raw water sold to the Districts by LCRA under a 2008 Raw Water Contract. The Highlands, composed of all of TCMUDs 12 and 13 and the western portion of TCMUD 11¹⁰ also share the wholesale water services provided under the 2009 LCRA Wholesale Water Services Agreement that was conditionally transferred to WTCPUA in 2012.¹¹ Under the Wholesale Water Services Agreement, the raw water for The Highlands is diverted from Lake Travis, transported to the West Travis County Regional Water Treatment Plant on Highway 71 to be treated to potable water standards, and then delivered to TCMUD 12's Delivery Point on Highway 71, and then through the Districts' facilities to The Highlands.¹²

The City of Bee Cave (the "City") is a Type A general law municipality of the State, and one of the three PUA Participants that created WTCPUA.¹³

⁷ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 1, p. 10 of 46.

⁸ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 4 (Wholesale Water Services Agreement) at p. 1 of 27, 3rd and 4th recitals.

⁹ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 4:7-20.

¹⁰ The Highlands does not include the eastern portion of TCMUD 11 that is called Rough Hollow.

¹¹ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 3:9-12 and JAD Exhibit 1 (MOU), JAD Exhibit 2 (Raw Water Contract), JAD Exhibit 4 (Wholesale Water Services Agreement), and JAD Exhibit 5 (Transfer Agreement).

¹² *Id.* at 4:7-20, and JAD Exhibit 7.

¹³ TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at JZ Exhibit 2 (Acquisition, Water Supply, Wastewater Treatment and Conditional Purchase Agreement entered into by PUA, Bee Cave, Hays County and MUD 5. (Mar. 19, 2012) ("*Acquisition Agreement*") at 30.

Hays County (the “County”) is a political subdivision of the State of Texas, and one of the three PUA Participants that created WTCPUA.¹⁴

Travis County MUD 5 (“MUD 5”) is a municipal utility district and political subdivision of the State, and one of the three PUA Participants that created WTCPUA.¹⁵

On December 21, 2011, the City, County and MUD 5 (collectively, the “PUA Participants”) created the West Travis County Public Utility Agency (“WTCPUA” or the “PUA”) by Concurrent Ordinance or Resolution pursuant to Chapter 572, Texas Local Government Code, as amended (the “PUA Act”). WTCPUA serves as the PUA Participants’ “constituted authority, instrumentality and agent to plan, finance, acquire, construct, own, operate, or maintain facilities necessary for the collection, transportation, treatment, and disposal of sewage and the conservation, storage, transportation, treatment, and distribution of water for the Participants pursuant the PUA Act.”¹⁶ Pursuant to the terms of Utilities Installment Purchase Agreement,¹⁷ LCRA transferred to WTCPUA the West Travis County Water and Wastewater System, with operational control transferring on March 19, 2012. Pursuant to TEX. LOCAL GOV’T CODE § 572.052(c)(2), a public utility agency is a “political subdivision of the state.” Accordingly, the PUA is a retail public utility under TEX. WATER CODE §§ 13.002(19)¹⁸ and 13.042(f). WTCPUA holds CCN No. 13207 (the West Travis County System, transferred to the PUA from the Lower Colorado River Authority (“LCRA”)) pursuant to Section 3.2 of the Utilities Installment Purchase Agreement.

The Staff of the Public Utility Commission is a party to this proceeding pursuant to P.U.C. PROC. R. § 22.103.

III. PROCEDURAL HISTORY

The procedural history reflecting the major procedural events in this case is set forth in Attachment B to this brief.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 8 (Utilities Installment Purchase Agreement).

¹⁸ “Retail public utility” means any person, corporation, public utility, water supply or sewer service corporation, municipality, political subdivision or agency operating, maintaining, or controlling in this state facilities for providing potable water service or sewer service, or both, for compensation.”

IV. GENERAL DESCRIPTION OF PROTESTED RATES

On November 21, 2013, WTCPUA's Board changed the wholesale Monthly Charge for water to \$8,140.89 and the Volumetric Rate to \$2.11/1,000 gallons, effective January 1, 2014.¹⁹ TCMUD 12 received notice of the rate change on December 17, 2013.²⁰

WTCPUA and Commission Staff make much out of the undisputed fact that the 2014 Protested Rates are lower than the rates WTCPUA charged in 2013.²¹ However, no provision of the Water Code or the Commission's rules, so much as *suggest* that the Commission's jurisdiction arises only if there is a rate increase. Rather, TEX. WATER CODE § 13.043(f) refers to "a decision of the provider of water service affecting the amount paid for water service" and it is undisputed that WTCPUA's action in November 21, 2013 affected the amount TCMUD 12 pays for water service.

In this Appeal it is important to carefully consider the breadth of the Commission's authority. The term "*rate*," as defined in TEX. WATER CODE § 13.002(17) and P.U.C. SUBST. R. 24.3(38), includes not only the compensation or charge, but also any rules, regulations, practices or contracts affecting the compensation or charge by any retail public utility for any *service*. "*Service*" is defined in relevant part as any act performed, anything furnished or supplied, and any facilities or lines committed or used by a retail public utility in the performance of its duties *to other retail public utilities*. TEX. WATER CODE § 13.002(21) and P.U.C. SUBST. R. 24.3(44). When the terms as defined in the statute are properly understood, it becomes clear that the Commission is charged in this Docket with determining if WTCPUA's 2014 Wholesale Water Rates, including the methodology utilized to establish the rates, adversely affects the public interest.²² TCMUD 12 has presented persuasive, credible evidence that WTCPUA's decision in setting the wholesale water rates for 2014 rested on a new methodology for computing WTCPUA's revenue requirement and for establishing the rates. WTCPUA's newly adopted methodology resulted in lower Monthly Charges for the first year (2014) but quickly escalating

¹⁹ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 11:23-28, and at JAD Exhibit 13 (Notice to Adjustment to Wholesale Rate for Travis County Municipal Utility District No. 12).

²⁰ *Id.*

²¹ WTCPUA Exhibit No. 5 (TCMUD 12's Admission RFA 2-1); and Staff Attorney Gray Cross of J. DiQuinzio at Tr. 88-89

²² P.U.C. SUBST. R. 24.132(a)

Charges beginning in the second year and extending through 2045.²³ TCMUD 12 initiated this Appeal to challenge WTCPUA's action in applying the new wholesale water rate methodology to set the rates.

V. JURISDICTION

TCMUD 12 filed its Petition Appealing Change of Wholesale Water Rates at TCEQ on March 6, 2014 and asserted jurisdiction under TEX. WATER CODE §§ 11.036, 11.041, 12.013 and 13.043(f) and TEX. LOCAL GOV'T CODE § 572.061(d). At the June 11, 2014 preliminary hearing, Administrative Law Judge William G. Newchurch accepted jurisdiction over the Petition under TEX. WATER CODE §13.043(f), but did not rule on other claimed, but disputed, jurisdictional basis.²⁴ The Petition was scheduled to proceed pursuant to 30 TEX. ADMIN. CODE §§ 291.133 and 291.134, which was applicable to cases arising under Water Code Chapters 11, 12 and or 13.

On September 1, 2014, pursuant to changes to the Texas Water Code wrought by HB 1600 and S.B. 567,²⁵ jurisdiction over the Petition was transferred to the Public Utility Commission ("PUC"). The jurisdictional transfer conferred jurisdiction on the PUC to consider Petitions, such as this one, arising under Texas Water Code Chapters 12 and 13, but did not confer jurisdiction on the PUC for matters arising under Texas Water Code Chapter 11.²⁶ Following the transfer to the PUC, the Petition was processed pursuant to P.U.C. Subst. R. 24.128 *et. seq.*, which is the set of rules governing Wholesale Water and Sewer Service rates that the Commission adopted effective September 1, 2014.²⁷

At the time jurisdiction of this Petition was transferred to the PUC, the Executive Director of TCEQ remained a party under TEX. WATER CODE §§ 11.036 and 11.041. In addition, the Staff of the PUC became a party to the case. Because the standard for review and the procedure for processing this Petition are identical whether jurisdiction attaches under Chapter 11, 12 or 13 of the Water Code, in the interest of inter-agency efficiency, TCMUD 12 amended its Petition to withdraw the claim of jurisdiction under TEX. WATER CODE §§ 11.036

²³ See, Attachment A.

²⁴ SOAH Order No. 1 (Jun. 12, 2014).

²⁵ Acts 2013, 83rd Leg., R.S., Ch. 170 (H.B.1600), eff. Sept. 1, 2013 and Acts 2013, 83rd Leg., R.S., Ch. 171 (S.B. 567), eff. Sept. 1, 2013.

²⁶ See, TEX. WATER CODE §§ 12.013 and 13.043(f), and contrast §§ 11.036 and 11.041.

²⁷ P.U.C. Project 42190, Order Adopting New Chapter 24 to Substantive Rules (Jul. 11, 2014).

and 11.041. On September 17, 2014, in SOAH Order No. 4 the Administrative Law Judge granted TCMUD 12's motion to amend its jurisdictional claim and also granted the TCEQ Executive Director's motion to withdraw.

The Public Utility Commission's jurisdiction over this Petition was accepted under TEX. WATER CODE § 13.043(f).

VI. THE REQUIRED PUBLIC INTEREST DETERMINATION AND ITS SCOPE

A. The Requirement for an Initial Public-Interest Determination

This case is an appeal by TCMUD 12 of the wholesale water service rates set by WTCPUA which went into effect on January 1, 2014. The case was originally filed at the Texas Commission on Environmental Quality ("TCEQ") on March 6, 2014. It was subsequently transferred to the Public Utility Commission of Texas ("PUC") on September 1, 2014.

At the time the case was filed at TCEQ, that commission's rules set forth the procedural mechanism for handling wholesale rate appeals at TCEQ. Under 30 TAC §291.131, when a petition or appeal to review a rate charged pursuant to a written contract was filed, the TCEQ Executive Director was required to forward the petition or appeal to the State Office of Administrative Hearings ("SOAH") to conduct an evidentiary hearing on public interest.²⁸ SOAH would conduct an evidentiary hearing on public interest to determine whether the protested rate adversely affected the public interest.²⁹ If, as a result of the evidentiary hearing on public interest, the commission determined the protested rate did not adversely affect the public interest, the commission would deny the petition or appeal by final order.³⁰ On the other hand, if the commission determined the protested rate adversely affected the public interest, the commission would remand the matter to SOAH for further evidentiary proceedings on the rate.³¹ This bifurcated approach was intended to identify frivolous appeals and more efficiently process legitimate ones.³²

²⁸ 30 TAC §291.131(a).

²⁹ 30 TAC §291.132(a).

³⁰ 30 TAC §291.134(a).

³¹ 30 TAC §291.134(b).

³² WTCPUA Exhibit No. 76, 19 Tex. Reg. 6227–6232 (Aug. 9, 1994), (hereinafter "Preamble") at 6227–6228.

In anticipation of the transfer of jurisdiction over this type of case, effective September 1, 2014, the PUC adopted rules to migrate the substantive rules regulating water and sewer utilities from TCEQ to the Commission. New chapter 24 of the Commission's rules implemented the substantive rules related to the economic regulation of water and sewer and included necessary changes to implement the rules in accordance with Commission procedures.³³ Accordingly, the same bifurcated procedural process established by TCEQ governs this Petition under P.U.C. SUBST. R. Chapter 24, Subchapter I: Wholesale Water and Sewer Service (§§ 24.128 -24.138.) TCMUD 12's Petition is currently within the public interest phase of the proceeding.

Pursuant to the PUC's rules, the Commission shall determine whether 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; (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; or (4) the protested rate is unreasonably preferential, prejudicial, or discriminatory, compared to the wholesale rates the seller charges other wholesale customers.³⁴

In adopting the Wholesale Water and Sewer Service Rules,³⁵ TCEQ noted that the Petition originating review should contain specific allegations which will support a finding of *at least one criteria* identified in § 291.133 (now P.U.C. SUBST. R. 24.133). This standard is reiterated later in the preamble: "the violation of any one of the four public interest criteria shows there has been a substantial breach of the public interest."³⁶

B. Public-Interest Considerations In This Case

In this case, TCMUD 12 has argued that the protested rate evidences the seller's abuse of monopoly power in its provision of water or sewer service to the purchaser. In analyzing the

³³ P.U.C. Project 42190, Order Adopting New Chapter 24 to Substantive Rules (Jul. 11, 2014) at 1–2.

³⁴ P.U.C. SUBST. R. 24.133(a)

³⁵ WTCPUA Exhibit No. 76, Preamble at 6227, bottom of middle column.

