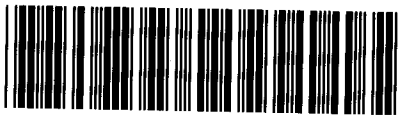

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SOAH DOCKET NO. 473-14-5144.WS
PUC DOCKET NO. 42866

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**

TCMUD 12'S REPLY BRIEF

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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**

TCMUD 12'S REPLY BRIEF

TO THE HONORABLE WILLIAM G. NEWCHURCH:

I. INTRODUCTION

TCMUD 12 entered into a 40 year Wholesale Water Services Agreement with LCRA because LCRA was the only provider of wholesale water services that was capable of providing the potable water services needed by The Highlands. The three Participating Entities, City of Bee Cave, Hays County and TCMUD No. 5, *chose* to create the WTCPUA. The WTCPUA was created in order to, and affirmatively *chose,* to acquire LCRA's West Travis County Water System. That choice included *choosing* to serve LCRA's wholesale water services customers. LCRA was "monopolistic" according to WTCPUA's own recitation of the history of its creation. TCMUD 12, on the other hand, did *not choose* WTCPUA as its wholesale water service provider, but instead was required to not unreasonably refuse to consent to the transfer of its Wholesale Water Services Agreement from LCRA to WTCPUA. TCMUD 12 also had *no choice* other than continuing to take and pay for service from the West Travis County Water System operated by WTCPUA because that service was necessary to the Districts' continued ability to serve their retail water customers in The Highlands.

WTCPUA and its Participating Entities operate as a monopoly, and exercise exclusive control over all, or nearly all, of the supply and the price of wholesale water service in the area in

which TCMUD 12 operates. WTCPUA is also by definition a monopoly under Water Code § 13.001(b). At the time WTCPUA stepped into LCRA's "monopolistic" shoes and became TCMUD 12's wholesale water service provider, TCMUD 12 could not have avoided the rates WTCPUA chose to impose on LCRA's former wholesale customers, even if it had refused to consent to the transfer of the contract to WTCPUA. At the time WTCPUA made the rate decision complained of herein, TCMUD 12 could not have obtained wholesale water service from an alternative provider because no alternative provider existed. None of the hypothetical alternative water service providers suggested by WTCPUA and the other parties, were viable, cost effective, or reasonable alternatives for TCMUD 12 in lieu of WTCPUA.

As a result of the absence of any alternative wholesale water service providers, WTCPUA has disparate bargaining power, which it exercised by changing the computation methodology for its wholesale water service revenue requirement and rates with impunity, secure in the knowledge that TCMUD 12 had no ability to switch to another provider and that TCMUD 12 had to have potable water to serve The Highlands' retail customers. This disparate bargaining power enabled WTCPUA to change the methodologies for computing its wholesale water revenue requirement and rates to the detriment of TCMUD 12. There is no reasonable credible evidence to refute TCMUD 12's contention that the Protested Rates reflect a new, proposed, or changed methodology. But if there is any doubt that WTCPUA's changed the computational methodologies to arrive at the Protested Rates, its own Rate Analysis and form contract amendment explain the changes in detail. The new rate methodology adopted by WTCPUA was *designed* to dramatically increase TCMUD 12's wholesale rates over the next 30 years and that escalating fee is expressly <u>not</u> subject to amendment (unless WTCPUA refunded its bonds). TCMUD 12 had no meaningful opportunity to influence WTCPUA's decision to change to the new methodologies for calculating the revenue requirement and rates that are protested here. WTCPUA's exercise of its disparate bargaining power and changing the methodologies for computing the revenue requirement and rate constitute "substantial breaches of the public interest."

II. <u>PARTIES</u>

The complexities of the arrangement between the three Participating Entities (City of Bee Cave, Hays County and West Travis County MUD 5) and WTCPUA (collectively,

"Respondents"), which make the three Participating Entities necessary parties to this case, are set out in the Acquisition, Water Supply, Wastewater Treatment and Conditional Purchase Agreement.[1] Due to the requirements of the Public Utility Agency Act, Chapter 572, TX. LOCAL GOV'T CODE, WTCPUA conveyed to the Participating Entities by Conditional Sale the water distribution components within the service area of each entity, that had been acquired from LCRA. Because WTCPUA is not able to serve end users directly under the PUA Act, TCMUD 12 is classified somehow in the WTCPUA system as a customer of one of the Participants. TCMUD 12 has no desire to try to unravel or completely understand this complex arrangement, but presents this analysis solely to explain why the three Participating Entities are necessary parties to this case.

There should be no doubt at this juncture that WTCPUA and its Participating Entities are aligned on all legal issues in this case, but Hays County confirms its position by adopting the Initial Brief of the WTCPUA, with which it considers itself aligned.[2]

Challenges by the Respondents to TCMUD 12's role as the designated representative of TCMUD 11, 12 and 13,[3] reflect a startling ignorance of the terms of the Wholesale Water Services Agreement under which the Respondents provide wholesale water service to TCMUD 12 on behalf of the three Districts.

III. PROCEDURAL HISTORY

No reply is offered concerning Procedural History.

IV. GENERAL DESCRIPTION OF PROTESTED RATES

WTCPUA's, the Participating Entities,' and PUC Staff's briefs focus intently on the fact that the 2014 wholesale rate decreased for one year[4] while ignoring the undisputed fact that the new rate methodology adopted in 2013 to be effective initially in 2014, backloads WTCPUA's debt[5] and therefore the methodology is designed and intended to result in higher wholesale rates

[1] TCMUD 12 Exhibit 3 (Zarnikau Direct) at JZ Exhibit 2.

[2] Hays County Brief (hereinafter "Hays Brief") at 3.

[3] Hays Brief at 3 ("MUD 12 *purporting* to represent itself as well as TCMUDs 11 and 13").

[4] Hays Brief at 7; PUC Staff's Brief at 6.

[5] The debt is identified as Series 2013, 2015 and 2019 Bonds. *See,* **TCMUD 12 Initial Brief, Attachment A.** Attachment A is WTCPUA's Response to TCMUD 12's RFP 2-3 pages WTCPUA00009767 – 9769, which is **in**

in subsequent years. It is noteworthy that neither PUC SUBST. R. 24.133 nor the Preamble to the predecessor rule contain any language that supports the argument that a decreased or lower rate prevents a finding that the seller abused its monopoly power. TCMUD 12 is *neither* protesting the subsequent years' rate increases nor asking the Commission to speculate[6] about future rates, but rather this appeal focuses on the 2014 rates as set by the new rate methodology that *WTCPUA designed* [7]to cause rate increases in future years and which WTCPUA has no intention of changing,[8] as well as WTCPUA's exercise of its disparate bargaining power in setting the rates and new rate methodology. If TCMUD 12 had waited to appeal when the rate methodology was designed to result in higher rates in 2015 or later, WTCPUA would undoubtedly argue that the door had closed on TCMUD 12's ability to challenge the change to Rate and Revenue Methodology under P.U.C. SUBST. R. 24.133(a)(3)(C) because the methodology change in 2013 for the 2014 rates is inherently going to remain the same going forward (unless WTCPUA's bonds are refunded).

V. JURISDICTION

Staff affirms[9] and no party disputes that TCMUD 12 timely filed its appeal of WTCPUA's decision affecting rates within 90 days of receipt of notice as required by TEX. WATER CODE § 13.043(f) and P.U.C. SUBST. R. 24.130(c).

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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), which shows that TCMUD 12's Annual Minimum Bill will increase from $97,690.68 in 2014 (the Protested Rate year), to $201,302 in 2015, to $743,460 in 2019, and continue increasing until 2024, based on WTCPUA's methodology for assigning debt per bond issue.) *See, also,* Schedule B "Schedule of Annual Allocated Debt Service Payments" to the Amendments to the Wholesale Water Services Agreements for Hays County WCID #1 and #2, Reunion Ranch WCID, Senna Hills MUD, Lazy Nine/Sweetwater, and Barton Creek West WSC at **TCMUD 12 Exhibit Nos. 7, 10, 13,16, 18, and 20.**

[6] WTCPUA's conclusion at p. 14 of its Brief that "speculative future behavior cannot form the basis for any finding of abusive behavior in fact" should be rejected because neither the statute and the Commission rule that require an appeal to be initiated within 90 days of the seller's decision affecting rates, may occur prior to the effective date of the rates and therefore after a challenge to the rate is filed.

[7] WTCPUA's Brief at 13 mischaracterizes TCMUD 12's appeal as "protesting rates that *it* forecasts would increase in the future", and the mischaracterization is clear from the testimony cited in its brief at pp. 13-14.

[8] *See,* TCMUD 12's Initial Brief at 62.

[9] PUC Staff Brief at 8.

As Hays County correctly notes,[10] the ALJ took jurisdiction over TCMUD 12's Petition pursuant to TEX. WATER CODE §§ 13.043(f) but did not rule on TCMUD 12's claim that jurisdiction over this matter also arises under TEX. WATER CODE §12.013.

VI. THE REQUIRED PUBLIC INTEREST DETERMINATION AND ITS SCOPE

A. The Requirement for an Initial Public-Interest Determination

There is no dispute among the parties that under the Commission's bifurcated Public Interest rules, the scope of this phase of the case is to determine whether the protested rates adversely affect the public interest. There is also no dispute that TCMUD 12, as the purchaser, bears the burden of proof in the public interest phase of this case. The parties have differing interpretations, however, of the weight to be afforded to the evidence and whether a violation of any one of the public interest criteria is sufficient to establish that there has been a substantial breach of the public interest.[11] The PUC Staff has correctly noted[12] that P.U.C. SUBST. R. 24.136 states that if the Commission determines *that at least one* of the criteria has been violated, the Commission *must* find that the rate change violates the public interest.