³⁶ WTCPUA Exhibit No. 76, Preamble at 6228, right column.

public interest criteria related to whether or not the seller has abused its monopoly power, the commission may weigh all relevant factors including the following:

- (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 or 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 the purchaser.³⁷

TCMUD 12 has presented evidence of WTCPUA's abuse of monopoly power based upon the factors listed in subparts (A) and (C) of P.U.C. SUBST. R. 24.133 (a)(3).³⁸ The fact that a utility is a monopoly does not alone determine a violation of the public interest but rather the rule requires an examination of whether there exists an *abuse* of monopoly power.³⁹ As is clear from the Preamble discussion of the public interest rules, if the Commission concludes that the protested rate evidences the seller's *abuse* of monopoly power in its provision of water or sewer service to the purchaser, that is a "violation of ... one of the four public interest criteria [that] shows there has been a substantial breach of the public interest."⁴⁰ Based upon the persuasive and credible evidence presented by TCMUD 12, WTCPUA's disparate bargaining power enabled it to abuse its monopoly power in setting the Protested Rates based upon a change to the methodology for computing the revenue requirement and rate, and that action constitutes a "substantial breach of the public interest."

³⁷ P.U.C. SUBST. R. 24.133(a)(3).

³⁸ The other factors were addressed in SOAH Order No. 13, in which WTCPUA's motion for summary disposition was granted as to the other factors listed in § 24.133(a)(3): (B) and (D)-(H). SOAH Order No. 13 (Mar. 24, 2015) at 2.

³⁹ WTCPUA Exhibit No. 76, Preamble at 6229, top of left column.

⁴⁰ *Id.* Preamble at 6229, right column.

C. Cost of Service Analysis Is Not Relevant To Determining Whether Rates Adversely Affect The Public Interest (P.U.C. Subst. R. 24.133(b))

1. An examination of the seller's change to the computation of the revenue requirement or rate methodology.

While P.U.C. SUBST. R. 24.133(b) prohibits the Commission from determining whether the protested rate adversely affects the public interest based on an analysis of the seller's cost of service, P.U.C. SUBST. R. 24.133(a)(3)(C) states that the Commission shall weigh whether the seller changed the computation of the revenue requirement or rate from one methodology to another, in determining if the protested rate evidences the seller's abuse of monopoly power. While at first blush it may seem there is an inconsistency between prohibiting a cost of service analysis in subpart (b) and mandating consideration of a change to methodology of revenue requirement or rate in subpart (a)(3)(C) the two provisions must be reconciled in order to give effect to both provisions.

As reflected in the Preamble , the Commission may not declare a rate adverse to the public interest because it does not equal the seller's cost of service:

Most of the comment received was directed at all or parts of §291.133. About half of these commenters argued that the determination of the public interest requires an analysis of the seller's cost of service. On the other hand, the other half of the commenters argued that the seller's cost of service cannot be part of the analysis of the public interest, and that the proposed rules should be revised to clarify that the cost of service will not be considered during the evidentiary hearing on public interest. *The commission concludes that the public interest does not demand that a wholesale rate shall equal the seller's cost of providing service to the purchaser.*⁴¹

The same limitation is expressed later in the preamble, and provides insight as to the origin of the concept:

The commission's conclusion is also consistent with the opinions of the courts. The court in *High Plains Natural Gas Company v. Railroad Commission of Texas*, 467 S.W.2d 532 (Tex. Civ. App.--Austin 1971, writ ref'd n.r e.) was confronted by a similar wholesale rate dispute, but concerning a contract for the sale of natural gas. The court specifically rejected the argument that the court should compare the disputed rate

⁴¹ WTCPUA Exhibit 76, Preamble at 6228, left column, et. seq. (emphasis added).

with a rate based on cost of service in order to determine the public interest.⁴²

A careful reading of the rule helps to remove any facial inconsistency in subparts (b) and (a)(3)(C). Subpart (b) prohibits the commission from basing its public interest determination on an *analysis of the seller's cost of service*; where Subpart (a)(3)(C) requires consideration of the methodology for calculating revenue requirement or rate. As reflected in Mr. Joyce's testimony on behalf of TCMUD 12, he neither analyzed WTCPUA's cost of service, nor did he identify or advocate that the Commission adopt different rates based on his own cost of service analysis. Nowhere in the preamble, or the rule, is there a prohibition against using cost of service information to show that the seller has changed the computation of the revenue requirement or the rate. Evidence may be admissible to address one relevant issue and inadmissible to address another. In this case, evidence concerning WTCPUA's computation method of the revenue requirement and/or rates demonstrates that "the seller changed the computation of the revenue requirement or rate from one methodology to another"⁴³ which evidences abuse of monopoly power.

Thus, the two regulatory provisions may and should be reconciled by allowing an analysis of the methodologies used to set the revenue requirement and rates to determine if the methodology changed, while prohibiting consideration of whether the protested rate adversely impacts the public interest because it does not equal the seller's cost of providing service to the purchaser. This interpretation gives effect to P.U.C. SUBST. R. 24.133 (b) without eviscerating P.U.C. SUBST. R. 24.133 (a)(3)(C).

2. TCMUD 12 has not argued that WTCPUA's rates exceed its cost of service.

In the most recent wholesale water rate appeal decided prior to TCMUD 12's Petition,⁴⁴ the petitioner's evidence was directed at proving the protested rate did not equal the seller's cost of service. The *Corsicana* PFD at page 16, states: "Throughout the case, Ratepayers have claimed that the protested rates are not based on Corsicana's cost of service."⁴⁵ In the next

⁴² WTCPUA Exhibit 76, Preamble at 6228 middle column.

⁴³ P.U.C. SUBST. R. 24.133 (a)(3)(C)

⁴⁴ *Navarro County Wholesale Rate Payers et. al v. City of Corsicana*, TCEQ Docket No. 2009-1925-UCR, SOAH Docket No. 582-10-1944, Order (Nov. 10, 2011) (hereinafter "*Corsicana*.")

⁴⁵ *Corsicana* PFD at 16. This is the opening line in Section VI(D) of the PFD "Cost of Service is Not Relevant to Determining Whether Rates Affect the Public Interest."

paragraph, the ALJ reiterates that point, stating that “The Ratepayers contend that Corsicana’s rates exceed the reasonable cost of serving them and evidence Corsicana’s abuse of monopoly power.”⁴⁶ The significance of this point is laid out succinctly on the second page of the *Corsicana* PFD, where the ALJ explains that the rationale behind the Public Interest Rule’s prohibition against cost of service analysis was to keep purchasers from making arguments that the public interest was violated because the rates exceeded the seller’s cost of service:

When it adopted its wholesale-service rules, the Commission explained them in detail in its preamble. The Commission chose to end a policy that had nearly automatically cancelled rates set by contract and substituted rates based on cost of service. It instituted the public-interest review process to give deference to the contractual agreements between the purchaser and seller. In doing so, the Commission sought to balance the parties’ constitutional right to contract with the Commission’s statutory authority to review wholesale rates. The Commission favored a conservative approach when evaluating evidence regarding the public-interest criteria to determine whether to cancel a rate that was set pursuant to a contract. The Commission stated its legal conclusion that the *public interest does not demand that a wholesale rate equal the seller’s cost of service. That is why the Commission decided that it would not consider the seller’s cost of services in the public-interest hearing.*⁴⁷

The ALJ concluded in the *Corsicana* case that the Public Interest Rule prohibited the *Corsicana* Petitioners’ claim that the protested rate violated the public interest because the rate exceeded Corsicana’s cost of service. But TCMUD 12 makes no such claim. TCMUD No. 12 has *not* argued that the rate protested herein exceeds WTCPUA’s cost of service, but instead has presented evidence that the methodology used to compute the WTCPUA’s revenue requirements and rates has changed.⁴⁸ The Public Interest Rule expressly allows an analysis of the methodologies used to set the revenue requirement and rates to determine if a change has occurred.⁴⁹ This very significant distinction was highlighted during the hearing on the merits by TCMUD 12 witness Jay Joyce. As he explained, he is not recommending a specific cost of

⁴⁶ *Id.*

⁴⁷ *Id.* at 17. (emphasis added).

⁴⁸ A shorthand description of TCMUD 12’s evidence is that the formulas, not the dollar amounts used to populate the formulas, has changed.

⁴⁹ P.U.C. SUBST. R. 24.133 (a)(3)(C).

service level⁵⁰ and unlike in a non-public-interest rate case such as the recently concluded City of Austin case, TCMUD 12 is not seeking to have the Commission set a specific rate.⁵¹

3. An examination of the cost of service formulas is allowed by the rule.

P.U.C. Subst. 24.133 (a)(3)(C) states that the Commission shall weigh all relevant factors, including whether “the seller changed the *computation of the revenue requirement* or rate from one methodology to another.” Because the terms “cost of service” and “revenue requirement” are largely used interchangeably, it stands to reason that the rule which requires the Commission to consider if WTCPUA changed the computation of the revenue requirement methodology, allows the Commission to consider whether WTCPUA changed the methodology for computing cost of service.

In the context of the PUC Water Rules generally, and the public interest rule specifically, there are no clear distinctions between the definitions of *revenue requirements* and *cost of service*. This was acknowledged by Your Honor in the *Corsicana*⁵² PFD which stated that the terms “cost of service” and “revenue requirement” are synonymous. Other Administrative Law Judges have also used the terms interchangeably such as in the *San Saba*⁵³ and the *Chisholm Trail*⁵⁴ cases.⁵⁵ Accordingly, an examination of the seller’s method for computing cost of service is allowed under the public interest rule.

4. Commission’s Order Overturning SOAH Order No. 6 supports the argument that an examination of the seller’s cost of service formulas are relevant to a public interest proceeding.

Mr. Joyce’s rebuttal testimony notes that although this Commission has not had jurisdiction over wholesale water rate appeals for very long, it has already shown that

⁵⁰ Tr. 205–206.

⁵¹ Tr. 210.

⁵² *Corsicana* PFD at 51.

⁵³ *In Re: Application of North San Saba Water Supply Corporation to Change its Water Rates Under Certificate of Convenience and Necessity No. 11227 in San Saba County*, TCEQ Docket No. 2008-1481-UCR; SOAH Docket No. 582-09-0660, Proposal for Decision at 4-5 (March 25, 2010).

⁵⁴ *Petition Requesting Review of Chisholm Trail Special Utility District’s Special District’s Rate Increase Pursuant to Texas Water Code Section 13.043*; SOAH Docket No. 582-05-0003, TCEQ Docket No. 2004-0979-UCR, Proposal for Decision, Proposed Finding of Fact 19 (February 8, 2006).

⁵⁵ TCMUD 12 Exhibit No. 5 (Joyce Rebuttal) at 31:5 – 32:8.

consideration of the seller's cost of service computations is allowed under the rule.⁵⁶ Earlier in this case, TCMUD 12 appealed SOAH Order No. 6, which ruled that certain WTCPUA documents and spreadsheets containing background formulas were not discoverable on the grounds that they were not relevant to this action. In defending Order No. 6, the WTCPUA argued that all cost of service evidence is irrelevant in the public interest phase of this case.⁵⁷ WTCPUA also argued that "[f]ormulae, in particular, are relevant only the determination of the cost of service, and workpapers are not relevant to the public interest test."⁵⁸ The Commission was not persuaded by WTCPUA's arguments and granted TCMUD 12's appeal, overturned the decision of the ALJ, and required the underlying cost of service formulae and computations to be produced.⁵⁹ The Commission's ruling shows that the formulas and methodologies that are used to derive the figures in the cost of service studies are relevant to or, at a minimum, reasonably calculated to lead to the discovery of admissible evidence.

VII. DOES THE PROTESTED RATE EVIDENCE WTCPUA'S ABUSE OF MONOPOLY POWER? (P.U.C. Subst. R. 24.133(a)(3))

The rates set by WTCPUA that are the subject of TCMUD 12's Petition evidence WTCPUA's abuse of monopoly power which is adverse to the public interest.

The persuasive evidence from Dr. Zarnikau demonstrates that WTCPUA operates as a monopoly. WTCPUA has disparate bargaining power over TCMUD 12 which is exercised to its own benefit in setting the Protested Rates and changing the methodologies established by the Wholesale Water Services Agreement, as demonstrated by TCMUD 12's witnesses and exhibits. WTCPUA changed the rate and revenue methodologies in setting the protested rates as explained by Mr. Joyce and Dr. Zarnikau, and as confirmed by WTCPUA's own words.⁶⁰ The economic analysis presented by TCMUD 12, supports Dr. Zarnikau's conclusion that WTCPUA exercised its market power, which is the same as abuse of monopoly power. He also testified that the facts of this case fit squarely within the contractual situation described in the Preamble to the public

⁵⁶ *Id.* at 37:10-25

⁵⁷ *Id.* citing WTCPUA Response to TCMUD 12's Interim Appeal of SOAH Order No. 6 (Oct. 17, 2014), at 4-5.

⁵⁸ *Id.* citing WTCPUA Response to TCMUD 12's Interim Appeal of SOAH Order No. 6 (Oct. 17, 2014), at 6.