B. Public Interest Considerations in This Case

The factors that are listed in P.U.C. SUBST. R. 24.133(a)(3), are non-exclusive and other factors may be considered if appropriate. [13] The scope of the record was limited however by SOAH Order No. 13, granting partial summary disposition based on the undisputed fact that because TCMUD 12 did not present evidence concerning the public interest factors listed in P.U.C. SUBST. R. 24.133(a)(1), (2), and (3)(B), (D) – (H) and (4). Hays County's suggestion, notwithstanding SOAH Order No. 13 which granted WTCPUA's Motion for Partial Summary Disposition, that the Commission should consider arguments under P.U.C. SUBST. R. 24.133(a)(3)(G) concerning "the rates charged in Texas by other sellers of water or sewer service for resale"[14] is without merit. First, Hays County's argument represents an impermissible attack

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[10] Hays Brief at 8.

[11] WTCPUA Exhibit No. 76, Preamble at 6228, right column.

[12] PUC Staff Brief at 9.

[13] *Navarro County Wholesale Ratepayers et al v. Zachary Covar, Executive Director of the Texas Commission on Environmental Quality; The Texas Commission on Environmental Quality, its Commissioners, Bryan Shaw, Carlos Rubenstein and Toby Baker, and City of Corsicana,* No. 01-14-00102-CV, (Tex. App. – Houston [1st Dist.] June 25, 2015, Mot. for Reh. filed), Attachment A (hereinafter "*NCWR v. TCEQ.*").

[14] Hays Brief at 4-5.

on the Summary Disposition Order which was issued at the behest of WTCPUA, with which Hays County has admitted it is aligned. Hays County did not participate in the Dispositive Motion filings at the time WTCPUA's Motion was filed and should not now be allowed to advance an argument that is contrary to the partial summary judgment disposition Order. Second, assuming *arguendo* that Order No. 13 does not preclude consideration of Hays County's argument, then Hays County has misconstrued P.U.C. SUBST. R. 24.133(a)(3)(G) by applying it to rates charged in previous years.

Hays County also mis-states SOAH Order No. 13 when it argues that SOAH has determined that P.U.C. SUBST. R. 24.133(a)(3)(A) and (C) are the *only* public interest considerations in this case.[15] SOAH Order No. 13 disposes of matters that could have been raised under P.U.C. SUBST. R. 24.133(a) (1), (2), and (3)(B), (D) – (H) and (4), but does *not* preclude consideration of other factors that may be considered as appropriate.[16]

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))

WTCPUA's, Hays County's and PUC Staff's Briefs[17] reflect that they continue to cling to the theory that the evidence concerning the changes to rate and revenue requirement methodologies constitutes impermissible cost of service evidence. WTCPUA's arguments that its changes in computation methodologies that could adversely affect the public interest must be legally limited to changes between the cash and utility bases for calculating cost of service and consequently revenue requirement and rates, were rejected in SOAH Order No. 13. Similarly, WTCPUA's objections to production of documents concerning the formulas and methodologies that are used to derive the figures in the cost of service studies were ultimately overruled by the Commission.[18]

In its Brief, the WTCPUA argues that through PUC Subst. R. 24.133(b), "the Commission has placed cost of service evidence 'completely off the table' and 'all cost-of-

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[15] Hays Brief at 8.

[16] *NCWR v. TCEQ* at 13.

[17] WTCPUA Brief at 62-66; Hays Brief at 9 ("Hays County's brief will not address public interest arguments that conflict with Texas Public Utility Commission Rule 24.133(b)"; and Staff Brief at 10.

[18] Order on Appeal of SOAH Order No. 6 (Nov. 24, 2014).

service evidence is irrelevant in the public interest hearing.'"[19] In support it its position, WTCPUA cites to page 22 of the Corsicana PFD. Staff also cites to the same page of the Corsicana PFD for the proposition that cost of service evidence is not relevant to a public interest hearing.[20]

But the ALJ's ruling in the Corsicana PFD must not be taken out of context, and it is important to examine the arguments the ALJ in the Corsicana case had before him when he excluded cost of service arguments. On the very page cited by both the WTCPUA and the Staff, the ALJ in the Corsicana PFD sets out the kind of arguments that constitute "cost of service" arguments which he later ruled were not relevant to the proceeding:

> When judged under the detailed meaning of "cost of service" set out in 30 TAC § 291.31, many of the arguments put forth by Corsicana and the Ratepayers are clearly cost of service arguments. They directly or indirectly concern whether certain operation and maintenance expenses were used, useful, necessary, and reasonable to provide water service.[21]

This conclusion by the ALJ in the Corsicana PFD is consistent with the preamble to the rule, which addresses why the Public Interest rule does not contain terms such as just and reasonable, not unreasonably preferential, prejudicial or discriminatory. The adopting agency stated "While these terms are traditionally used to invoke a regulatory authority's duty to set *rates that are based upon cost of service*, the circumstances which justify cost of service ratemaking are not present here."[22]

In this case, TCMUD 12 did not make cost of service arguments such as claiming certain expenses were used, useful, necessary, and reasonable to provide water service. Neither the WTCPUA nor the Staff cite to any such argument made by TCMUD 12. In fact, WTCPUA states that there have been no allegations or evidence that the Protested Rates are *not* calculated

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[19] WTCPUA Brief at 64–65.

[20] PUC Staff Brief at 10, f.n. 31 (which incorrectly states that the "TCEQ adopted the ALJ's Proposal for Decision, with minor modifications" in the *Corsicana* case, SOAH Docket No. 582-10-1944. (August 17, 2011) As reflected in the TCEQ Order in the *Corsicana* case, the Commission "considered" but did not adopt the ALJ's PFD. The Commission's Order contains the following Conclusion of Law: #18. The Commission shall not determine whether the protested rate adversely affects the public interest based on an analysis of the seller's cost of service. 30 TAC § 291.133(b).)

[21] Corsicana PFD at 22.

[22] WTCPUA Exhibit 76, at 6228, first column.

to recover WTCPUA's costs.[23]Bee Cave points out in its Brief that TCMUD 12 made no allegations that the resulting rates are unfair, unjust or unreasonable.[24] Bee Cave also affirms in its Brief that TCMUD 12 did not make any arguments claiming that certain expenses were used and useful or just and reasonable.[25] TCMUD 12 has consistently argued and presented evidence that the methods by which the monthly charge and volume rate are computed have changed, and that examination is explicitly allowed by the Public Interest rule.

The Corsicana PFD also provides examples of arguments that were made in that case, that he deemed irrelevant because they are fundamentally cost of service arguments:

> For example, Corsicana's claim that its expenses were exceeding its costs clearly raises questions about whether those expenses were necessary and reasonable. Along those lines the Ratepayers want to argue that the rates they pay are actually covering a portion of Corsicana's cost of providing *wastewater* service; hence, not necessary and reasonable to provide *water* service. Similarly, arguments over whether an expense was incurred too long before or after Corsicana changed its rates anticipate disputes over whether the expense was incurred during the test year and, if it occurred after, whether it was known and measureable when the rates were set.[26]

Unlike the Wholesale purchaser in *Corsicana*, TCMUD 12 did not present evidence of and does not argue in this case that WTCPUA's rates are not just, unreasonable or not used and useful.

Although no citation to the Corsicana PFD is given, WTCPUA echoes additional language from the Corsicana PFD in its Brief.[27] As with the language from the Corsicana PFD discussed above, it is important to put the unattributed language into context. The section of the Corsicana PFD in which the relevant sentence is found opens with the sentence "Throughout the case, the Ratepayers have claimed that the protested rates are not based on Corsicana's cost of service."[28] At the end of the following paragraph, the ALJ writes "The Ratepayers contend that

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[23] WTCPUA Breif at 26.

[24] Bee Cave Brief at 7.

[25] Bee Cave Brief at 9.

[26] *Id.*

[27] Compare the WTCPUA's Brief at 64: "P.U.C. SUBST. R. 24.133(b) specifically, clearly, and unambiguously renders the seller's cost of service legally irrelevant to determining whether the public interest will be adversely affected by the seller's rates" with the language in the Corsicana PFD at 16: "Rules 291.133(b) specifically, clearly, and unambiguously renders Corsicana's cost of service legally irrelevant to determining whether the public interest will be adversely affected by Corsicana's rates."

[28] Corsicana PFD 16.

Corsicana's rates exceed the reasonable cost of serving them and evidence Corsicana's abuse of monopoly power."[29] Again, TCMUD 12 makes no so such arguments here. The ALJ in the Corsicana case was addressing an entirely different set of facts and arguments than the facts and arguments presented by TCMUD 12 in this case. The snippet of the *Corsicana* PFD relied on by WTCPUA, while apparently on point when taken out of context, is not applicable once the totality of the facts are considered.

Moreover the passages of the Corsicana PFD cited in support the WTCPUA's and Staff's arguments must be read while keeping in mind the ALJ's explanation of the rationale behind the prohibition against using cost of service arguments to determine whether the public interest was violated:

> 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.[30]

The WTCPUA also attempts to bolster its position that cost of service arguments are not relevant to this proceeding by citing to portions of the preamble to the Public Interest rule.[31] It is very telling that the WTCPUA chose to apply careful editing to the preamble passage it cited. Of note, the preamble offers guidance in this case in the passage represented by the ellipsis after the first paragraph. The preamble language the WTCPUA chose to omit states:

> The commission reaches this conclusion [that under the adopted bifurcated hearing procedure the commission should not consider cost of service in the determination on public interest] after conducting numerous public meetings where both sellers and purchasers generally agreed that most agreements for the sale of wholesale services are reasonable and are the product of arms length negotiations. However, 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

[29] *Id.*

[30] Corsicana PFD, 17, citing 19 Tex. Reg. 6228-6229.

[31] WTCPUA Brief at 65.