⁵⁹ Order on Appeal of SOAH Order No. 6 (Nov. 24, 2014).

⁶⁰ TCMUD 12 Exhibit No. 4 (DiQuinzio Rebuttal) at JAD Exhibit R2 at 2 ("monopolistic LCRA water . . . utility").

interest rules, to wit: “There are situations where a seller and 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 that latter type of agreement so much that it invokes the public interest.”⁶¹

While LCRA was the original monopoly seller from whom TCMUD 12 obtained wholesale water services, that entity’s bargaining power compared to WTCPUA’s bargaining power is not relevant to this proceeding. As explained by Dr. Zarnikau, economists analyze the issue in this proceeding as competition within the field, because the supplier (WTCPUA) has already been selected, and the inquiry focuses on the behavior of that supplier, rather than the predecessor supplier (LCRA).⁶² Under the Commission’s rules, WTCPUA, having stepped into LCRA’s shoes in the Wholesale Water Services Agreement, is the only Seller whose actions must be examined in this docket.

A. Is the WTCPUA a Monopoly?

1. Introduction: WTCPUA is a Monopoly

WTCPUA operates as a monopoly and abused its monopoly power in its dealings with TCMUD 12 as evidenced by its violation of two public interest criteria under P.U.C. Subst. R. § 24.133(a)(3).⁶³ Regulatory agencies such as the Commission are concerned with analyzing and protecting the public interest in situations where a supplier has a sustainable ability to control prices or the quantities supplied in a market, *i.e.*, a monopoly. When that situation occurs, as it has with WTCPUA’s actions in setting the 2014 wholesale water service rates charged to TCMUD 12, the public interest may require the Commission to review and approve prices charged by the dominant firm.⁶⁴

⁶¹ Tr. 284–285, Preamble at 6228.

⁶² Tr. 286–287.

⁶³ TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 5:3–28.

⁶⁴ TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 7:15–21.

WTCPUA was created by the three Participants for the express purpose of acquiring the West Travis County Water System from the LCRA.⁶⁵ At the time of WTCPUA's creation, TCMUD 12 was an LCRA customer under two contracts: a Firm Water Contract⁶⁶; and a Wholesale Water Services Agreement.⁶⁷ When WTCPUA acquired the West Travis County Water System from LCRA in 2012, and as contemplated by the Utilities Installment Purchase Agreement,⁶⁸ TCMUD 12's Wholesale Water Services Agreement was conditionally transferred to WTCPUA.⁶⁹

WTCPUA's own description of the West Travis County Regional Water and Wastewater System characterizes its creator, LCRA, as "monopolistic."⁷⁰ So, after WTCPUA entered into the Installment Purchase Agreement with LCRA to acquire the West Travis County Regional Water and Wastewater System, and then obtained TCMUD 12's consent to the transfer of TCMUD 12's Wholesale Water Service Agreement, WTCPUA stepped into LCRA's monopolistic shoes as the only provider of wholesale water services, and thereby acquired all the bargaining power for providing that service to TCMUD 12 on behalf of The Highlands.⁷¹

TCMUD 12 presented the expert economic testimony of Dr. Jay Zarnikau, who holds a Ph.D. and M.A. in Economics, and has more than 30 years experience in the utility field, including eight years of employment at the PUCT where he was Manager of Economic Analysis, Assistant Director of the Electric Division and Director of the Electric Division. Dr. Zarnikau held faculty-level research position at The University of Texas Center for Energy Studies from 1991 through 1993, and currently teaches graduate-level classes as an Adjunct Lecturer and Visiting Professor at the University of Texas LBJ School of Public Affairs and College of

⁶⁵ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct), JAD Exhibit 5 (Agreement Regarding Transfer) at 167, 2nd Recital; and JAD Exhibit 8 (Utilities Installment Purchase Agreement).

⁶⁶ *Id.*, at 4:21-5:18; and JAD Exhibit 2 (Raw Water Contract) (entitling TCMUD 12 to 1,680 acre-feet of raw or untreated water per year for use by TCMUDs 11, 12 and 13 (the "Districts") over a 40 year term).

⁶⁷ *Id.*, at JAD Exhibit 4 (Wholesale Water Services Agreement) (under which LCRA sells "Wholesale Water Services" to TCMUD 12 on behalf of the Districts; Section 1.01: "Wholesale Water Services" means the diversion of raw water from the Colorado River, the transmission of the raw water to a place or places of treatment, the treatment of the water into potable form and the transmission of the potable water to the Delivery Point.).

⁶⁸ *Id.*, at JAD Exhibit 8.

⁶⁹ *Id.*, at 3:12, and JAD Exhibit 5 (Agreement Regarding Transfer of Operations of the West Travis County Water System from the LCRA to the WTCPUA).

⁷⁰ TCMUD 12 Exhibit No. 4 (DiQuinzio Rebuttal) at JAD Exhibit R2 at 2.

⁷¹ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 15:25-27.

Natural Sciences Division of Statistics. He has been an economic consultant for more than 20 years and has published extensively in refereed and other journals.⁷² This section of TCMUD 12's Brief relies upon Dr. Zarnikau's expert opinions included in the evidentiary record in his prefiled and live testimony.⁷³

2. Definitions of Monopoly

Dr. Zarnikau explained and applied definitions of "monopoly" from economic literature and case law to conclude that the Suppliers⁷⁴ operate as a monopoly. He then explored whether WTCPUA and its three participants, City of Bee Cave, Texas; Hays County, Texas and WTCMUD No. 5, (collectively referred to as "Suppliers") abused that monopoly power in their relationship with TCMUD 12.

The Suppliers operate as a monopolist in the provision of wholesale water services to TCMUD 12 under two definitions: First, under antitrust law, the Suppliers hold a dominant position in this market and have *the ability to control prices and quantities* associated with the provision of wholesale water services to TCMUD 12; and second, under modern economic theory, the Suppliers *exercise exclusive control over the provision of wholesale water services* to the TCMUD 12 service area.⁷⁵ While in this case where the purpose is to explore the public interest, the definition of a monopoly developed in antitrust law is more applicable than the stricter definition used in the modern economics literature, the Suppliers are clearly a monopolist under either definition.⁷⁶ Dr. Zarnikau's findings and opinions, however, are unaffected by which definition is employed, and his analysis therefore includes both definitions.⁷⁷

In the economics literature, a monopoly is a market structure within which one producer, or group of producers acting in concert, exercises *exclusive* control over all, or nearly all, of a supply of a good or service in a certain area or market, and where there are formidable barriers to

⁷² TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 3 and JZ Exhibit 1.

⁷³ TCMUD 12 Exhibit No. 3 (Zarnikau Direct); TCMUD 12 Exhibit 6 (Zarnikau Rebuttal); Tr. 225-319 (Examination on Direct During Hearing); Tr. 516-557 (Examination on Rebuttal During Hearing).

⁷⁴ Dr. Zarnikau's uses the term "Suppliers" to refer collectively to the WTCPUA and its three participant entities, City of Bee Cave, Texas; Hays County, Texas; and WTCMUD No. 5.

⁷⁵ TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 4:26-5:2. "TCMUD 12 service area" refers to The Highlands, consisting of all of TCMUD 12 and 13, and the portion of TCMUD 11 that is not the Rough Hollow Development.

⁷⁶ *Id.*, at 5:22-25 and at 7:3-10.

⁷⁷ *Id.*, at 7:11-21.

entry.⁷⁸ The antitrust cases and law⁷⁹ have developed a much lower standard to classify a market structure as a monopoly. Antitrust cases often result in a court considering a 70% market share sufficient to establish a *prima facie* case of monopoly power, even if there are some smaller “fringe” suppliers with a significant market share in the same market. While economists would be reluctant to accept that level of concentration as proof of a true monopoly, but instead would characterize that as a market structure with a *dominant firm*, WTCPUA is the only provider of services for diversion, treatment, and delivery of wholesale water within the water service area of TCMUD 12.⁸⁰ Therefore, WTCPUA’s control of wholesale water services fits the definition of monopoly under either definition discussed herein.

In addition to these definitions, as Dr. Zarnikau notes, the Texas Water Code also addresses the issue of “monopoly.” TEX. WATER CODE § 13.001(b) provides that “retail public utilities are by definition monopolies in the area they serve; [and therefore] the normal forces of competition that operate to regulate prices in a free enterprise society do not operate.”⁸¹ WTCPUA is a retail public utility, as that term is defined in Texas Water Code §13.002(19) and P.U.C. SUBST. R. 24.2(41)⁸² and as it is used in Section 13.001(b).⁸³ The definition of a “retail public utility” is not limited to an entity that provides only retail water or sewer service but includes any of the listed entities that provide potable water or sewer *service* for compensation. “Service” is defined, in relevant part, as anything furnished or supplied, etc. by a retail public utility in the performance of its duties to other retail public utilities.⁸⁴ The reference in §13.001(b) to the “area they serve,” in this case was originally LCRA’s “service area”⁸⁵ as

⁷⁸ *Id.*, at 6:3–6.

⁷⁹ Including the Sherman Act passed in 1890. TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 6.

⁸⁰ TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 6–7.

⁸¹ Comparable provisions for electric utilities are found in PURA § 31.001(b)

⁸² “Retail public utility” means any person, corporation, public utility, water supply or sewer service corporation, municipality, political subdivision or agency operating, maintaining, or controlling in this state facilities for providing potable water service or sewer service, or both, for compensation.” *Contrast*: “Water and sewer utility”, “Public utility,” or “utility” excludes “a municipal corporation, water supply or sewer service corporation, or a political subdivision of the state, except an affected county.” Tex. Water Code § 13.002(23).

⁸³ *See*, Section V., Jurisdiction, above.

⁸⁴ Tex. Water Code § 13.002(21) and P.U.C. Subst. R. 24.3(44).

⁸⁵ For purposes of defining the terms under Tex. Water Code § 13.001(b)(1): “retail public utilities are by definition monopolies in the area they serve.”

depicted in the Wholesale Water Services Agreement, Exhibit B and is defined as the West Travis County Regional Water System,⁸⁶ and is now called the PUA Water Service Area.⁸⁷

In sum, the Suppliers operate as a monopoly in the provision of wholesale water services to TCMUD 12 under the definitions from the economics literature and antitrust case law, and under TEX. WATER CODE § 13.001(b).

3. Factors that Establish WTCPUA is a Monopolist

In addition to the statutory provision that defines WTCPUA, as a retail public utility, as a monopoly,⁸⁸ evidence that the WTCPUA operates as a monopolist includes: WTCPUA is presently the only provider of services related to the diversion, treatment, and delivery of water, *i.e.*, wholesale water services, within the retail water service area of The Highlands. In addition, WTCPUA exercises sole control over the supply of wholesale water services that the Districts must obtain in order to provide potable water to the retail customers of The Highlands.⁸⁹

Another factor considered by Dr. Zarnikau in determining if WTCPUA is a monopoly is whether there are barriers to entry. If a new supplier could easily enter the market, then the current Suppliers⁹⁰ would have less control over the supply of the good or service, and less control over prices because of the threat of competition. When there is ease of entry and exit such that the market is contestable, any attempt to change a price or the quantity of the good or service supplied could invite competition, which would diminish control by the incumbent supplier. A more competitive market, *i.e.*, a market where there is ease of entry, is a key consideration in determining if the Suppliers are a monopoly.⁹¹ As discussed below in Section VII.B. of this Brief, there are formidable barriers to entry for alternative wholesale water service suppliers that could serve The Highlands. The overwhelming persuasive evidence addressed in detail below demonstrates that there are no other existing suppliers of wholesale water services

⁸⁶ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 4.

⁸⁷ TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at JZ Exhibit 2, p. 78 (Exhibit C – PUA Water Service Area). Under section 3.2 of the LCRA-WTCPUA Utilities Installment Purchase Agreement, LCRA's CCN No. 11670 was to be transferred from LCRA to WTCPUA. TCMUD 12 Exhibit No. 1 (DiQuinzio Direct), at JAD Exhibit 8, page 13 of 124.

⁸⁸ TEX. WATER CODE § 13.001(b)(1)

⁸⁹ TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 7:22–8:2.

⁹⁰ WTCPUA and its three participating entities.

⁹¹ TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 8:3–13.

with the capacity and infrastructure necessary to provide an alternative to the wholesale water services and system controlled by WTCPUA, and building a new water services system as a substitute for the West Travis County Water System would be prohibitively expensive, and could lead to the stranding of TCMUD 12's reserved capacity in the System.⁹² These formidable barriers to entry to any alternative supplier meet the stricter definition of a monopolist used in modern economic theory and the Suppliers are accordingly operating as a monopoly.⁹³

In addition to the absence of any existing alternative wholesale water service supplier with the capacity to serve The Highlands, the City of Bee Cave, Hays County and TCMUD No. 5, the "Participants", are contractually obligated to prohibit competing systems "to the extent permitted by law." Section 7.07(h) of the Acquisition, Water Supply, Wastewater Treatment and Conditional Purchase Agreement⁹⁴ signed by the three WTCPUA Participants reads:

No Competition. To the extent permitted by law, it will not grant any franchise or permit for the acquisition, construction, or operation of any competing facilities which might be used as a substitute for such Participant's System's facilities, and, to the extent permitted by law, each Participant will prohibit any such competing facilities.