> whether the protested rate reflects this latter type of agreement so much that it invokes the public interest.[32]

Broken down, this passage concludes that most wholesale water service agreements are reasonable. But it also acknowledges that when the agreement is *long term*, the seller may begin to exercise near monopoly power as time goes by *because* the purchaser "substantially has no alternatives" (not "has no alternatives" but "*substantially* has no alternatives"). In those instances, 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."[33] A purchaser therefore, should be able to use the adopted criteria to show whether the protested rate reflects this latter type of agreement (e.g. one where the agreement is long term, the seller has near monopoly power and the purchaser substantially has no alternatives).

One of the adopted criteria, of course, is whether the seller changed the computation of the revenue requirement or rate from one methodology to another. The crux of the issue is whether the seller changed the way it computed the revenue requirement or rate – not whether the revenue requirement or rate was just or reasonable, or used or useful, or whether the rate was supported by the seller's cost of service. In this case, 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.[34] WTCPUA's computation of its revenue requirement and rate changed, as reflected by the changes in the formulas, evidences abuse of monopoly power. As much as the WTCPUA wants to simply wave its hand and dismiss this evidence as a prohibited cost of service analysis, it may not do so by ignoring those portions of the Public Interest rule and preamble that do not support is argument.

Neither WTCMUD No. 5[35] nor Bee Cave[36] address this issue in their respective Briefs. Hays County does not present any argument on the cost of service issue, but instead includes simply states that it will not address public interest arguments that conflict with P.U.C. SUBST. R. 24.1334(b). Hays County's statement presumes that the evidence offered by TCMUD 12 in this case constitute cost of service arguments, but fails to provide any argument or any citations to

[32] WTCPUA Exhibit 76, pg. 6228, bottom of second to top of third column.

[33] *Id.*

[34] P.U.C. SUBST. 24.133 (a)(3)(C).

[35] WTCMUD No. 5 Brief at 9.

[36] Bee Cave Brief, Table of Contents.

legal authority to support its presumption, so in essence Hay County did not address this issue in any meaningful way either.[37]

In addition, the WTCPUA, its Participants, and the Staff do not address the fact that this analysis should be informed by the Commissioners' Order overruling SOAH Order No. 6. While it is not surprising that none of the Respondents would mention the Commission's Order overturning SOAH Order No. 6, it is unclear why the PUC Staff fails to mention the Commission's Order but instead simply reiterates the argument that any evidence relating to cost of providing service is irrelevant and must not be considered[38] and that the change of methodology testimony presented by Mr. Joyce is "an impermissible reliance on cost of service evidence."[39] Although the Commission did not, and indeed need not, explain its reason for granting TCMUD 12's appeal and overturning SOAH Order No. 6, the arguments advanced by TCMUD 12 in its appeal to the Commission provide valuable information for gleaning the import of the Commission's ruling, and the Commission's Order should not be ignored. WTCPUA had objected to RFPs on the grounds that the documents sought were not relevant, based on P.U.C. SUBST. R. 24.133(b). SOAH Order No. 6 sustained the relevance objection and TCMUD 12 appealed. TCMUD 12's Appeal of Order No. 6 argued that the documents were relevant under P.U.C. SUBST. R. 24.133(a)(3)(c). In defending Order No. 6, the WTCPUA argued that all cost of service evidence is irrelevant in the public interest phase of this case.[40] The Commission granted TCMUD 12's Appeal, overturning SOAH Order No. 6 and ordering WTCPUA to produce the items sought in the RFPs. Assuming there is no dispute that the Commission's Order should be given some weight, it is reasonable to conclude that the Commissioners agreed that evidence concerning changes to rate or revenue requirement methodology should not be excluded under P.U.C. SUBST. R. 24.133(b).

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[37] Hays County Brief at 9.

[38] PUC Staff Brief at 9-10.

[39] PUC Staff Brief at 16; Staff also characterizes Mr. Joyce's testimony as encroaching into cost of service territory at p. 17.

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

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

A. Is the WTCPUA a Monopoly?

1. Expert Economist Opinion on this Issue

Your Honor stated in the *Corsicana* PFD, after hearing from two rate consultants and the TCEQ Staff witness, the determination of monopoly power and its abuse would have been better informed by hearing from an economist: "Determining whether a monopoly exists is fundamentally an economic question."[41] "The ALJ is troubled by the lack of expert testimony from an economist on the issue of monopoly, which is fundamentally an economic issue."[42]

TCMUD 12 addressed the ALJ's concern about the lack of expert testimony from an economist on the issue of monopoly by presenting the testimony of Dr. Zarnikau, who holds a Ph.D. and M.A. in economics. Dr. Zarnikau's expert testimony explained what a monopoly is and why the violations of two criteria under PUC SUBST. R. 24.133(a)(3) support TCMUD 12's assertion that WTCPUA abused its monopoly power. Dr. Zarnikau has extensive experience analyzing market power and market restructuring issues, although he has not previously testified about a wholesale water monopoly in Texas.[43] WTCPUA cites in its Brief to three wholesale water rate appeals that were decided by the TCEQ under the bifurcated Public Interest rule, but in none of those was an economist presented to offer expert testimony.

By contrast, WTCPUA presented Mr. Baudino, who like Mr. Stowe, is a rate analyst with no experience in analyzing markets or monopolies.[44] PUC Staff witness, Ms. Graham, similarly brought no experience in analyzing the public interest criteria, and as an engineer, demonstrates no expertise to opine on the existence of a monopoly or the abuse of monopoly power.[45]

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[41] *Corsicana* PFD at 47.

[42] *Corsicana* PFD at 48 (citations to record omitted). (The ALJ went on to state: "Mr. Stowe [purchasers' witness] and Mr. Mullins [seller's witness] have degrees in accounting and deep expertise in a wide variety of water-utility issues. Mr. Dickey [staff witness] was trained in mechanical engineering and has deep experience in water-utility regulatory issues. They clearly are familiar with economic issues and have related expertise, but none of the three is an economist.")

[43] Tr. 227-228.

[44] WTCPUA Ex. 2, Attachment A (Resume of Mr. Baudino which does not list any cases involving Public Interest, Monopoly, Markets, etc. but which lists the subject of his expert testimony appearances as: return on equity, rate of return, cost allocation, cost of service, rate design, etc.) and Tr. 354-357.

[45] Tr. at 401-431.

2. Factors that Establish WTCPUA as a Monopolist

First, as PUC Staff agrees in its Brief, "based on the plain reading of the definition of 'retail public utility' in the Texas Water Code, WTCPUA is a monopoly."[46] 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."[47] 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)[48] and as it is used in Section 13.001(b).[49] 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. WTCPUA does not address this statutory provision in its Brief.

Second, WTCPUA and its three Participating Entities, which Dr. Zarnikau termed "the Suppliers" operate as a monopolist in the provision of wholesale water services to TCMUD 12 under two definitions: As defined by 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 under modern economic theory, the Suppliers *exercise exclusive control over the provision of wholesale water services* to the TCMUD 12 service area.[50]

Third, the key to determining whether Suppliers are a monopoly is not the existence of the contract, but whether they meet the definition of monopoly. There is nothing in either the definition developed in applied economic studies or in case law that provides an exception from being a monopoly if the monopoly power or market power was gained by acquiring a contract

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[46] PUC Staff Brief at 11.

[47] Comparable provisions for electric utilities are found in PURA § 31.001(b)

[48] "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).

[49] *See,* Section V., Jurisdiction, above.

[50] 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.

signed by a different firm or organization.[51] WTCPUA's argument that it is not a monopolist but instead is a "sole-source provider"[52] based on TCMUD 12's decision to enter into the Wholesale Water Services Agreement with LCRA, which was then acquired by WTCPUA, is refuted by Mr. DiQuinzio's testimony explaining how the Wholesale Water Service Agreement came to be executed and by Dr. Zarnikau's expert analysis.

"In the economics literature, a monopoly is a market structure within which one producer (or a 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 entry."[53] It simply does not matter whether such power is obtained through a contract or not. If the supplier has this power, it is a monopoly, regardless of whether this power was obtained through a contract, by offering superior product or service, by excluding competitors, or by whatever means. To the extent LCRA's status is relevant, WTCPUA's own characterization of LCRA as a monopolist[54] should be considered as an admission.

Because WTCPUA's witness, Mr. Baudino focuses on the 2009 Wholesale Water Services Agreement as the primary basis for his opinion that WTCPUA is not a monopoly, he also identified several provisions of the Wholesale Water Services Agreement that he argued a monopoly provider would be highly unlikely to agree to.[55] His list included some,[56] but not all of the contract provisions listed in WTCPUA's Brief at 16-17. TCMUD 12's response to the list of contract provisions Mr. Baudino cites in his testimony as well as those that WTCPUA includes in its Brief is found in Section VII. B. 2. a., Other Disparate Bargaining Power Factors, below.

While WTCPUA concedes that it did not participate in the discussions that lead up to the execution of the LCRA/TCMUD 12 Wholesale Water Services Agreement, in the same paragraph, it also makes the erroneous claims it was the only party that presented any evidence

[51] TCMUD 12 Exhibit No. 6 (Zarnikau Rebuttal) at 16:9- 17:5 and 18:14-26.

[52] WTCPUA Brief at 12.

[53] TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 6 and TCMUD 12 Exhibit No. 6 (Zarnikau Rebuttal) at 5.

[54] TCMUD 12 Exhibit No. 4 (DiQuinzio Rebuttal) at JAD Exhibit R2.

[55] WTCPUA Exhibit No. 2 (Baudino) at 12; cited in WTCPUA Brief at 17.