Under the Participants' Acquisition Agreement, they are also prohibited from reselling water that they purchase from the PUA to third party wholesalers without obtaining consent of the PUA and the other Water Participants; and the Water Participants are prohibited from entering into contracts with any entity other than the PUA for supply of water during the term of the Acquisition Agreement.⁹⁵

The WTCPUA and its three Participants are contractually bound to ensure there are formidable barriers to entry by any third party alternative wholesale water service provider. WTCPUA, City of Bee Cave, Hays County and TCMUD No. 5 have agreed to do whatever they can to ensure the continued monopolistic operation of the West Travis County Water System by WTCPUA, thereby creating even greater barriers to entry for water services by another entity.

⁹² Tr. 318-319.

⁹³ TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 5:20-22.

⁹⁴ *Id.*, at JZ Exhibit 2, "Acquisition Agreement" (WTCPUA00006075-6125).

⁹⁵ *Id.*, at 9 and at JZ Exhibit 2, "Acquisition Agreement," Section 5.08.

Another obstacle for TCMUD 12 obtaining an alternative wholesale water service provider is the provision in the Wholesale Water Services Agreement under which TCMUD 12 obtains service from WTCPUA. That contract obligates LCRA, and now WTCPUA, to divert, transport, and treat for TCMUD 12 all the water needed and requested up to the peak hourly flow rate of 414,000 gallons per hour and a maximum daily flow rate of 3,980,000 GPD.⁹⁶ If TCMUD 12's demand for wholesale water services ever exceeds that amount, which it has not to date and is not forecasted to do for many years, then TCMUD 12 must notify WTCPUA of the shortage and the amount of additional water needed. Only if WTCPUA is unable to provide additional water under that hypothetical scenario may TCMUD 12 seek water from another source.⁹⁷ The Wholesale Water Service Agreement reserves to WTCPUA a right of first refusal in the event additional water services are ever needed for The Highlands. There were comparable provisions in other Wholesale Water Service Agreements transferred or assigned to WTCPUA.⁹⁸ This contract provision would not have permitted TCMUD 12 to seek an alternative supplier of wholesale water service when WTCPUA changed the wholesale service rates in 2014, because TCMUD 12's demand for wholesale water service was not anywhere close to the amount specified in the Agreement.⁹⁹

It is evident from even just this one provision of the Wholesale Water Services Agreement, that the parties to the contract understood that LCRA was the only wholesale water services provider available to TCMUD 12 in 2008-09, and that the parties expected LCRA to continue in that role. WTCPUA has now taken over LCRA's role as the sole provider of wholesale water services, and therefore controls the quantity of that service. This contractual provision is additional evidence of WTCPUA's control of the quantity of wholesale water services, which supports Dr. Zarnikau's opinion that the Suppliers are a monopoly.¹⁰⁰

⁹⁶ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 4, Section 3.03.a.

⁹⁷ *Id.*, at JAD Exhibit 4, Section 3.03.c.

⁹⁸ TCMUD 12 Exhibit No. 8 (Hays County WCID #1) at Section 3.03.b; TCMUD 12 Exhibit No. 11 (Hays County WCID #2) at Section 3.03.b; TCMUD 12 Exhibit No. 14 (Reunion Ranch) at Section 3.03.b; TCMUD 12 Exhibit No. 17 (Senna Hills MUD) at Section 3.03.d; TCMUD 12 Exhibit No. 19 (Lazy Nine MUD) at Section 3.03.c; TCMUD 12 Exhibit No. 21 (Barton Creek West WSC) at Section 8.

⁹⁹ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 4, Section 3.03.c.

¹⁰⁰ TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 8:25-9:24 and 13:1-2.

4. HHI Screen Supports Finding WTCPUA is a Monopoly

One screen that provides useful information, albeit not conclusive evidence, of market power is the Herfindahl-Hirschman Index (HHI), which is often used by the U.S. Department of Justice (USDOJ) to measure market concentration.¹⁰¹ Under the HHI formula, WTCPUA's HHI is 10,000, which indicates a highly concentrated market, and in Dr. Zarnikau's opinion, indicates that a monopoly exists.¹⁰² Although market concentration is not exactly synonymous with market power, higher market concentration such as is evident in WTCPUA's service area, is associated with a greater ability to control prices and quantities, which are factors that support a finding of monopoly power.¹⁰³

5. Water Utilities are Natural Monopolies and the Effect of Price Inelasticity

It is common for there to be a single utility providing goods and services because it tends to be uneconomical to construct and operate competing systems to transport and distribute a commodity such as potable water or electricity. This imbues these types of utility services with natural monopoly characteristics.¹⁰⁴ Due to the importance of and human necessity for water (and electricity) services, the demand for these utility services tends to be price-inelastic which means a change in price tends to have a less-than-proportionate effect on the demand for the product.¹⁰⁵ The significance of price-inelasticity in this case is that it gives the monopolist, WTCPUA, greater control over prices. Because water is a necessity for human life it is imbued with the public interest and because it is supplied by a utility that has monopoly characteristics, the Water Code establishes the process to enable the Commission to exercise regulatory oversight.¹⁰⁶ In this proceeding, the Commission has jurisdiction to examine WTCPUA's change to wholesale water service rates to determine if that action is adverse to the public interest, and upon finding that it is, to determine WTCPUA's cost of service.

¹⁰¹ *Id.*, at 11:3–24 (The USDOJ considers markets with an HHI over 1,800 to be highly concentrated that may merit further examination).

¹⁰² *Id.*

¹⁰³ *Id.* at 11:25–12:1.

¹⁰⁴ *Id.* at 12:4–9.

¹⁰⁵ *Id.* at 12:19–22.

¹⁰⁶ *Id.* at 12:10–22.

6. Conclusion: WTCPUA is a Monopoly and has Abused its Monopoly Power

WTCPUA operates as a monopoly under the definitions of monopoly found in the economics literature, as established by antitrust cases, and as expressly provided by TEX. WATER CODE § 13.001(b). The WTCPUA is the only entity that currently exists that can provide the wholesale water services to TCMUD 12 necessary for The Highlands' retail customers to receive water service. There are significant barriers to entry for a new supplier of wholesale water service, and the Utilities Installment Purchase Agreement as well as the Wholesale Water Services Agreement contain provisions that strengthen the Suppliers' ability to limit competitors' entry and to control the quantity of water services. Under the HHI screen, the WTCPUA service area is highly concentrated. WTCPUA also has all the characteristics of a natural monopoly and because potable water is a necessity for human life, the demand for water services tends to be price-inelastic which gives WTCPUA even greater control over prices. For each of these reasons, WTCPUA operates as a monopoly.

Under the Commission's rules, a finding that WTCPUA is a monopoly is not sufficient to grant TCMUD 12 the relief requested. Relief in this Public Interest phase is appropriate only if the monopolist has abused its monopoly power. This is consistent with standards established in antitrust cases.¹⁰⁷ As discussed in detail in Section VII. B. below, WTCPUA has exercised or abused its disparate bargaining power to the advantage of the WTCPUA but contrary to the public interest. As discussed in Section VII. C., below, WTCPUA changed the methodology for computing the revenue requirement and the rates for wholesale customers which also evidences abuse of monopoly power. The persuasive evidence of violations of the factors found in P.U.C. SUBST. R. 24.11(a)(3)(A) and (C), supports Dr. Zarnikau's conclusion that WTCPUA abused its monopoly power in establishing the protested rates.¹⁰⁸ TCMUD 12 urges the Honorable Administrative Law Judge to find the protested rate evidences WTCPUA's abuse of monopoly power and recommend same to the Commission so that the Commission may exercise its regulatory authority to protect the public interest and remand this matter to SOAH to determine WTCPUA's cost of service.

¹⁰⁷ *Id.* at 13:4-15, citing *U.S. v. Grinnel Corp.*, 384 U.S. 563, 570-571 (1966). (Under Section 2 of the Sherman Act an offense requires not only the possession of monopoly power in the relevant market, but also the willful acquisition or maintenance of that power, as distinguished from growth or development as a consequence of superior product, business acumen, or historic accident.)

¹⁰⁸ *Id.* at 13-18.

B. Disparate Bargaining Power of the Parties (P.U.C. SUBST. R. 24.133(a)(3)(A))

1. What Are TCMUD 12's Alternative Means, Alternative Costs and Problems of Obtaining Alternative Wholesale Water Services?

a. Introduction: Scope of Inquiry Under P.U.C. SUBST. R. 24.133(a)(3)(A)

P.U.C. SUBST. R. 24.133(a)(3) identifies the seller's abuse of monopoly power as one of four criteria to be considered by the Commission in determining if a Protested Rate adversely affects the public interest. In making that inquiry, the commission is required to weigh all relevant factors, and under subpart (3)(A) that includes the disparate bargaining power of the parties. Dr. Zarnikau described this key economic concept as follows: "Bargaining power refers to the relative ability of parties to exert influence over each other. In a competitive market where there are many viable suppliers and many buyers, there is equal bargaining power. In situations where there is a monopoly or a dominant firm, there is disparate bargaining power, with the supplier holding more power."¹⁰⁹ To TCMUD 12's General Manager, Mr. DiQuinzio, the term "bargaining power" means both sides to an agreement or contract have alternatives.¹¹⁰

In addressing disparate bargaining power, the Commission's rule includes a list of various alternatives that may be considered. In this case, TCMUD 12 has presented evidence that it cannot obtain wholesale water service from an alternative provider, by explaining that no alternative provider exists, the costs associated with a hypothetical alternative supplier, and the problems that would be associated with obtaining or constructing an alternative wholesale water service. The lack of an alternative supplier allows WTCPUA to change its rates and methodologies with impunity, secure in the knowledge that its wholesale customers have no ability to switch to another seller and that the wholesale customers must continue to obtain wholesale water services from WTCPUA in order to provide retail water services to their end-use customers.

In adopting the bifurcated process which requires the wholesale purchaser to prove that the protested rate is adverse to the public interest, the predecessor agency to the Commission explained that in instances such as are present here, the seller "exercises near monopoly power over the purchaser because many agreements allow the seller the unilateral right to adjust the rate

¹⁰⁹ TCMUD 12 Exhibit No. 6 (Zarnikau Rebuttal) at 24:18-25.

¹¹⁰ TCMUD 12 Exhibit No. 4 (DiQuinzio Rebuttal) at 6:22-23.

[and] the purchaser substantially has no alternatives to obtain water . . . 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 latter type of agreement so much that it invokes the public interest.”¹¹¹

There is no dispute that while WTCPUA was not the party with whom TCMUD 12 originally contracted for wholesale water service, it is now the contractual seller, having entered into an Installment Purchase Agreement with LCRA that lead to the transfer of the TCMUD 12 Wholesale Service Agreement and the LCRA’s obligations arising thereunder, which are now WTCPUA’s. In TCMUD 12’s dealings with LCRA, and then with WTCPUA after it took over operations of the West Travis County Water System from LCRA, TCMUD 12 had no alternative means of obtaining wholesale water service.¹¹² The persuasive evidentiary record demonstrates that WTCPUA exercised its greater bargaining power over TCMUD 12 which has no alternatives to obtain wholesale water service.

WTCPUA suggested through the testimony of Mr. Baudino that TCMUD 12 failed to explore *all* alternative providers when it entered into the wholesale water services contract with LCRA. However, Mr. Baudino has no personal knowledge of other providers in the vicinity of TCMUD 12, and his testimony suggests that TCMUD 12 should prove that it analyzed something that does not exist.¹¹³ Similarly, any suggestion that Lakeway MUD or the City of Austin might provide an alternative wholesale water service arrangement for The Highlands is unsupported by any credible evidence. Construction of a new WTP, either in 2008-09 when the Districts were in discussions with LCRA about wholesale water service, or beginning in 2012 through the present, after WTCPUA took over the System and changed the wholesale water service rates, has never been a financially viable alternative.

TCMUD 12 cannot obtain wholesale water service from an alternative provider, because one does not exist, the costs associated with an alternative supplier would be prohibitive, and there are practical problems with obtaining alternative wholesale water service as discussed

¹¹¹ Preamble at 6228, top of right column.

¹¹² TCMUD 12 Exhibit 4 (Baudino Direct) at 6:24–7:11.

¹¹³ Tr. at 352 and WTCPUA Exhibit No. 2.

throughout this section. TCMUD 12 has presented persuasive evidence that WTCPUA possesses disparate bargaining power, which enabled it to abuse its monopoly power.¹¹⁴

b. Alternative to Whom? How WTCPUA Came to Be TCMUD 12's Wholesale Water Services Supplier

In order to put in context the evidence concerning the lack of alternative providers,¹¹⁵ it is essential to understand the current wholesale water service system that provides potable water to TCMUD 12 on behalf of The Highlands. The Highlands' quest for potable water began with seeking and obtaining a source of raw water. LCRA was and remains the sole provider of state surface water in the Colorado watershed in which The Highlands is located.¹¹⁶ There was not then and there is not now a viable alternative water source, such as ground water, available to TCMUD 12. In 2008, TCMUD 12 was successful in securing raw water for The Highlands through a Firm Water Contract with LCRA, which obligates LCRA to supply 1,680 acre-feet (547,429,680 gallons) of raw water annually over a 40 year term.¹¹⁷

The next step in TCMUD 12's quest for potable water was to obtain water services to divert, treat and transmit the raw water purchased from LCRA to The Highlands. LCRA was the only provider of wholesale water *services* in proximity to and with the ability to divert, treat and transmit the potable water needed to serve The Highlands.¹¹⁸ At the same time that TCMUD 12 was discussing with LCRA wholesale water services, LCRA was exploring the possibility of constructing a new Water Treatment Plant ("WTP") at The Highlands, as explained in more detail below. As a result of LCRA's exploration of a possible new WTP, the discussions about wholesale water service took about a year. When LCRA ultimately abandoned the idea of constructing a new WTP at The Highlands, it entered into a contract to provide wholesale water

¹¹⁴ TCMUD 12 Exhibit No. 6 (Zarnikau Rebuttal) at 26:7-18

¹¹⁵ TCMUD 12 did not meet with any wholesale water service supply providers other than LCRA in 2009, 2010, or 2011 *because* there were no alternative wholesale water service providers. Tr. 61. By 2012 and continuing through March 6, 2014 (when TCMUD 12 filed its Petition in this Docket), TCMUD 12 did not meet with any wholesale water service supplier other than WTCPUA, because it had taken over that service from LCRA and was the only provider. Tr. at 62.

¹¹⁶ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 15:16-19.

¹¹⁷ *Id.* at JAD Exhibit 2 (Raw Water Contract).

¹¹⁸ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 15:19-20.

service to TCMUD 12 through a line along Highway 71 that had been constructed by Lazy 9 MUD. TCMUD 12's Point of Delivery ("POD") is on the Lazy 9 MUD line on Highway 71.¹¹⁹

TCMUD 12 was able to obtain wholesale water services from LCRA because: LCRA's West Travis County Regional WTP had capacity to treat the water needed to serve The Highlands; the Lazy 9 MUD line had transmission capacity that would provide a means to get the treated water to a POD near the Districts; and The Highlands service area is located within the LCRA service area.¹²⁰ The key terms of the Wholesale Water Services Agreement between TCMUD 12 and LCRA are described in Mr. DiQuinzio's Direct Testimony¹²¹ and include, in part:

- LCRA diverts, transports and treats water not to exceed 3,980,000 gallons per day (GPD), the maximum daily flow rate under the Contract which is presumed to be sufficient for up to 2,125 LUEs;¹²²
- LCRA delivers potable water to the Delivery Point on Tx. Hwy 71 W;¹²³
- TCMUD 12 holds title to the water, even when it is commingled with water belonging to other customers of the LCRA System;¹²⁴
- Charges for wholesale water services consist of three rates:¹²⁵ a Connection Fee, Monthly Charge and Volume Rate;
- The methodology for calculating each of the three rates is set out in the Wholesale Water Services Agreement¹²⁶ as are the provisions related to changing these rates;¹²⁷ and

¹¹⁹ *Id.* at 6:6–11 and JAD Exhibit 6 (Map).

¹²⁰ *Id.* at 6:12–16, and at JAD Exhibit 4 (Water Services Agreement, Exhibit B and definitions of "LCRA Service Area" and "LCRA System" at page 4.)

¹²¹ *Id.* at 6:16–9:6.

¹²² *Id.* at JAD Exhibit 4, Section 3.03.

¹²³ *Id.*, at JAD Exhibit 4, Section 1.01 ("Delivery Point") and at Exhibit A (map).

¹²⁴ *Id.*, at JAD Exhibit 4, Section 3.02.

¹²⁵ *Id.*, at JAD Exhibit 4, at (Article IV), p. 10 – 13 (of 27) .

¹²⁶ *Id.*, at 7:14 – 9:2, and JAD Exhibit 4 at Section 4.01.a., b., c. (Connection Fee); Section 4.01.d. (Monthly Charge); and Section 4.01.e. (Volume Rate).

¹²⁷ *Id.*, at JAD Exhibit 4 at Section 4.01.a (changes to Connection Fee); Section 4.01.f (changes to 3 rates).

- The term of the Wholesale Water Services Agreement is the same as the term for TCMUD 12-LCRA's Raw Water Contract (ending September 25, 2048).¹²⁸

When LCRA's Board decided to divest itself of the West Travis County Water and Wastewater Utilities System, that System was put up for sale through a bid process.¹²⁹ The entities that ultimately became WTCPUA banded together to buy the "monopolistic LCRA water and wastewater utility."¹³⁰ LCRA and WTCPUA executed the Utilities Installment Purchase Agreement effective January 17, 2012, with the transfer of operations set for March 19, 2012.¹³¹ TCMUD 12's Wholesale Water Services Agreement with LCRA was one of the "intangible assets" that were to be transferred from LCRA to WTCPUA under the Installment Purchase Agreement, which required LCRA and WTCPUA to obtain TCMUD 12's consent.¹³² Under the terms of TCMUD 12's Wholesale Water Services Agreement, TCMUD 12's consent could not be unreasonably withheld or delayed.¹³³ On February 28, 2012, WTCPUA emailed TCMUD 12 seeking to obtain TCMUD 12's consent to the transfer of the Wholesale Water Services Agreement prior to March 19, 2012 when LCRA was scheduled to transfer operations of the West Travis County Water System to WTCPUA.¹³⁴ TCMUD 12 ultimately consented to the transfer on June 19, 2012, and agreed to a retroactive effective date of March 19th, after the parties agreed to include certain critical provisions necessary to protect TCMUD 12's rights under the Wholesale Water Services Agreement.¹³⁵

¹²⁸ *Id.* at JAD Exhibit 4, Section 7.13.

¹²⁹ *Id.*, at 9:7–13 and at JAD Exhibit 8 (LCRA-WTCPUA Utilities Installment Purchase Agreement) Recital C.

¹³⁰ TCMUD 12 Exhibit No. 4 (DiQuinzio Rebuttal) at JAD Exhibit R2 p. 2.

¹³¹ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 8 (Utilities Installment Purchase Agreement).

¹³² *Id.*, at 9:7–17; and at JAD Exhibit 8, Art. III., Section 3.1.

¹³³ *Id.*, at 9:17–19 and at JAD Exhibit 4, Section 7.08.

¹³⁴ *Id.*, at 9:20–23 and at JAD Exhibit 9 (Email from Ms. Kalisek to Ms. Brooks Littlefield with Draft Resolution for TCMUD 12's Board's consideration.)

¹³⁵ *Id.*, and at JAD Exhibit 5 (Transfer Agreement); and TCMUD 12 Exhibit No. 4 (DiQuinzio Rebuttal) at 13:19 – 14:7.

c. There are no viable alternative providers of wholesale water services for The Highlands.

There are no other existing suppliers of wholesale water services in the proximity of The Highlands with the capacity and infrastructure that would be necessary to provide an alternative to the wholesale water services TCMUD 12 purchases from WTCPUA.¹³⁶ Mr. DiQuinzio's testimony to that effect is based on his experience as the manager of the Districts, in consultation with other professionals, including engineers who assist him with managing districts; and based on his experience as a developer in Central Texas in which capacity he has evaluated over the course of many years various sources and the economic viability of alternative water treatment options.¹³⁷ In evaluating alternative suppliers, if any exist, the cost of the alternative is an important consideration that in turn depends on the economy at the time the options are being considered, and the districts' and/or developers' ability to find and sustain financing for a project.¹³⁸

The following lists alternatives to the wholesale water services provided by WTCPUA that were discussed at the hearing, none of which are viable, reasonable or without insurmountable problems:

- (i) Lakeway MUD: The portion of TCMUD 11 that is called Rough Hollow takes wholesale water service from Lakeway MUD ("LMUD"). LMUD does not provide an alternative wholesale water service option for The Highlands, however, because the contract between LMUD and TCMUD 11 limits service to Rough Hollow and because LMUD has no additional water service capacity that could provide wholesale water service to The Highlands.¹³⁹ The agreement between TCMUD 11 and LMUD limits the water services provided by LMUD to Rough Hollow, and a maximum peak day volume of 362,500 gallons.¹⁴⁰ That

¹³⁶ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 15:28-32.

¹³⁷ Tr. at 80.

¹³⁸ Tr. 81-82.

¹³⁹ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 5:19-26, and at JAD Exhibit 7 (Agreement for Wholesale Water and Wastewater Service Between LMUD and TCMUD 11) at page 3 of 78 (Definition of Service Area); and at page 27 of 78, Exhibit A (Rough Hollow Service Area and Approved Development map).

¹⁴⁰ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 179, JAD Exhibit 7 (Agreement for Wholesale Water and Wastewater Service Between LMUD and TCMUD 11, Apr. 6, 2006) page 4 of 78, Section 2.01(b).

level of wholesale water services provided by LMUD is sufficient to serve Rough Hollow, but not The Highlands. There is no evidence that LMUD would or could provide additional wholesale water services to The Highlands.¹⁴¹ The only evidence is that LMUD was not capable of providing wholesale water service to The Highlands. TCMUD 12 never made a written request to LMUD for additional wholesale water services¹⁴² because Mr. DiQuinzio knew through his daily conversations with LMUD concerning capacity, points of interconnection and construction plans, that LMUD did not have additional water service capacity that could be provided to The Highlands.¹⁴³ The raw water that is diverted out of Lake Travis through the Lakeway Raw Water Intake, depicted on the map included in the Raw Water Contract, serves only Rough Hollow, which is not hydrologically connected to The Highlands. The Highlands's raw water is diverted out of Lake Austin through the West Travis County Regional Water System Raw Water Intake, now operated by WTCPUA and ultimately delivered to TCMUD 12 at the delivery location selected by LCRA on Highway 71, on the opposite side of The Districts from the Lakeway Raw Water Intake.¹⁴⁴

Another alternative option related to LMUD discussed during the hearing was the "emergency interconnect." The Districts planned, designed and constructed an "emergency interconnect" after experiencing three boil water alerts in a 60 day period that were attributable to problems on the LMUD and West Travis County Systems.¹⁴⁵ However, that emergency interconnect does not constitute an alternative to the wholesale water services provided to The Highlands by

¹⁴¹ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 13:10–20.

¹⁴² Tr. 66.

¹⁴³ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 5:23–26; WTCPUA Exhibit No. 17 (TCMUD 12's Response to RFI 2-12 explaining Mr. DiQuinzio's "routine dealings"); WTCPUA Exhibit No. 24 (TCMUD 12's Response to RFI 2-23 explaining Mr. DiQuinzio's "business dealings with LMUD"); WTCPUA Exhibit No. 25 (TCMUD 12's Response to RFI 2-24 (explaining why TCMUD 12 did not make a written request to LMUD for wholesale water service for The Highlands).

¹⁴⁴ Tr. 72, and TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 2, page 23 of 76.

¹⁴⁵ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 13:26–14:4; Tr. 68–69 (The cost of that interconnection, approximately \$377,000, had been paid by TCMUD 12, as reflected in WTCPUA Exhibit 26 (partial copy [pages 80 – 83 out of 177] of Construction Contract.)

WTCPUA for three inter-related reasons. First, the “emergency interconnect” is not in use because it is “valved off.”¹⁴⁶ Second, the Districts cannot unilaterally connect the LMUD and WTCPUA Systems (Rough Hollow is served by LMUD and The Highlands is served by WTCPUA) but would have to obtain permission to interconnect the two systems from both LMUD and WTCPUA. Not only has permission to interconnect not been granted, *LMUD has expressly refused to give permission for the interconnection, even in an actual emergency.*¹⁴⁷ Third, and most importantly, the emergency interconnection cannot provide a permanent alternative to the wholesale water services provided by WTCPUA.¹⁴⁸ Even assuming that WTCPUA and LMUD were convinced some day in the future to agree to let TCMUD 12 open the valves and allow water to flow through the emergency interconnection, it was not designed and does not have the capacity to provide a permanent alternative to the wholesale water services provided by WTCPUA. Instead, the “emergency interconnection” was designed to provide only temporary water service to The Highlands and/or Rough Hollow in the event of an actual emergency and is not a viable alternative to the wholesale water services that TCMUD 12 pays for pursuant to the Wholesale Water Services Agreement. In order for TCMUD 12 to utilize the emergency interconnect as a permanent source of potable water for The Highlands, it would also have to resolve all the issues identified in the previous paragraph, *e.g.* the lack of treatment capacity on the LMUD system, and the fact that raw water for The Highlands comes from Lake Austin, not Lake Travis, to a POD on the south side of The Highlands on Highway 71.