[56] WTCPUA Exhibit No. 2 (Baudino) at 8 (refers to Sec. 4.01 and 1.01), 9 (refers to Sec. 4.03 and 6.06) and at 10 (refers to Sec. 7.02).

about the relationship between LCRA and TCMUD 12.[57] Mr. Baudino focused on the Wholesale Water Service Agreement even though he had no personal knowledge of the relationship between LCRA and TCMUD 12 in 2008–09. In his review of that Agreement, however, he failed to appropriately analyze or understand the contractual terms, and he could only speculate that TCMUD 12 freely negotiated the contract with LCRA. Not only are the contract provisions he discusses not indicative of TCMUD 12's bargaining power, but Mr. Baudino's conclusion that the provision of the Agreement prove it was freely negotiation, was persuasively rebutted by Mr. DiQuinzio.[58]

The only witness who was involved in the 2008–09 discussions leading up to the execution of the LCRA Wholesale Water Services Agreement was Mr. DiQuinzio. He testified that Mr. Baudino's speculative opinion that there were "voluntary negotiations" was "absurd" and instead, the only meaningful discussion between TCMUD 12 and LCRA was *how* but not *how much* TCMUD 12 was going to pay LCRA for wholesale water service.[59] Based on his extensive experience in Central Texas, Mr. DiQuinzio identified LCRA as the *only* water service supplier capable of serving The Highlands.[60] His declaration that LCRA was the only water service supplier is supported by the fact that in 2008-09, LCRA studied the possibility of constructing a new water treatment plant ("WTP") at The Highlands because there was no other centralized water supplier from The Highlands all the way to the west (near Marble Falls).[61] Mr. Baudino had to speculate about the Wholesale Water Services Agreement because he lacked personal knowledge of the "negotiations" in 2008-09 and he lacked personal knowledge of alternative providers.[62] Finally, Mr. Baudino was apparently unaware, since he made not mention of it in his testimony, that WTCPUA itself described LCRA as monopolistic and that in WTCPUA's dealings with LCRA his client was forced to make significant concessions in order to purchase the West Travis County System.[63]

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[57] WTCPUA Brief at 18.

[58] TCMUD 12 Exhibit No. 4 (DiQuinzio Rebuttal) at 5:18-20.

[59] *Id.*

[60] *Id.* at 4-5.

[61] TCMUD 12 Exhibit No. 4 (DiQuinzio Rebuttal) at 4:14-16; 4:28 – 5:2; and 5:11-14.

[62] Tr. at 352.

[63] TCMUD 12 Exhibit No. 4 at JAD Exhibit R2.

Fourth, another consideration in determining that WTCPUA is a monopoly is the existence of barriers to entry, which makes the wholesale water service market not "contestable." In a non-contestable market, WTCPUA's change to price or quantity of water services is unfettered.[64] One matter that is indicative of a barrier to entry Dr. Zarnikau discussed was WTCPUA and its three Participants' Acquisition and Purchase Agreement, which contractually binds them to: (1) prohibit competing systems; (2) prohibits the three Participants from reselling water to third party wholesalers without consent of WTCPUA and each other; and (3) prohibits the Participants from entering into contracts with any entity other than WTCPUA for water.[65] WTCPUA argues that Dr. Zarnikau's reliance on the "No Competition" provision is "grossly misplaced" because Dr. Zarnikau did not know if this contractual provision was legitimate or enforceable.[66] This argument suggests that the Participants do not have any legal authority to act to prohibit a possible competitor,[67] but that implied suggestion is unsupported by any evidence in this record. More importantly, it also suggests that WTCPUA's position is that the Participants' Acquisition and Purchase Contract included a provision that either had no meaning or was not enforceable.

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[64] TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 8:

[65] TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 8-9 and JZ Exhibit 2, Section 5.08, and Sec. 7.07(h) provide as follows:

> Section 5.08 Other Contracts. The PUA shall not enter into contracts with other persons for the supply of water outside of its service area (as more fully described in Exhibit C) without the prior consent of Water Participants and any Water Participant may withhold its consent in its sole and absolute discretion. The Water Participants may not resell water that they purchase from the PUA to third party wholesalers without obtaining the written consent of the PUA and the other Water Participants. The Water Participants shall not enter into contracts with any entity other than the PUA for supply of water during the term of this Agreement.
>
> Section 7.07 Each Participant further represents, covenants and agrees that in accordance with and to the extent permitted by law: (h) 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.

[66] WTCPUA Brief at 20. In addition, WTCPUA's argument that Dr. Zarnikau relied "extensively and *exclusively*" on the Participant Agreement as support for his opinion that there are formidable barriers to entry rests on a myopic review of his testimony as is evident from the portion of Dr. Zarnikau's Direct testimony to which WTCPUA cites – TCMUD 12 Exhibit No. 3 at 8:14 – 9:13 (referring to the lack of practical viable alternatives to the West Travis County Water System, and the prohibitively expensive cost to build a substitute for the WTCPUA system).

[67] Tr. 249

WTCPUA's conclusion that the "No Competition" provision of the Participants' contract would not prevent TCMUD 12 from seeking an alternate wholesale water service provider[68] also misses the mark. The No Competition and No Other Contracts provisions preclude the Participant suppliers from becoming alternative suppliers and require them to prevent others from doing so. WTCPUA actually concedes that the No Competition provision protects the value of the assets it purchased,[69] but misses the importance of that point. WTCPUA protects its status as a monopoly provider of wholesale water service by contractually limiting the Participants' ability to become or approve others as wholesale water service providers, which creates a contractual barrier to entry. These provisions are clearly intended to limit alternative wholesale water service providers that TCMUD 12 might "seek," thereby helping to ensure the continuation of WTCPUA's monopoly. Dr. Zarnikau's testimony is that the No Competition provision and Section 5.08 in Participants' contract is one of several facts that should be considered in determining that there are barriers to entry.

Assuming the No Competition and No Contracts provisions are successful, and there is no evidence that they have not been, the absence of any alternative suppliers gives WTCPUA unbridled rein to set prices and control quantities. WTCPUA's attempt to tie this argument to the fact that Lakeway MUD provides wholesale water service for Rough Hollow[70] is factually and logically flawed. Lakeway MUD (LMUD) is *not* a competitive alternative for water service to *The Highlands,* located within WTCPUA's Service Area; because the two areas are not hydrologically connected; LMUD does not have the capacity to serve The Highlands; and LMUD has never agreed to serve *The Highlands.*

3. The "Pure Monopoly" Definition WTCPUA Relies Upon is Simplistic and Should Not be Applied in this Public Interest Inquiry

Mr. Baudino's reliance on *Microeconomics: Principles, Problems and Policies* by Campbell R. McConnell, Stanley L. Bure and Sean M. Flynn demonstrates his lack of expertise

[68] WTCPUA Brief at 21 and 36 (characterizing TCMUD 12's discussion of the No Competition provision of the WTCPUA/Participants Acquisition and Purchase Agreement as a "red herring", when it is WTCPUA's gross mischaracterization of Dr. Zarnikau's testimony on this issue that is without any support in the record.).

[69] WTCPUA Brief at 36

[70] *Id.*

[71] This is analogous to the situation in *Corsicana* in which TRWD chose not to sell water to one of the Ratepayers which meant TRWD was not an alternative provider. *Corsicana* PFD at 28 – 34 and Order, FOFs 29-30.

in applied economics. As Dr. Zarnikau explained, the referenced material is a freshman-level economics textbook. Mr. Baudino relied exclusively on this text in formulating his definition of "monopoly market structure."[72]

Mr. Baudino's opinion was based upon the definition of "Pure Monopoly" he obtained from the referenced introductory textbook.[73] A pure monopoly is a rather extreme situation and is merely a hypothetical market structure used because of its simplicity, which includes not needing to be concerned about other existing or potential sources of supply that might materialize at a high price. While Mr. Baudino recites five characteristics of a Pure Monopoly, he applies only three of them: (1) There is a single seller of a good or service; (2) The pure monopolist is a price maker, controlling the total quantity supplied and thus has considerable control over the price of the service; and (3) There is blocked entry to the market, also known as barriers to entry.[74] Mr. Baudino's conclusion follows from his use of this restrictive definition. Applying the more appropriate definition of a dominant firm used in applied economic studies, causes Mr. Baudino's conclusion that WTCPUA is not a monopoly to fail.[75] As Dr. Zarnikau testified: the word "pure" does not appear in P.U.C. Subst. R. 24.133. Mr. Baudino's use of "pure monopoly" is the most restrictive of all shades of monopoly discussed in the economics literature and is not the appropriate standard for the Commission to apply.[76]

By contrast, Dr. Zarnikau's definition, established through court decisions, is more useful and appropriate when examining the public interest under P.U.C. Subst. R. 24.133 because the court decisions were rendered with a similar public interest goal in mind, for the purpose of determining if regulatory oversight over the supplier is warranted:[77] *"a monopoly is a market structure within which one producer (or a 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 entry."*[78] The Public Interest concern in this

[72] TCMUD 12 Exhibit No. 6 (Zarnikau Rebuttal) at JZ Exhibit R9 (Baudino response to RFI 5-4).

[73] TCMUD 12 Exhibit No. 6 (Zarnikau Rebuttal) at 12:20.

[74] WTCPUA Exhibit 2 at 14:1-11 and 15:5-10.

[75] TCMUD 12 Exhibit No. 6 at 4:18-22.

[76] TCMUD 12 Exhibit No. 6 at 4-5.

[77] *Id.* at 12:25 – 13:15.

[78] TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 6 and TCMUD 12 Exhibit No. 6 (Zarnikau Rebuttal) at 5.

case is to determine if WTCPUA, the Supplier, has a sustainable ability to control prices or the quantity of wholesale water services in the market where it serves.[79] Based upon Dr. Zarnikau's definition of monopoly, WTCPUA and its Participating Entities are operating as a Monopoly.[80]

The key distinctions between Mr. Baudino's "pure monopoly" and Dr. Zarnikau's definition are:

- The "pure monopoly" definition requires a single seller, whereas Dr. Zarnikau's definition of "monopoly" permits a group of producers to exercise control.

- The "pure monopoly" definition requires control over the entire quantity of the good or service, whereas Dr. Zarnikau's definition of "monopoly" permits control over a lesser share of the supply, as long as that market share is sufficient to allow the producer(s) to control prices.