(ii) There is Not Another Centralized WTP: Between 2008 and 2009, the LCRA considered and rejected the possibility of constructing a new WTP at The

¹⁴⁶ Tr. 84–85. (There is a 12-inch water line that is connected to a valve in the Rough Hollow portion of TCMUD 11, that goes across a ravine, across a bridge, and connects to another valve in the TCMUD 11 portion of The Highlands.)

¹⁴⁷ Tr. at 85 (LMUD has refused to entertain any discussion of allowing the “emergency interconnection” to be used, *i.e.*, to allow the valve to be opened, because LMUD is concerned it would drain their system, thereby causing a water shortage crises for LMUD.) Tr. at 92 (Remarkably, LMUD’s refusal to allow the valves to be opened, extends to actual emergencies.)

¹⁴⁸ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 13:21–14:16.

Highlands.¹⁴⁹ The decision to not undertake that construction was financially driven as discussed in the next section of this Brief, but germane to this discussion about the absence of any viable “alternatives,” is the fact that LCRA was interested in expanding its service to the west as far as Marble Falls for two reasons: first and foremost, because there were no other centralized water service providers from Bee Creek to the west all the way to Marble Falls. LCRA’s second rationale for considering construction of a new WTP at The Highlands was LCRA’s interest in controlling the water supply because smaller water systems, some of which LCRA was buying, often failed or were mismanaged.¹⁵⁰ LCRA considered construction of a new WTP at The Highlands because there was no other centralized water service providers all the way to Marble Falls. There is no evidence that a new centralized water service provider has materialized in the intervening years which means the current service from the PUA’s West Travis County Water System are the only services available to TCMUD 12. Finally, any suggestion that the City of Austin should have been considered as an alternative wholesale water service supplier¹⁵¹ was completely discredited. The City of Austin’s WTP is “extremely far away” from The Highlands, and The Highlands are not in the City’s CCN water service area.¹⁵²

(iii) Additional Facilities: Hypothetically, if there were some alternative water treatment plant available or that could be constructed, all the associated facilities necessary for an entire water system would have to be constructed. This would include facilities to divert raw water out of the lake, which would involve a new intake structure (barge), a new transmission line from the intake structure to the location of the new hypothetical WTP, additional transmission lines from the new WTP to a new point of delivery (POD), and the construction of a new POD to replace TCMUD 12’s Highway 71 POD. That would just get the potable water to

¹⁴⁹ TCMUD 12 Exhibit No. 4 (DiQuinzio Rebuttal) at 4:7–18 and TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 6:7–8.

¹⁵⁰ TCMUD 12 Exhibit No. 4 (J. DiQuinzio Rebuttal) at 4:28–5:14 (excluding the portions on page 5, between lines 2 and 5 that were struck).

¹⁵¹ Tr. at 79.

¹⁵² Tr. at 108.

the supplier's side of TCMUD's water meter. In addition, TCMUD 12 would have to re-design the internal water system that it constructed to serve The Highlands from the Highway 71 POD.¹⁵³ Another factor that would have to be addressed if there was an alternative water supplier, is storage. Under TCMUD 12's Wholesale Water Services Agreement, LCRA assured the Districts of a static pressure at the POD,¹⁵⁴ which means the Districts do not have to provide additional water storage facilities in order to ensure appropriate pressurization in The Highlands. If the POD were changed for a hypothetical new WTP, the new system would either have to include water storage facilities to ensure appropriate pressurization in The Highlands, or TCMUD 12 would have to construct storage facilities within The Highlands.¹⁵⁵ There is no evidence that there is an existing alternative water treatment plant or that a new WTP could be constructed, but if a WTP was created, significant additional water facilities discussed herein would also have to be constructed in order to replace the wholesale water services provided by WTCPUA to TCMUD 12.

- (iv) TCMUD 12 Could Not Avoid WTCPUA's Rates If TCMUD 12 had simply refused to consent to the transfer of the Wholesale Water Services Agreement to WTCPUA at the time it assumed operation of the West Travis County Water System from the LCRA, TCMUD 12 would still be paying the rates set by WTCPUA, as well as an additional administrative fee.¹⁵⁶ Two wholesale water customers of LCRA, Deer Creek Water Co. and Lazy Nine MUD No. 1A, failed to agree to the assignment or transfer of their contracts to WTCPUA, but they were nonetheless required to pay the rates set by WTCPUA in October 2012, in addition to an administrative fee to LCRA. The LCRA administrative fee was \$831 per month for Deer Creek Water Co. and \$3,390 per month for Lazy Nine

¹⁵³ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 14:27–15:2.

¹⁵⁴ *Id.* at JAD Exhibit 4, Section 3.03.e.

¹⁵⁵ *Id.* at 15:3–7.

¹⁵⁶ TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 16:10–22 and JZ Exhibit 4 (LCRA Board Jan. 16, 2013). *See also*, TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 8 (Utilities Installment Purchase Agreement) at p. 13 of 124, section 3.1.A.

MUD No. 1A.¹⁵⁷ The LCRA Board adopted the rates as proposed by the WTCPUA plus the additional surcharge since these two wholesale customers were still LCRA's customers. This strongly suggests that LCRA's former wholesale customers could not avoid the rates imposed by WTCPUA. WTCPUA controls prices in this market, and any attempt to avoid those rates would result in the customer paying more. The LCRA "administrative fee" provided an incentive for the wholesale customers to agree to the transfer of their Wholesale Water Services Agreements, which apparently worked with respect to the 2 hold-outs since Mr. Rauschuber lists Deer Creek Water Co. and Lazy Nine MUD as WTCPUA's wholesale customers as of November 21, 2013.¹⁵⁸ LCRA's action in this situation (adopting WTCPUA's rates and imposing an additional fee on its remaining wholesale customers) also confirms that it is not interested in being an alternative supplier.

2. Are There Other Disparate Bargaining Power Factors?

a. Change in Connection Fee

Effective on November 1, 2012, less than 6 months after TCMUD 12 entered into the Transfer Agreement with LCRA and WTCPUA, and shortly after WTCPUA took over operations of the West Travis County Water System, WTCPUA changed TCMUD 12's Connection Fee (aka Water Impact Fee) by increasing it from \$4,120 per LUE to \$5,992 per LUE.¹⁵⁹ This change of rate was contrary to the express terms of the TCMUD 12/LCRA/WTCPUA Transfer Agreement, which limited WTCPUA's authority concerning the Connection Fees to the *collection*, but not the *setting* of that rate.¹⁶⁰ This restriction on WTCPUA's authority to set a new Connection Fee was not a minor provision of the Transfer Agreement, but instead is restated **three** times in paragraph 3 of the Transfer Agreement.¹⁶¹ And

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*, at 16:23–17:2; and WTCPUA Exhibit No. 1 (DiQuinzio Direct) at 12:11–20.

¹⁵⁹ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 11:1–11 and at JAD Exhibit 11 (WTCPUA Order Adopting Water Impact Fees, Nov. 1, 2012).

¹⁶⁰ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 10:19–30, and at JAD Exhibit 5, page 3 of 8, para. 3.

¹⁶¹ *Id.* at JAD Exhibit 5, page 3 of 8, para. 3: "LCRA desires . . . to delegate to the PUA the authority to **collect the Connection Fees** . . . and the authority to set and collect the Monthly Charges and Volume Rates . . . (collectively the 'Water Services Contract Fees')") * * * "Subject to the foregoing, and provided that all **Connection Fees are collected** and credited and all Water Services Contract Fees are set, collected, and credited

yet, WTCPUA ignored this contractual provision because, as a monopolist and due to its disparate bargaining power, it could. TCMUD 12 did not protest that change of rate (Connection Fee) but WTCPUA's action is additional probative evidence of WTCPUA's disparate bargaining power in its dealings with TCMUD 12.

b. WTCPUA's Offer to Reduce TCMUD 12's Maximum Reserved Capacity

Contemporaneous with notifying TCMUD 12 of the change to the wholesale Monthly Charge and the Volumetric Rate, WTCPUA also proffered a Contract Amendment that WTCPUA touted as providing a means by which TCMUD 12 could reduce its Monthly Charge.¹⁶² The details of WTCPUA's Contract Amendment offer¹⁶³ provide additional evidence of WTCPUA's significantly greater bargaining power.

First, WTCPUA's offer provided an extremely limited time for TCMUD 12 to respond – 10 days, which generously included the Christmas holidays.¹⁶⁴

Second, the standard Contract Amendment offered by WTCPUA to TCMUD 12, would have lowered TCMUD 12's Monthly Charge *only* by reducing the Districts' Maximum Day Reservation under the Wholesale Water Services Agreement, and that was problematic for two reasons:

(a) TCMUD 12 is a very young district, and to voluntarily give up water rights during the worst drought in the history of Texas, would have been foolish, especially since The Highlands is growing and expects to need the full capacity commitment under the Wholesale Water Services Agreement in 7 – 10 years, or by 2022 – 2025.¹⁶⁵ Full capacity for TCMUD 12

in strict accordance with the terms of the Water Services Contract, the District agrees that the LCRA may delegate to the PUA authority **to collect the Connection Fees** and to set and collect the Water Services Contract Fees under the Water Services Contract.”

¹⁶² *Id.* at 11:23–12:3, and at JAD Exhibit 13 (WTCPUA Dec. 3, 2013 Notice of Wholesale Water Rate Change).

¹⁶³ TCMUD 12 Exhibit No. 23 at HC 0775 – 0778, and 0782; and WTCPUA Exhibit No. 1 (Rauschuber Direct) at 209 – 214, Attachment Q (WTCPUA Nov. 21, 2013 Resolution Authorizing Negotiation and Execution of Form Amendments).

¹⁶⁴ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 12:1–3, and at JAD Exhibit 13 (WTCPUA's December 17, 2013 Notice of Wholesale Water Rate Change required that both parties execute the contract amendment on or before December 27, 2013.)

¹⁶⁵ WTCPUA Exhibit No. 53.

would be about 1,640 retail water connections, or close to 2,125 LUEs¹⁶⁶ (which is the number of LUEs that were assumed could be served with the maximum daily flow rate of 3,980,000 gallons per day (GPD) capacity under the Raw Water Contract);¹⁶⁷ and

(b) Voluntarily reducing the Max Day reservation would have potentially stranded TCMUD 12's \$1.5 million investment in capacity in the West Travis County Water System.

Third, and **most importantly**, the Contract Amendment would have replaced the provisions in the Wholesale Water Services Agreement that established the methodology for setting the Monthly Charge¹⁶⁸ and the Volume Rate¹⁶⁹ and replaced them with provisions that describe WTCPUA's new methodologies for setting the 2014 Rates, thereby incorporating new methodologies into TCMUD 12's contract for wholesale water service and depriving TCMUD 12 of the rate methodologies contained in the Agreement.

The WTCPUA Resolution authorizing the General Manager and Board President to negotiate and execute amendments to wholesale agreements in the form of the standard amendment, explicitly states that the purpose of the Amendment is to "effect these capacity changes and *establish wholesale rate methodology*."¹⁷⁰ So, WTCPUA's suggestion that TCMUD 12 could have *reduced* its Monthly Charge is a subterfuge that would have deprived TCMUD 12 of the value of its \$1.5 million investment in the West Travis County Water System, and contractually bound TCMUD 12 to a new methodology for setting rates that benefits WTCPUA and is detrimental to TCMUD 12. The proffer of the Contract Amendment, when understood in this light, evidences WTCPUA's disparately greater bargaining power. As discussed in Section VII. C., below, changes to the revenue requirement and rate methodologies implemented with the 2014 rates also evidence WTCPUA's abuse of monopoly power.

¹⁶⁶ WTCPUA Exhibit No. 51 (1,640 retail water service connections) and WTCPUA Exhibit No. 52 (close to 2,125 LUEs).

¹⁶⁷ Tr. 90-91, and 587-589.

¹⁶⁸ TCMUD 12 Exhibit No. 1 (DiQuinzio) at JAD Exhibit 4, Wholesale Water Services Agreement, Section 4.01.d; and WTCPUA Exhibit No. 2 (Rauschuber Direct) at 212-213, Attachment Q, draft Contract Amendment para. 3 (including (x), (Schedule B), and (xx)).

¹⁶⁹ TCMUD 12 Exhibit No. 1 (DiQuinzio) at JAD Exhibit 4, Wholesale Water Services Agreement, Section 4.01.e; and WTCPUA Exhibit No. 2 (Rauschuber Direct) at 212-213, Attachment Q, draft Contract Amendment para. 3 (including (xxx)).