- The "pure monopoly" definition requires that entry into the market is "totally blocked" whereas Dr. Zarnikau's definition of "monopoly" requires only formidable barriers to entry, but barriers that must be high enough to permit the producer(s) to control prices within some reasonable range.[81]

In the real world, there is a spectrum of market structures, ranging from pure monopolies to perfect competition. WTCPUA is advocating for the most-restrictive definition possible. TCMUD 12 urges the ALJ to adopt Dr. Zarnikau's more practical definition because even when a supplier controls less than 100% of the quantity in a market and/or entry is not completely blocked, the supplier may nonetheless possess the power to set prices above competitive levels and restrict the competitive options available to buyers.[82]

WTCPUA argues that because LCRA was not the only option for the provision of wholesale water services available to it in 2009, *i.e.,* LCRA was not the "single-seller" referred to in the first prong of the "pure monopoly" definition, LCRA is not a pure monopoly.[83] As

[79] TCMUD 12 Exhibit No. 6 (Zarnikau Rebuttal) at 13.

[80] *Id.*

[81] TCMUD 12 Exhibit No. 6 (Zarnikau Rebuttal) at 5:15 – 6:7.

[82] *Id.* at 6:14-21.

[83] WTCPUA Brief at 23–25.

discussed above, WTCPUA did not persuasively refute TCMUD 12's testimony that LCRA was the only provider of wholesale water service available in 2009. Even if LCRA controlled less than 100% of the market, which is the standard WTCPUA argues should apply, there is no credible persuasive evidence that there was a viable, cost-effective alternative provider available to TCMUD 12 in 2009. LCRA was a monopoly, and WTCPUA stepped into those monopolistic shoes when it assumed operation of the West Travis County Water System and obtained the intangible assets that included, as a part thereof, the wholesale water services contract from LCRA.

Applying the second prong of the Pure Monopoly definition, whether LCRA or WTCPUA had *complete* control over prices and quantities, WTCPUA argues supports a finding that neither LCRA nor WTCPUA was a pure monopoly, in 2009 or in 2012-13, respectively.[84] WTCPUA's analysis rests on Mr. Baudino's speculation that TCMUD 12 had bargaining power in its dealings with LCRA in 2009 concerning the Wholesale Water Services Agreement.[85] His speculation was persuasively rebutted by Mr. DiQuinzio. Applying the proper standard, the evidence supports a finding that LCRA had sufficient share of the services that it was able to control rates.

Moving next to the Transfer Agreement executed by LCRA, WTCPUA and TCMUD 12 in 2012, WTCPUA's contention that it is limited in what it can charge because it is supposed to operate under the terms of the Wholesale Water Services contract is not persuasive evidence that it does not have *complete control* over the prices it charges. As discussed more fully below, WTCPUA has the unilateral right to set the Monthly Charge and Volume Rate at "any time" under Section 4.01.f. of the Wholesale Water Services Agreement,[86] as confirmed by paragraph 3 of the Transfer Agreement. [87] This means WTCPUA alone is the arbiter of whether the rates it sets conform to the terms and conditions of both contracts, at least until the second phase of this proceeding when the Commission will decide if the rates reflect WTCPUA's cost of service. The overwhelming persuasive evidence supports the conclusion that WTCPUA controls the rates, and therefore is a monopoly.

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[84] WTCPUA Brief at 25–29

[85] TCMUD 12 Exhibit No. 4 (DiQuinzio Rebuttal) at 11.

[86] TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 4 page 12 of 27.

[87] TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 5 page 3 of 8.

Finally, Mr. Baudino suggests that WTCPUA's actions in setting the protested rate for 2014, including providing TCMUD 12 the "opportunity" to reduce the quantity of wholesale water services, which it was not obligated to do, evidences that it was not acting as a monopolist.[88] This contention was persuasively refuted by Dr. Zarnikau, who explained that from an economist's perspective, the Suppliers' offering an option to reduce the quantity sold to a buyer has nothing to do with WTCPUA's market position. For example, if the sole supplier of weekly garbage pickup and processing services in a neighborhood offered this deal: it will double the charge to its customer *but* the customer can get a 25% discount to that price if he agrees that garbage will be picked up every *other* week instead of every week. The consumer in that example is getting a lower service option and the garbage provider is exercising monopoly power. Since TCMUD 12 needs the capacity it contracted for to be able to provide potable water to The Highlands, the offer by WTCPUA to reduce the quantity of water does not represent an opportunity of value to TCMUD 12 and does not indicate a change to WTCPUA's market power. [89] See also, TCMUD 12's Initial Brief at 38 – 40.

The third prong of Mr. Baudino's "pure monopoly" definition, whether there was a *total* or *insurmountable* barrier to entry, confirms that this is the most restrictive definition and an inappropriate standard for this public interest inquiry.[90] WTCPUA first focuses on exclusive service franchises, which it claims is not applicable for wholesale water services.[91] If the only way that a wholesale water service provider can be found to be a monopoly is to have an exclusive service franchise – creating a *total or insurmountable* barrier to entry – as WTCPUA's argument suggests, then the Commission would *never* have the ability to find a wholesale water supplier had abused its monopoly power, and the Public Interest rules would be useless. This highlights why the extreme definition of "pure monopoly" should be rejected as the standard for determining if a monopoly exists under 24.133(a)(3).

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[88] WTCPUA Brief at 28 – 29.

[89] TCMUD 12 Exhibit No. 6 (Zarnikau Rebuttal) at 21: 16- 22:8.

[90] WTCPUA Brief at 29 – 32.

[91] WTCPUA acquired LCRA's CCN pursuant to the Utilities Installment Purchase Agreement (TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 8 at page 13 of 124 (The parties shall use their respective best efforts to obtain TCEQ approval for the transfer of CCN No. 11670 as it pertains to the Assets (the "WTC CCN"). WTCPUA also has a service area that includes The Highlands. (WTCPUA Exhibit No. 1 (Rauschuber) at Attachment E.)

WTCPUA next argues that because it does not control the essential resource, i.e., raw water, it does not satisfy the third prong of the definition of pure monopoly. The premise of this argument seems to be that potable water, which WTCPUA does control, is not an essential resource. This argument is meritless and should be rejected.

WTCPUA's Brief concerning the third prong of the pure monopoly definition then turns once again to its argument that there were alternatives available to TCMUD 12 in 2009.[92] TCMUD 12 has addressed that issue extensively in its Initial Brief and in other sections of this Reply Brief and will not repeat its responses here.[93]

WTCPUA's Brief then turns to barriers to entry based on economies of scale.[94] After stating "that ***retail*** public utilities typically have economies of scale, and it is more economic for one utility to provide service within a given market area," WTCPUA concludes with its argument that TCMUD 12 provided no evidence of barriers to entry because of economies of scale.[95] WTCPUA's conclusion is incorrect. Dr. Zarnikau testified that "the construction of multiple competing infrastructures to provide wholesale water services would be inefficient. Reliance upon a single system for these services is likely to provide such services to the areas served by Suppliers at a lower cost (which may, or may not, translate into lower rates). It would be difficult for a new supplier to enter this market and provide these same services at a lower cost than the existing Supplier."[96] Those economies of scale are one source of market power for WTCPUA in this case, and support a finding that it is a monopoly.[97]

Finally, still addressing the third prong of its pure monopoly definition, barriers to entry, WTCPUA discusses oligopolistic markets, which Mr. Baudino explains could exhibit economies

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[92] WTCPUA Brief at 30.

[93] *See,* TCMUD 12's Initial Brief at 27 – 37; and Section VII. B., below.

[94] WTCPUA Brief at 31.

[95] WTCPUA Brief at 31. The quote is from WTCPUA's brief, and is a quote from Mr. Baudino's testimony except the word ***"retail",*** which is bolded and italicized in WTCPUA's brief, does not appear in Mr. Baudino's testimony. In addition, WTCPUA is a retail public utility, and this is a part of their definition of pure monopoly, so WTCPUA should have at least presented some evidence that it is not a pure monopoly because it does *not* enjoy economies of scale and that it is *not* more economic for WTCPUA to provide service within the West Travis County market, instead of concluding, incorrectly as it turns out, that TCMUD 12 failed to present evidence to satisfy WTCPUA's definition.

[96] TCMUD 12 Exhibit No. 6 (Zarnikau Rebuttal at 15)

[97] *Id.*

of scale and high cost of entry but that does not necessarily mean an oligopoly is a monopoly market.[98] Dr. Zarnikau shed some light on and rebutted Mr. Baudino's limited analysis and conclusion. In an oligopoly market structure, the market is dominated by a small number of competitors, and one or more key suppliers must consider the pricing actions of their competitors, since more than one firm affects market prices. Many firms that an economist would classify as having oligopoly power have been found by the courts to be monopolists. While the Sherman Act could be used to attack oligopolistic firms if there is a combining or conspiring to monopolize, oligopolistic markets may be able to raise prices substantially above the competitive level without any explicit agreement or concerted practice.[99] So, contrary to Mr. Baudino's testimony, there are situations where oligopolistic markets could be a monopoly under the proper legal definition.[100]

WTCPUA's support for the most simplistic and restrictive definition of monopoly, a "pure monopoly," should be rejected. Under the proper definition of monopoly used by courts in public interest settings the important consideration is the ability of a single supplier or group of suppliers to control prices.[101] WTCPUA controls the rates for wholesale water services provided to TCMUD 12 and is a monopoly.

4. Conclusion: WTCPUA is a Monopoly and Abused its Monopoly Power in Setting the Protested Rate Which is Adverse to the Public Interest

Contrary to WTCPUA's argument that TCMUD 12 would have the Commission regulate WTCPUA's rates,[102] TCMUD 12's position is that the Commission should determine that the Protested Rate adversely affects the public interest based upon the evidence from this hearing, which persuasively demonstrates that WTCPUA is a monopoly, and that it has abused its monopoly power in providing wholesale water service to TCMUD 12, by exercising its disparate bargaining power and by changing the methodology for computing the revenue requirement and rates. P.U.C. Subst. R. 24.133(a)(3)(A) and (C). Once the Commission determines that the protested rate adversely affects the public interest, the Commission is required by P.U.C. SUBST.

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[98] WTCPUA Brief at 31.

[99] TCMUD 12 Exhibit No. 6 (Zarnikau Rebuttal) at 14-15.

[100] TCMUD 12 Exhibit No. 6 (Zarnikau Rebuttal) at 15.

[101] TCMUD 12 Exhibit No. 6 (Zarnikau Rebuttal) at 6.

[102] WTCPUA Brief at 36 -39.

R. 24.134(b) to remand this docket to SOAH for the second phase of the hearing on the rate. In the second phase of this docket, the Commission will set the rate on a cost of service basis, as required by P.U.C. Subst. R. 24.135, and the Commission will also have authority to continue to determine if the rates set by WTCPUA for three years after the end of the test year period are just, reasonable, nondiscriminatory, etc. pursuant to P.U.C. SUBST. R. 24.137.

Dr. Zarnikau is very familiar with the steps taken by the Texas Legislature and the Commission in the electric utility industry to promote competition and create a more efficient market for electricity resources. He applied some of his insights gleaned from his extensive experience in analyzing WTCPUA's position and in concluding that WTCPUA has market power, and therefore under the Commission's bifurcated public interest process, it would be reasonable for the Commission to take the next step and set the rates WTCPUA charges to TCMUD 12.

WTCPUA cites in its Brief to excerpts from the TNRCC's Preamble for the precursor of the Commission's rules (P.U.C. SUBST. R. 24.128, *et seq.*)[103] but fails to include in its Brief any analysis of the following excerpt from that Preamble, that is directly on point based on the "actual facts" of this case:

> most agreements for the sale of wholesale services are reasonable and are the product of arms length negotiations. However, 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 this latter type of agreement so much that it invokes the public interest.[104]

The evidence adduced at hearing establishes that TCMUD 12 Wholesale Water Services Agreement which was transferred to WTCPUA, is a long term contract, that allows WTCPUA "at any time" to set and collect the wholesale Monthly Charge and Volume rate. WTCPUA is also a monopoly as a matter of law, as PUC Staff confirms. The evidence also establishes that TCMUD 12 substantially has no alternatives to obtain wholesale water service. Accordingly,

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[103] WTCPUA Brief at 38-39; citing to WTCPUA Exhibit 76.

[104] WTCPUA Exhibit No. 76 at 6228 (bottom of middle column to top of right column)

under the "actual facts" of this case, WTCPUA is a monopoly and its actions in setting the Protested Rates pursuant to the Agreement violate the Public Interest.

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. Overview

At the start of the analysis under 24.133(a)(3)(A), and in light of the other parties' arguments, it is essential to consider the time frame in which TCMUD 12 should have identified an alternative wholesale water service provider. The language concerning an alternative provider is one of a non-exhaustive list of matters to be considered as part of the Disparate Bargaining Power factor, which addresses whether WTCPUA's disparate bargaining power evidences abuse of monopoly power *in setting the protested rates*. The time frame inherent in the rule is therefore, when WTCPUA set the protested rate.

WTCPUA's, its Participating Entities' and Staff's arguments would require TCMUD 12 to demonstrate that there were no alternative wholesale water service providers in 2009[105] when TCMUD 12 entered into the Wholesale Water Services Agreement with LCRA; and in 2012 when the Wholesale Water Services Agreement was transferred to WTCPUA; and also in 2013-14, when the WTCPUA changed the rates that are the subject of this Petition. TCMUD 12 does not challenge the ALJ's evidentiary rulings that the history of TCMUD 12's wholesale water service arrangement with LCRA has some relevance to this case, but does challenge the assumption in Respondents' and Staff's briefs that TCMUD 12's selection of LCRA in 2009 somehow proves that WTCPUA does not have disparate bargaining power and/or is not a monopoly.

The Public Interest Rule requires the Commission to determine if WTCPUA had disparate bargaining power in order to determine if that disparate power was exercised in setting the protested rates. In other words, If the 2014 protested rates were the result of WTCPUA's disparate bargaining power there must be a finding that the protested rate evidences WTCPUA's

[105] WTCPUA Brief at 15 (Prior to signing off on the Wholesale Water Services Agreement with LCRA, TCMUD 12 did not met with any other "treated water purveyors") and at 41 ("alternatives existed in 2009 and still exist");- Bee Cave Brief at 5 (referring to "when MUD 12 set out to obtain water services"); Hays Brief at 12; PUC Staff Brief at 11 ("TCMUD 12 failed to adequately explore other options available to it at either the time it entered into the LCRA Wholesale Agreement or at the time the agreement was transferred to WTCPUA.")

abuse of monopoly power, which in turn leads to the conclusion that the protested rate adversely affects the public interest. Whether there were alternative wholesale water service providers available to TCMUD 12 in 2009 has no tendency to make the existence of WTCPUA's disparate bargaining power in setting the 2014 rates more or less probable. The arguments concerning alternative wholesale water service providers that Respondents hypothesize may have existed between 2009 and 2012, is not of any consequence to the determination of whether WTCPUA exercised disparate bargaining power in setting rates in 2013 that were charged in 2014. City of Bee Cave seems to get this finally, by noting "Of course, MUD 12's current contract with the PUA overshadows current alternatives."[106]

In addition, it is not reasonable to interpret this part of the abuse of monopoly power rule in the manner suggested by the Respondents because their arguments would require the purchaser to rebut every hypothetical alternative supplier proposal tossed out by the seller no matter how far-fetched. As the Commission explained in the Preamble to the rule, the public interest inquiry was intended to address those situations in which "*the purchaser substantially has no alternatives to obtain water* ...service *because it has entered into a long term agreement with the seller.* The ... 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."[107] The "actual facts" in this case are: TCMUD 12's Wholesale Water Services Agreement that was transferred from LCRA to WTCPUA is for a term of 40 years, which means it will end in the year 2048.[108] There remain **more than 30 years** on the term of the Agreement between purchaser and seller – an indisputably "long term" which is exactly the type of agreement referred to in the Preamble as invoking the public interest. The protested rate was set in 2013, when WTCPUA changed the methodology for computing its revenue requirement and rates for 2014.

Furthermore, under the terms of the long term Wholesale Water Services Agreement, transferred to the WTCPUA, TCMUD 12 is obligated to pay the Monthly Charge whether or not

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[106] Bee Cave Brief at 5.

[107] WTCPUA Exhibit No. 76 (Preamble) at 6228 (top of right column) (emphasis added).

[108] TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 4 at p. 20 (Section 7.13 – term of Wholesale Water Services Agreement is same as the term for the Raw Water Contract: and at JAD Exhibit 2, page 9 (Section II.A. – Term is 40 years, ending in the year 2048).

it purchases any water.[109] The Monthly Charge protested by TCMUD 12 represented an annual expenditure of $97,690.68 in 2014.[110] There is no provision of the Wholesale Water Services Agreement that would allow TCMUD 12 to avoid paying that Monthly Charge even *if* an alternative provider was found, and *if* TCMUD 12 could afford the alternative; and *if* all the practical problems associated with switching to a hypothetical alternative provider were resolved.

WTCPUA's hypothetical alternatives assumed TCMUD 12 terminated the Agreement.[111] While there is no evidence that TCMUD 12 has even considered terminating the Agreement, there would be costs associated with switching to another provider and terminating the Agreement. As discussed in detail below, TCMUD 12 is not willing to abandon its investment in the West Travis County System. In addition, Mr. Rauschuber confirmed that even if TCMUD 12 terminated the contract in order to switch to an alternative provider, WTCPUA would charge TCMUD 12 under its standard wholesale contract rate for use of the "reserved capacity" that TCMUD 12 is entitled due to its prepayment of Connection Fees.

On the other side of that argument is the fact that WTCPUA is contractually bound to continue providing wholesale water service to TCMUD 12 in strict accordance with the terms of the Wholesale Water Services Agreement. WTCPUA's argument to the contrary notwithstanding, TCMUD 12 is limited by the Agreement to seek an alternative water services supplier only if WTCPUA refused to supply more services than are required by the Agreement[112]and TCMUD 12's demand has not grown sufficiently yet to lead it to seek more services than required by the Agreement.

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[109] TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 4, Section 4.01.d. (District No. 12 also shall pay LCRA a monthly charge ... for each full calendar month after the Effective Date.); contrast 4.01.e. (District No. 12 also shall pay LCRA a volumetric rate . . for diversion, transportation, treatment and delivery of the *actual amount of water delivered* to District No. 12, as measured by the Master Meter at the Delivery Point.)

[110] TCMUD 12 Exhibit No. 1 at JAD Exhibit 13 (Minimum Charge $8,140.89 x 12 = $97,690.68/yr.); and TCMUD 12 Initial Brief Attachment A (which is in evidence as two exhibits: WTCPUA Exhibit 3 (Stowe) at 103-105 (Stowe Attachment E) and TCMUD 12 Exhibit 2 (Joyce Direct) at Exhibit JJJ-15, pp. 14-16.)

[111] Tr. 606.

[112] TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 4 at p. 9 of 27.