¹⁷⁰ WTCPUA Exhibit No. 2 (Rauschuber Direct) at 209, Attachment Q (Board Resolution, 3rd Recital).

The details surrounding WTCPUA's Contract Amendment offer are illustrative of the problems TCMUD 12 encountered in trying to deal with the Agency. While the wholesale customer was offered some latitude in the form Contract Amendment to lower the amount of treated water it would get, the significant change that would be wrought by the Contract Amendment was the change in methodology for setting rates. When at least one wholesale customer expressed concerns about the change of methodology, those concerns were ignored by the PUA.¹⁷¹

Although TCMUD 12 declined WTCPUA's offer to amend its wholesale water services contract, WTCPUA nonetheless imposed on TCMUD 12 the new methodology spelled out in the standard contract amendment for the Monthly Charge and Volume Rate. So, while the "choice" to say "no"¹⁷² allowed TCMUD 12 to hold on to its maximum reserved capacity, the significance of declining that part of the offer was offset by WTCPUA unilaterally changing the methodology for determining the Wholesale Water Monthly Charge and Volume Rate.

c. No Opportunity for Meaningful Input Re WTCPUA's Changed Rates

(i) *Change of Methodology Reflected in Form Contract Amendment*

WTCPUA created a "wholesale customer committee" which held meetings between January 2013 and May 14, 2013.¹⁷³ At the end of those wholesale customer committee meetings, Ms. Nelisa Heddin sent a "draft contract amendment" to the wholesale customers for their consideration and required comments and red-line revisions to be returned to WTCPUA within three days, by May 17, 2015.¹⁷⁴ Six months later, without any additional wholesale customer committee meetings, on November 21, 2013, the WTCPUA Board adopted a resolution authorizing the PUA's General Manager and Board President to negotiate and execute contract amendments in substantially the form of the contract amendment included with the Resolution.¹⁷⁵ At that same meeting, the Board also adopted new wholesale monthly charges and

¹⁷¹ Tr. at 271.

¹⁷² Tr. at 36.

¹⁷³ Tr. at 45-46; WTCPUA Exhibit No. 7 (TCMUD 12's Response to RFA 4-19); WTCPUA Exhibit No. 1 (Rauschuber Direct) at 23:4-10. TCMUD 12 did not receive notice of other meetings that may have been held between October 2013 - January 2013.

¹⁷⁴ WTCPUA Exhibit No. 1 (Rauschuber Direct) at Attachment P.

¹⁷⁵ *Id.* at Attachment Q. *See also*, TCMUD 12 Exhibit No. 23 at HC 0775-0778.

volume rates that were determined pursuant to Nelisa Heddin's new methodology.¹⁷⁶ Ms. Heddin's draft contract amendment from May 14, 2013 and the standard form contract amendment included in the Board's November 21, 2013 Resolution were virtually identical with respect to the new methodology for determining the Monthly Charge and Volume Rate.

WTCPUA's unwillingness to engage its wholesale customers in any meaningful exchange, let alone negotiation, is illustrated by an email exchange between WTCPUA and some of its wholesale customers, concerning the draft contract amendment emailed to the customers by Ms. Heddin "for consideration" on May 14, 2013.¹⁷⁷ The discussion revolved around one provision in the draft contract amendment that provides as follows: *"If the PUA determines that the District is exceeding the Max Day Reservation the District will be subject to a surcharge as determined by the PUA's service rules and policies."*¹⁷⁸

A wholesale customer questioned what the phrase "PUA's service rules and policies" in the draft contract amendment meant. In response, WTCPUA's general counsel, Ms. Kalisek, explained that it referred to the WTCPUA's 2013 Amended Rate Tariff, and clarified that the tariff "really focused on rules and policies and rates for retail service." Ms. Kalisek went on to state that the contract terms for wholesale agreements "don't fall within the scope of these rules and policies." The wholesale customer then questioned, since there are no provisions in the PUA service rules and policies that apply to wholesale customers, why that provision shouldn't be struck from the draft contract amendment. Ms. Kalisek's response highlights WTCPUA's absolute and disparate bargaining power which to exercised to set the wholesale water service: "That's true the draft [contract amendment] references the tariff for the surcharge and the tariff does not have a provision for this right now. We anticipate making a recommendation to the Board for a tariff amendment on this in the future." In other words the provision which provided for a surcharge to the wholesale customer pursuant to the WTCPUA's *retail* tariff which, according to the PUA's general counsel, did *not* apply to wholesale customers, was nonetheless

¹⁷⁶ WTCPUA Exhibit No. 1 (Rauschuber Direct) at Attachment Q, Sections VIII(A) and (C) at testimony pages 224-226.

¹⁷⁷ TCMUD 12 Exhibit No. 23 at HC 0782.

¹⁷⁸ WTCPUA Exhibit No. 1 (Rauschuber Direct) at Attachment P, testimony page 208. (emphasis added); and at Attachment Q (Board Approved Form Contract Amendment) at testimony page 213.

included in the Board's approved form contract amendment,¹⁷⁹ and the Wholesale Water Services Amendments executed by six of WTCPUA's wholesale customers.¹⁸⁰ There is no evidence that the WTCPUA's *retail* tariff was ever modified to add the surcharge provision, or more importantly for this case, to make the "surcharge" provision applicable to the wholesale customers. The fact that the wholesale customers had no power to negotiate the terms of the Contract Amendment, even when WTCPUA's legal counsel agreed that a provision did not apply to wholesale customers, is clear from this exchange.¹⁸¹

(ii) *No meaningful Dialogue at Wholesale Customer Committee Meetings*

Representatives of TCMUD 12 attended some, but not all, of the "wholesale customer committee" meetings at WTCPUA at which presentations were made by Ms. Heddin. As Mr. Jay Joyce, who attended most of the meetings on behalf of TCMUD 12 where anything of substance was discussed, TCMUD 12 found WTCPUA was unwilling to engage in any meaningful dialogue or exchange of ideas related to the new rates, including the new rate methodology.¹⁸² In his direct testimony, Mr. Joyce explains that the WTCPUA did not provide concrete information on the new rates prior to the last meeting in May, and later notified the wholesale customers in mid-October the rates change would be up for consideration at its November 21, 2013 meeting a little over a month later:

...[D]uring the spring of 2013, TCMUD 12 participated in some of the wholesale water customer meetings held by WTCPUA and voiced several concerns about the rate methodology being considered. However, no agreement or consensus was reached among the parties regarding the method for WTCPUA's rates for wholesale customers before the WTCPUA halted the meetings in May 2013. Although WTCPUA indicated the wholesale customer

¹⁷⁹ WTCPUA Exhibit No. 1 (Rauschuber Direct) at Attachment Q at testimony page 213.

¹⁸⁰ TCMUD 12 Exhibit No. 7 (Hays Co. WCID #1 Second Amendment, Nov. 26, 2013) at p. 3 (2nd para. at top of page); TCMUD 12 Exhibit No. 10 (Hays Co. WCID #2 Second Amendment) at p. 3 (2nd para. at top of page); TCMUD 12 Exhibit No. 13 (Reunion Ranch WCID, First Amendment, Jul. 11, 2013) at p. 3 (2nd para. under subpart (j)); TCMUD 12 Exhibit No. 16 (Senna Hills MUD) at p. 3 (2nd para. under subpart (b-1)); TCMUD 12 Exhibit No. 18 (Lazy Nine MUD #1A, Jan. 15 & 16, 2014) at p. 3 (2nd para. under (ii)); and TCMUD 12 Exhibit No. 20 (Barton Creek West WSC First Amendment, Mar. 17 & 18, 2014) at p. 4 (2nd para. under subpart (b), which includes the same provision and an additional clause excepting emergency situations and water provided through the Interconnection Agreement).

¹⁸¹ TCMUD 12 Exhibit No. 23 at HC 0782. (See also, Ms. Kalisek's additional statement: "If the parties don't agree on the proposed terms for the contract amendments, there is no amendment and service is governed by the terms for the wholesale contracts currently in effect.")

¹⁸² TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 16:9-23.

meetings would resume in August 2013, no additional meetings were held and no communications between WTCPUA and TCMUD 12 occurred until an email from WTCPUA's attorney was sent to TCMUD 12 on October 15, 2013, which notified us that the WTCPUA Board intended to consider action to change wholesale water rates at its November 21, 2013 meeting.¹⁸³

Another example of the lack of meaningful opportunity for discussion is evident from Mr. Joyce's notes from the second to last wholesale committee meeting on May 6, 2013. In addition to the changes to methodology recorded by Mr. Joyce at that meeting, Ms. Heddin told the wholesale customers in attendance that the calculations she was presenting would be reviewed by the WTCPUA Board at their May 23, 2013 meeting with plans to finalize the rates at their June 6, 2013 meeting.¹⁸⁴ When the rates were not finalized at the WTCPUA's June 6 meeting, Mr. DiQuinzio asked Mr. Rauschuber whether the wholesale rate process was complete. Mr. Rauschuber informed Mr. DiQuinzio that "Development of wholesale rates is on-going and as such, not complete. We are in the refinement and contract amendment phases."¹⁸⁵

Subsequent to the October notice TCMUD 12 attempted to get four concerns about the new methodology addressed by WTCPUA. TCMUD 12 did manage to get a meeting with the WTCPUA scheduled on November 8, 2013 and was able to present its concerns to the WTCPUA at that meeting.¹⁸⁶ The WTCPUA, however, did not respond to TCMUD 12's concerns despite WTCPUA General Manager Don Rauschuber stating that they would be addressed.¹⁸⁷

3. Conclusion: If there was disparate bargaining power, does the protested rate evidence WTCPUA's abuse of monopoly power?

WTCPUA and its participating entities, the "Suppliers," abused their monopoly power. The Suppliers have superior bargaining power because they control prices charged, and the supply of water services sold, to TCMUD 12. By contrast, TCMUD 12 lacks any viable alternative means of obtaining the wholesale water services necessary to supply potable water to The Highlands and accordingly has little to no bargaining power. TCMUD 12 had little effective involvement in WTCPUA's establishment of the Protested Rates, including the imposition of

¹⁸³ TCMUD 12 Exhibit No. 3 (Joyce-Direct) at 24:5-14.

¹⁸⁴ WTCPUA Exhibit No. 54, page 108, 2nd para.

¹⁸⁵ TCMUD Exhibit No. 2 (Joyce Direct), JJJ Exhibit 11, at page 45 of 81.

¹⁸⁶ TCMUD 12 Exhibit No. 2 (Joyce Direct) at 24:14-25:2.

¹⁸⁷ *Id.*, at 25:4-25.

new methodologies for calculating the revenue requirement and rates that are protested here. WTCPUA's abuse of its market power adversely affects the Public Interest, and upon the Commission so finding, the Commission should move to the second phase and review WTCPUA's cost of service and set the wholesale water rates.¹⁸⁸

C. Methodology for Computation of Revenue Requirement and Rate (P.U.C. SUBST. R. 24.133(a)(3)(C)).

The purpose of the Commission's bifurcated process is to give deference to wholesale contracts¹⁸⁹ while allowing a purchaser to redress a situation that develops when "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 . . . service because it has entered into a long term agreement with the seller."¹⁹⁰ TCMUD 12 entered into a 40 year contract for wholesale water services and the WTCPUA has unilaterally changed the rate by changing the computation of the revenue requirement or rate from methodology to another.¹⁹¹

Throughout the proceeding, WTCPUA's argued that under P.U.C. SUBST. R. 24.133(a)(3)(C) changes to "revenue requirement methodology" are limited solely to a change between cash and utility basis. But WTCPUA cites no legal authority to support its argument that changes to revenue requirement "methodology" found in P.U.C. Subst. R. 24.133(a)(3)(C) refers only to the Cash and Utility Bases. To the contrary, where that argument has been offered, it has been rejected by the ALJ.¹⁹²

In the *Corsicana* case, the Seller, City of Corsicana, made the same argument that WTCPUA has made here – that evidence of a change between the Cash Basis and the Utility Basis for determining revenue requirement would be necessary to find that Corsicana changed its

¹⁸⁸ TCMUD 12 Exhibit No. 6 at 26:7–18.

¹⁸⁹ Preamble, at 6227, middle column.

¹⁹⁰ Preamble at 6228, bottom of middle column to top of right column.

¹⁹¹ P.U.C. SUBST. 24.133 (a)(3)(C).