This situation is similar to some of the facts in the *Corsicana* case, which Your Honor summarized in the PFD, which is reflected as a Finding of Fact in the Commission's Order, as follows:

> Even if there was another source from which they could obtain water, the [Purchasers] could face large practical, legal and other obstacles to obtaining water from another source. Witnesses for [Purchasers] generally testified that the cost of pipelines, regulatory uncertainty . . . and environmental disturbance due to construction of infrastructure would make it difficult and expensive to obtain water from another source even if one could be found. More specifically, [the Purchasers] have contracts with [the Seller] that require them to pay . . .for at least a minimum amount of water even if they obtain water from another source. [Purchasers] testified that these provisions . . . would make it very expensive for them to switch to another supplier even if they could find one.[113]

The conclusion in *Corsicana,* based on those facts, was that the Purchasers had few or no alternatives to the Seller for obtaining water and Corsicana therefore had disparately greater bargaining power over the Ratepayers.[114] The facts of this case support a comparable conclusion: TCMUD 12 has no alternatives to WTCPUA for obtaining wholesale water service and WTCPUA therefore has disparately greater bargaining power over TCMUD 12. Further, the facts of this case support a finding that WTCPUA, unlike Corsicana,[115] abused its greater bargaining power.

The WTCPUA's and its Participating Entities' arguments rest on hypothetical scenarios that they formulated during cross-examination. The City of Bee Cave characterizes TCMUD 12's evidence about the various changes to methodology as a "throw something against the wall and see if it sticks" process, [116] but that characterization is more aptly applied to Respondents' various scenarios based on hypothetical alternative providers of water services.

TCMUD 12 presented the only testimony based upon a witness' personal knowledge that there is no alternative supplier to the wholesale water services provided under the Wholesale Water Services Agreement. Mr. DiQuinzio's testimony is based upon 32 years of experience in

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[113] *Corsicana* PFD at 27; TCEQ Order at 7 (FOFs 34).

[114] *Corsicana* Order at FOF 24.

[115] *Corsicana* Order at 6 (FOF 25).

[116] Bee Cave Brief at 8.

the central Texas area,[117] and is entitled to considerable evidentiary weight. 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.[118] There is simply no basis for discounting the credibility of Mr. DiQuinzio's testimony which explained why WTCPUA's hypothetical alternatives were not viable, cost effective, or practical. Mr. DiQuinzio's personal knowledge about water service systems in Central Texas is certainly entitled to more weight than Mr. Baudino's speculation that there might exist alternative wholesale water service providers, since Mr. Baudino had no personal knowledge of any such providers. To the limited extent that Mr. Baudino's testimony can be interpreted to state his opinion that there are alternative wholesale water service providers and hence WTCPUA does not have disparate bargaining power, that opinion testimony is conclusory and speculative and does not tend to make the existence of a material fact more probable or less probable.[119]

WTCPUA and the Participating Entities' General Manager, Mr. Rauschuber, in his testimony filed after and purportedly in response to Mr. DiQuinzio's direct testimony, failed to identify a single existing or potential new wholesale water service provider that could serve The Highlands as an alternative to WTCPUA. A review of WTCPUA's Brief Section VII. B. 1. a. "Alternative Wholesale Water Treatment Service providers existed in 2009 and 2012, and still exist today."[120] shows that WTCPUA does not have *a single citation* to any evidence sponsored by WTCPUA. WTCPUA's argument that TCMUD 12 failed to investigate alternatives[121] assumes its hypothetical alternatives are real, viable, affordable, and practical – which they are not. TCMUD 12 successfully carried its burden of proof by presenting evidence in its direct prefiled case that there were no viable, cost effective alternatives to wholesale water service for The Highlands. WTCPUA had the opportunity to present evidence to contradict Mr. DiQuinzio's testimony, but instead presented Mr. Baudino's speculation about unidentified

[117] TCMUD 12 Exhibit No. 4 (J. DiQuinzio Rebuttal) at 10:1-12.

[118] TCMUD 12 Exhibit No. 1 (J. DiQuinzio Direct) at 15:28-32; See also, WTCPUA Exhibit No. 4, TCMUD 12's Response to RFA 1-48 and 1-49 (denying there are alternative wholesale water services to the PUA.

[119] *Coastal Transp. Co. v. Crown Cent. Pet. Corp.,* 136 S.W. 3d 227, 232 (Tex. 2004).

[120] WTCPUA Brief at 41 – 49. All transcript pages cited are for testimony of TCMUD 12's witnesses; and all WTCPUA Exhibits cited are either TCMUD 12's discovery responses, or documents such as the contracts.

[121] WTCPUA Brief at 42-43.

alternatives that TCMUD 12 should have considered. And, WTCPUA failed to have Mr. Rauschuber, who it appears has extensive experience with Central Texas water service providers, identify a single alternative.

Hays County's argument in its brief that "Dr. Zarnikau conceded . . . that his finding that a monopoly exists is based upon assumptions that were provided to him, primarily by Mr. DiQuinzio" patently mischaracterizes the evidence. Mr. Kennedy cites to the transcript at page 276, lines 1-14 and page 277, lines 10-17 in support of this argument. The mischaracterization occurs because Hays County ignores the intervening portions of Dr. Zarnikau's testimony (Transcript page 276, line 25 through page 277, line 9) in which he testified: "In order to find that PUA is a monopoly, I examined a number of factors, including price elasticity of demand, alternative sources of supply, the cost of alternatives. So there's a number of factors that go into the definition for a finding of monopoly. Indeed, one of them is a lack of practical, feasible economic alternatives. And for that portion I relied on Mr. DiQuinzio's testimony." As an expert, it is entirely permissible for Dr. Zarnikau to rely on the facts made known to him at or before the hearing by Mr. DiQuinzio that are of the type reasonably relied upon by economists in forming an opinion on the existence of a monopoly.[122]

PUC Staff faults Mr. DiQuinzio for failing to explore whether other surrounding service providers would be amenable to expanding their facilities in order to provide service to TCMUD 12.[123] However, on the same page of the transcript that Staff cites in its brief in support of this argument, Mr. DiQuinzio testified: "We specifically explored that with Lakeway MUD, which is the only entity that has a system that had any capabilities whatsoever of providing water."[124] In other words, Mr. DiQuinzio's uncontradicted testimony was that only Lakeway MUD had any capability to provide water and TCMUD 12 specifically explored that possibility with LMUD. The evidence concerning possible expansion of the Lakeway Regional Raw Water Transportation System is discussed further below.

Are there other providers of various types of water services, including water utilities in Central Texas? Of course. But there is no evidence that any of them are viable, cost-effective

[122] TRE 703

[123] PUC Staff Brief at 12, citing Tr. at 124:5 – 125:3.

[124] Tr. 124:12-17; and TCMUD 12 Exhibit No. 4 (DiQuinzio Rebuttal) at 4:10 – 14.

alternative providers of wholesale water service with the capacity to serve the Highlands. The parties opposed to TCMUD 12 – i.e., all the parties, including PUC Staff – presented not an iota of evidence to the contrary, but instead offered only speculation on how some of those other water providers could change their systems to be transformed into an alternative wholesale water service provider for The Highlands. Each of the hypothetical "alternative" providers briefed by the other parties is addressed below:

b. WTCPUA's Disparately Greater Bargaining Power: Lack of Alternatives, Unreasonable Cost and Insurmountable Problems

i. Undisputed Facts[125]

Before responding to the points raised by other parties' briefs concerning alternative providers, a few of the basic facts that underpin this issue are identified here:

First, WTCPUA provides wholesale water service under the Wholesale Water Service Agreement to The Highlands, which is an area that includes all of TCMUD 12 and 13, and a portion of TCMUD 11. The Highlands is internally hydrologically interconnected.[126]

Second, Rough Hollow, a development in the portion of TCMUD 11 that is not part of The Highlands, obtains wholesale water service from Lakeway MUD.

Third, WTCPUA delivers potable water to TCMUD 12 for use within The Highlands at the Point of Delivery on Highway 71, as established in the Wholesale Water Services Agreement.[127]

Fourth, TCMUD 12 designed and constructed an "emergency interconnect" consisting of a 12-inch water line connected to a valve in the Rough Hollow portion of TCMUD 11, across a ravine and bridge, and connected to another valve in the TCMUD 11 portion of The Highlands, but the valves have never been opened so water has never flowed through the interconnect.

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[125] *See,* WTCPUA Brief at 44.

[126] *See,* Attachment B, TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 6 (Map depicting MUD Boundaries for 11, 12 & 13, and the two areas known as The Highlands and Rough Hollow and at JAD Exhibit 4 p. 24 of 27 (Exhibit A of the Wholesale Water Services Agreement) showing the Districts Service Area Map and Delivery Point. *See,* also, TCMUD 12 Exhibit No. 1, JAD Exhibit 4 (Wholesale Water Services Agreement) at page 4 of 27 definitions of "Delivery Point" and "District Service Area."

[127] *See,* Attachment A, JAD Exhibit 6 and Exhibit A from the Wholesale Water Services Agreement.

ii. Use of raw water for irrigation to reduce need for wholesale water services

WTCPUA raises a new theory in its brief when it argues that "TCMUD 12 did have the ability to use raw water from a third party for irrigation purposes which could offset a portion of the wholesale water services it needs from LCRA or WTCPUA, but has not chosen to do this."[128] This argument evidences the extreme lengths to which WTCPUA is willing to go, including completely mis-stating the evidence, in its futile quest to identify an alternative wholesale water service provider. In support of this argument, WTCPUA cites to Transcript 64-65, which is Mr. DiQuinzio's testimony under cross-examination by WTCPUA's counsel. Mr. DiQuinzio's testimony on the subject of irrigation water began at page 64, lines 11-12 when he stated:

> "MUD 12 doesn't have any irrigation facilities that use treated water"
>
> After Mr. Klein objected,[129] and re-stated the question, Mr. DiQuinzio responded:
>
> 21 Q (BY MR. KLEIN): Did the -- did the Board of
> 22 Directors of MUD 12,at a public meeting, ever consider
> 23 using raw water for irrigation purposes rather than
> 24 treated water received from the--from LCRA or the PUA?
> 25 Yes or no?
>
> Page 65
> 1 A: It's not quite that simple an answer. Travis
> 2 County MUD 12 does not have any irrigation facilities
> 3 that utilize either treated effluent or raw water.
> 4 There may have been a discussion as to the use of raw
> 5 water by the Rough Hollow South Community homeowner's
> 6 association under their separate raw water contract with
> 7 LCRA for their separate irrigation facilities.