¹⁹² See, SOAH Order No. 13 ("the Administrative Law Judge (ALJ) agrees with District 12 that changes in computation methodologies that could adversely affect the public interest are not legally limited to changes between the cash and utility bases for calculating cost of service, and consequently revenue requirement and rates. He also agrees that District 12's pleadings, discovery responses, and prefiled evidence show that there are genuine issues of material fact concerning whether WTCPUA has changed other computational methodologies that might ultimately lead the PUC to conclude that the protested rate adversely affect the public interest.")

revenue requirement or rate methodology.¹⁹³ Like the City, WTCPUA witness Jack Stowe claims that P.U.C. SUBST. R. 24.135(b) limits the change of methodology discussion to changes between the cash basis and the utility basis.¹⁹⁴ In the *Corsicana* PFD, the ALJ squarely addressed this issue as follows:

... are the methodologies specifically mentioned in 30 TAC § 291.1335 – the Cash and Utility Bases for calculating revenue requirement – the only ones to which the Commission was referring in 30 TAC § 291.133(a)(3)(C)? Citing Section 291.135(b), *Corsicana* basically makes that argument. It also claims that the Commission’s decisions in the *McAllen* and *Multi-County* cases affirm its position. The ALJ disagrees with *Corsicana* on that point.¹⁹⁵

The ALJ later concludes in the PFD that the public interest rule does not limit changes between the Cash Basis and the Utility Basis as the only methodological changes that would show abuse of monopoly power:

However, nowhere in those cases [*McAllen* and *Multi-County*] did the Commission conclude that switches between the Cash and Utility Bases were the only methodological changes that might indicate monopoly abuse. Nor did the Commission cite 30 TAC § 291.135 as the source of, much less a limitation on, the meaning of the word "methodology" as used in 30 TAC § 291.133(a)(3)(C). Additionally, nothing in the preamble to the adoption of the wholesale-service rules indicates that the Commission intended to narrowly construe 30 TAC § 291.133(a)(3)(C) as advocated by the ED and *Corsicana*.¹⁹⁶

Other provisions of the Commission’s wholesale water rules¹⁹⁷ provide an alternative interpretation of “methodology” which do not support WTCPUA’s narrow construction of that term as used in P.U.C. SUBST. R. 24.133(a)(3)(C). First, P.U.C. SUBST. R. 24.135(a) references “reasonable methodologies set by contract” in a context that unmistakably indicates a contract may contain alternative methodologies to the Cash v. Utility bases. Second, the use of “cash or utility bases” in P.U.C. SUBST. R. 24.135(b) but not in P.U.C. SUBST. R. 24.133(a)(3)(C) demonstrates that the Commission knows when to specify it is limiting the word “methodology”

¹⁹³ *Corsicana* PFD at 51 and TCMUD Exhibit No. 5, 15:5 – 16:11.

¹⁹⁴ WTCPUA Exhibit No. 3, at 23: 21 - 24: 7.

¹⁹⁵ *Corsicana* PFD at 55, citations omitted.

¹⁹⁶ *Id.*

¹⁹⁷ P.U.C. SUBST. R, Chapter 24, subchapter I.

to only the Cash v. Utility bases and it is inappropriate to imply that the Commission intended to refer only to Cash v. Utility basis when it included the word “methodology” in 24.133(a)(3)(C). Administrative rules are to be construed in the same manner as statutes.¹⁹⁸ In interpreting a statute or rule, effect should be given not only to the terms used, but also to the terms that the drafting body chose *not* to use.¹⁹⁹ P.U.C. SUBST. R. 24.133(a)(3)(C) does not have the same limiting language found in P.U.C. SUBST. R. 24.135(b) and it is improper to “read into” 24.133 words (i.e., Cash or utility basis) that are not in that rule.

Consistent with the cases and rules cited above, the ALJ in this case addressed this issue when ruling on WTCPUA’s Motion for Summary Disposition:

Reading § 24.133(a)(3)(C) in context, the Administrative Law Judge (ALJ) agrees with District 12 that changes in computation methodologies that could adversely affect the public interest are not legally limited to changes between the cash and utility bases for calculating cost of service, and consequently revenue requirement and rates.²⁰⁰

Accordingly, changes between the Cash and Utility Bases are *not* the only methodological changes that might indicate monopoly abuse. As discussed in Section VI above, the formulas and methodologies that are used to derive the figures in the revenue requirement or rates may be examined under the Public Interest rule to show a change in methodology.

1. Did WTCPUA change the methodology for the computation of the revenue requirement?

WTCPUA changed the methodologies for the computation of the revenue requirement in setting the wholesale water customers’ Monthly Charge and Volume Rate for 2014.

In the contract between the parties, the methodologies for setting the Monthly Charge and Volume Rate charged by WTCPUA to TCMUD 12 are established.²⁰¹ The WTCPUA’s changes

¹⁹⁸ *Rodriguez v. Service Lloyds Ins. Co.*, 997 S.W.2d 248, 254 (Tex.1999); *County of Reeves v. Texas Com’n on Environmental Quality*, 266 S.W.3d 516, 527 (Tex.App.-Austin 2008, no.pet.).

¹⁹⁹ *Cameron v. Terrell & Garrett, Inc.*, 618 S.W.2d 535, 540 (Tex. 1981). See also; *City of Houston v. Swinerton Builders, Inc.*, 233 S.W.3d 4, 12 (Tex.App.-Houston [1st Dist.] 2007, no pet.)

²⁰⁰ SOAH Order No. 13 (Mar. 24, 2015) at 2.

²⁰¹ See, TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 4 (LCRA TCMUD12 Wholesale Water Services Agreement) at Art. IV, Sec. 4.01.d: “The Monthly Charge has been designed primarily to recover District No. 12’s *allocable share* of the capital-related *Costs of the LCRA System* not recovered in the Connection Fee;” Sec. 4.01.e. “The Volume Rate shall be designed primarily to recover the operation and maintenance related *Costs of the LCRA System*, together with any other *Costs of the LCRA System* not recovered through the Connection Fee or the Monthly Charge;” and at Art. I Definitions: “Costs of the LCRA System.”

to the method of allocating costs between the FY 2013 and FY 2014 revenue requirements is a “change of revenue requirement methodology” as that term is used in P.U.C. SUBST. R. 24.133(a)(3)(C).²⁰² For example, the Wholesale Water Services Agreement, that establishes the PUA’s rate-setting authority and the methodology for calculating TCMUD 12’s rates, provides in part that costs attributable to the provision of *retail* water service shall *not* be included in TCMUD 12’s rates.²⁰³ And yet, as Mr. Joyce explains, WTCPUA changed the methodology of allocating repair and maintenance costs from “retail-only” in FY 2013 to an allocation method referred to as “Common-to-All” where costs are allocated to all water customers, in addition to “retail-only” in FY 2014. WTCPUA therefore changed the revenue requirement methodology so that TCMUD 12 and other wholesale customers are now bearing those costs, instead of only the retail customers.²⁰⁴ This allocation change is a major change to the revenue requirement methodology used by WTCPUA in 2013 and established in the contract, and evidences WTCPUA’s abuse of monopoly power under P.U.C. SUBST. R. 24.133(a)(3)(C).²⁰⁵ Mr. Joyce’s testimony describes numerous other changes that WTCPUA made to the revenue requirement methodology between FY 2013 and FY 2014, including, for example: allocating costs for untreated water loss to potable water customers for the first time in FY 2014; removing costs for the General Manager, Bookkeeper and Financial Manager from the wholesale water rate analysis in FY 2013, but retaining those accounts in the wholesale water rate analysis in FY 2014; and changing the bases for allocating O&M costs and miscellaneous revenues²⁰⁶ from FY 2013 to FY 2014.

In addition, Schedule 29 of the FY 2013 rate study shows that 2013 revenue requirements were set using historical water usage and a base/extra capacity calculation.²⁰⁷ The same calculations are shown on Schedule 21 of the FY 2014 Final Analysis.²⁰⁸ In 2013, the base

²⁰² TCMUD 12 Exhibit No. 2 (Joyce Direct) at 8:11–10:29.

²⁰³ TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 4, Wholesale Water Services Agreement at 3–4, Art. I Definitions: Costs of the LCRA System.

²⁰⁴ TCMUD 12 Exhibit No. 2 (Joyce Direct) at 1:19–13:18, and JJJ Exhibit 6.

²⁰⁵ TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 17:3–21.

²⁰⁶ TCMUD 12 Exhibit No. 2 (Joyce Direct) at 11–18, and Exhibits JJJ-4, 6, 7, 8, 9, and 10. (E.g. allocation based on time estimates versus allocation based on direct expenses, versus allocation based on salaries, versus allocation based on scheduled projects, etc.)

²⁰⁷ *Id.*, Exhibit JJJ-13, page 47.

²⁰⁸ *Id.*, Exhibit JJJ-14, page 48.

cost of service was tied to the historical average day usage.²⁰⁹ In 2014, the base cost of service was computed by taking the average day and applying an 8% water loss factor for an “adjusted average day.”²¹⁰ Regardless of whether the 8% water loss factor is correct or not, this is a change to the methodology used to calculate the revenue requirement from 2013 to 2014. This represents another major change to the revenue requirement methodology from 2013 to 2014.

2. Did WTCPUA change the methodology for the computation of the rate?

a. The WTCPUA did change the methodology for the computation of the rate.

All wholesale water service rates charged to TCMUD 12, initially by LCRA and from 2012 to 2014 by the PUA, included a minimum monthly charge and a volume charge.²¹¹ This is not surprising since those rate components are required by the Wholesale Water Services Agreement and are the type of rates commonly charged by retail public utilities. The Commission’s Public Interest Rules, however, were written to permit a challenge to the seller’s change to the rate *methodology* even if the rate is still in a form required by the parties’ contract. The mere fact that the rates continue to contain a minimum monthly charge and a volume charge does not mean that the rate methodology used to compute the minimum monthly charge and a volume charge has not changed. The PFD in the *Corsicana* case recognizes that a change in rate methodology may mean a change in the computation of the rate: “Given the common meaning of methodology and the AWWA Manual’s use of the term ‘methodology’ when referring to rate designs, the ALJ concludes that 30 TAC § 291.133(a)(3)(C) is broad enough to include changes in the method of computing a rate design.”²¹²

First, with respect to the volumetric rate, in 2013 WTCPUA charged all of its wholesale water services customers that have their own raw water supply, including TCMUD 12, a uniform \$2.77/1,000 gallons for wholesale water services.²¹³ But in adopting the 2014 Protested Rate, WTCPUA changed the rate methodology so that the wholesale water services customers are charged widely differing volumetric rates per thousand gallons, to wit: \$1.86, \$2.00, \$2.02,

²⁰⁹ *Id.*, Exhibit JJJ-13, page 47, columns 4–6.

²¹⁰ *Id.*, Exhibit JJJ-14, page 48, columns 4–8.

²¹¹ WTCPUA Exhibit No. 5 (TCMUD 12’s Admissions RFA2-2, 2-3 and 2-4.)

²¹² *Corsicana* PFD at 56.

²¹³ TCMUD 12 Exhibit No. 2 (Joyce Direct) at 20:22–30.)

\$2.06, \$2.08, \$2.11, \$2.14 or \$2.35.²¹⁴ WTCPUA changed its rate methodology from a single, uniform volumetric rate for all of its wholesale customers in 2013 to different volumetric rates for each of its wholesale customers in 2014.

Second, the methodology used by the WTCPUA to calculate the minimum monthly rate charged to its wholesale water services customers was changed. Mr. Joyce explains in his direct testimony the methodology WTCPUA used to calculate the 2013 monthly rates and the different methodology used to calculate the 2014 protested minimum monthly rate. The WTCPUA used a simple three-step methodology to set the 2013 Wholesale Monthly Rates, which included: (1) calculate the total wholesale costs; (2) calculate the total wholesale revenues at current rates; and (3) calculate the resulting required rate increase.²¹⁵

For FY 2014 rates, by contrast, the WTCPUA applied an entirely different and much more complex methodology to set the 2014 wholesale monthly rates by:²¹⁶

(1) Separating the total capital cost allocation to TCMUD 12 into Series 2013, Series 2015, and Series 2019, related to the existing or anticipated WTCPUA bond issues;

(2) Adding approximately 6.5% to this total capital cost allocation for Reserve Requirements;

(3) Adding another 2% to the total capital cost allocation for Issuance Costs;

(4) Considering the growth projection in TCMUD 12 each year from 2014 through 2048;

(5) Subtotaling the results from #1, #2, and #3 (capital cost + 6.5% + 2%) and to that subtotal adding another 25% for bond coverage;

(6) Subtotaling the results from #1, #2, and #3 (capital cost + 6.5% + 2%) and from that subtotal subtracting 17% for system-wide impact fee credit;

(7) Taking the subtotal and adding the 25% from #5 and subtracting the 17% from #6 to calculate the total amounts owed by Bond Series (one amount for Series 2013, another for Series 2015, and another for Series 2019); and

²¹⁴ *Id.*, at Exhibit JJJ-14 (p. 52 of 76).

²¹⁵ *Id.*, at 18: 25–20:8, and Exhibit JJJ-12.

²¹⁶ *Id.*, at 21, lines 1–24 and Exhibit JJJ-15.