WTCPUA's Brief mis-states this testimony. TCMUD 12 does not have any irrigation facilities that use treated water, and therefore there is no offset that could be obtained by using raw water for irrigation. There is no third party identified in this testimony from whom TCMUD 12 could obtain raw water for irrigation. The Rough Hollow South Community homeowner's association (HOA) [130] buys its raw water from LCRA for irrigation purposes and is a part owner

[128] WTCPUA Brief at 43.

[129] Mr. Klein's objection was not ruled on.

[130] Tr. 619:4-8 (Lakeway Rough Hollow South Community, Inc. is a registered homeowners association and is not affiliated with TCMUD 11 that serves Rough Hollow.)

of the Lakeway Raw Water Transportation System, as discussed below. Contrary to WTCPUA's Brief, TCMUD 12 does not have any irrigation facilities that use treated water, there is no evidence that TCMUD 12 is hydrologically interconnected to the HOA, and there is no evidence that the HOA would allow TCMUD 12 to use the HOA's raw water for irrigation. Therefore, there is *no evidence* to support WTCPUA's argument that TCMUD 12 could reduce its wholesale water services needs by using raw water for irrigation.

iii. Lakeway Regional Raw Water Transportation System, including HCMUD and the Emergency Interconnection

The Lakeway Regional Raw Water Transportation System was purchased by Lakeway MUD ("LMUD"), Hurst Creek MUD ("HCMUD"), TCMUD 11 and Lakeway Rough Hollow South Community, Inc.[131] from LCRA in 2011.[132] Mr. DiQuinzio is the General Manager of TCMUD 11, and was a signatory on the Purchase Agreement, and his testimony related to the Lakeway Raw Water System is based upon his personal knowledge. The four listed entities purchased the Lakeway Raw Water Transportation System because LCRA was divesting itself of a variety of water and sewer system infrastructures, [133] much like their sale of the West Travis County Water and Wastewater System to WTCPUA. The Lakeway Raw Water System consists of facilities that allow the four purchasers' raw water supplies (purchased separately from LCRA) to be withdrawn from Lake Travis and transported to them.[134] The Lakeway Regional Raw Water System does not include any water treatment facilities.

TCMUD 11 is one of the owners of the Lakeway Regional Water Transportation System, and this System provides raw water for the portion of TCMUD 11 that serves Rough Hollow by transporting TCMUD 11's raw water to Lakeway MUD's water services facilities.[135] The

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[131] Tr. 619:4-8 (Lakeway Rough Hollow South Community, Inc. is a registered homeowners association and is not affiliated with TCMUD 11 that serves Rough Hollow.)

[132] WTCPUA Exhibit No. 80.

[133] Tr. at 617:18 – 618:10 When LCRA decided to divest itself of the Lakeway Regional Raw Water System the purchasers decided to buy it in order to ensure the System did not wind up in the hands of an entity that had no relationship to the utilities that were taking raw water service from those facilities.

[134] WTCPUA Exhibit No. 80 at p. 1.

[135] Tr. at 618: 9-12.

Lakeway Raw Water Transportation System is not connected to any facilities that would allow it to be used to serve The Highlands.[136]

For each of the reasons described herein, the Lakeway Regional Raw Water System and its Barge are not an option that could provide an alternative water service for The Highlands and therefore does not obviate WTCPUA's disparate bargaining power.

The Joint Owners of the Lakeway Raw Water Transportation System also entered into an Operating Agreement,[137] which reflects the four owners' percentage share of the system, the capacity of the existing system at an average lake level of 640 msl, [138] and the Right of First Offer.[139] TCMUD 12 is not an owner and has no rights to the Lakeway Raw Water System on its own behalf or on behalf of The Highlands. WTCPUA's and its Participating Entities' speculation that the Lakeway Raw Water Transportation System could provide an alternative to WTCPUA for The Highlands was refuted by the uncontradicted testimony of Mr. DiQuinzio, [140] who explained the following impediments:

a. Under drought conditions, the effective capacity of the barge drops with the lake levels, and to achieve greater capacity, the barge would have to be moved farther out into the Lake, which has physical and cost limitations;[141]
b. In order for TCMUD 12 to purchase any capacity in the barge, the owners would have to consent and if one of the owners wanted to sell some or all of its capacity that owner would be required to offer the other owners the right of first refusal to purchase that capacity;[142]
c. The entire capacity on the barge is spoken for and needed by the owners to transport raw water: LMUD's capacity cannot be sold or they would have no source of raw water for their existing customers; HCMUD can't sell for the

[136] Tr. 619.

[137] WTCPUA Exhibit No. 81.

[138] *Id.*, at Section 3.01: LMUD - 59% (4.0 MGD); HCMUD - 32% (2.2MGD); TCMUD 11 – 2% .144 MGD); and Rough Hollow – 7% (.468 MGD); total capacity is 6.812 MGD based on 4 existing raw water pumps located on the Barge.

[139] *Id.* at 8 (Article VII).

[140] Tr. 597–615

[141] Tr. 600–01 (there is a limit to how far out you can go because it is not practical to extend the electrical cables infinitely, or install the size pumps that would be necessary to overcome the head resistance or to extend the water lines to go back to shore.)

[142] WTCPUA Exhibit No. 81 at Article VII., Section 7.01(a) and (e).

same reason; TCMUD 11 couldn't sell because the Lakeway System provides the only raw water transportation system for the 375 LUEs currently served by TCMUD 11 in Rough Hollow; and Rough Hollow South Community Association's share provides the HOA only source of water for irrigation.[143]

d. As reflected in the Operating Agreement, the System is designed to achieve a capacity of 9 MGD by adding two raw water pumps, with associated electrical and other upgrades and improvements to the System; however, the purchasers had no due diligence information when they acquired the System from LCRA, and now they know that the barge may not be structurally capable of adding any pumps without significant capital improvements and that may not be possible due to the low lake levels.[144] Mr. DiQuinzio confirmed WTCPUA's assumption that the Owners of the Lakeway Raw Water System would expand the capacity only if they needed the additional capacity themselves, and would not expand the capacity in order to sell it to another entity (such as TCMUD 12).[145]

e. The fact that TCMUD 11 is one of the owners of the System does not support the implied suggestion that TCMUD 11 could sell capacity to TCMUD 12 to provide an alternative wholesale water service provider for The Highlands, and TCMUD 11's ownership interest is only 2%, representing only 0.144 MGD at an average lake level of 640 msl, which would be insufficient as an alternative to the 3.98 maximum daily flow WTCPUA is obligated to provide to TCMUD 12.[146]

f. TCMUD 12/The Highlands is not connected to this System and hence the Lakeway Raw Water Transportation System is not now an alternative wholesale water service provider and could not become an alternative provider even *if* capacity was increased by adding 2 new pumps on the barge and *if* the owners were willing to sell that new capacity to TCMUD 12.

TCMUD 12 buys raw water from LCRA that is delivered to The Highlands through the West Travis County Regional Water System Raw Water Intake in Lake Austin. Under the Wholesale Water Services Agreement, TCMUD 12 receives wholesale water services from the intake on Lake Austin, treatment from the West Travis County (now PUA) Water Treatment Plant, and, after transmission from the WTP to the Point of Delivery (POD) on Highway 71, TCMUD 12 transports the treated water through its own 3 mile line to The Highlands.

[143] Tr. 602-03.

[144] Tr. 615.

[145] Tr. 603:7-11.

[146] Tr. 615; Wholesale Water Services Agreement Section 3.03.a..

The Lakeway Regional Raw Water Transportation System provides raw water from Lake Travis, and transports that raw water to the water treatment facilities of LMUD and HCMUD, or directly to the Rough Hollow HOA for use in irrigation, but the Lakeway Regional Raw Water Transportation System does not provide any form of water treatment and does not connect to The Highlands distribution system. The Highlands internal system is not designed to take water from a POD originating from Lake Travis, but instead The Highlands' system is designed with pressure zones to take (and pay) for water that comes out of Lake Austin and is delivered to TCMUD 12 at the POD on Highway 71.

Hays County's and WTCPUA's arguments that the Lakeway Raw Water System and/or Hurst Creek MUD as one of the owners of the Lakeway Raw Water System, presents a possible partner for TCMUD 12 to obtain an alternative wholesale water supply[147] ignores the new facilities that would have to be constructed to make the *barge* an alternative raw water supplier, as well as the cost of those facilities, including the likely need to construct a new barge based on the structural limitations of the existing barge.

Hays County and WTCPUA also ignore the fact the barge alone would not provide water *services* for The Highlands but would be only the first step necessary to provide wholesale water services. WTCPUA's argument is that the Lakeway Regional Raw Water barge "had additional capacity that could be used to *serve* TCMUD 12,"[148] but does not acknowledge the service to which is refers would be neither for potable water nor for the 3.98 MGD of water services WTCPUA is contractually obligated to provide TCMUD 12.[149] WTCPUA's continues to add confusion in the next section of its Brief when it characterizes TCMUD 11's participation in the purchase of the Lakeway Regional Raw Water System as "fatal to TCMUD 12's position" that it

[147] Hays Brief at 11 and WTCPUA's Brief at 45-46 (subsection (iii)(c)) and at 47 (subsection (iv)) and at 53-55 (subsection c. (i)).

[148] WTCPUA Brief at 45.

[149] WTCPUA Brief at 46 WTCPUA's argues that the barge was designed for a capacity of 9.7 MGD, if and when 2 pumps were added, and that would represent *nearly* 3 MGD of additional capacity. WTCPUA then argues that TCMUD 12 does not need the 3.98 MGD of water services capacity it is contractually entitled to receive under the Wholesale Water Services Agreement, implying that the hypothetical *nearly* 3 MGD of capacity that could be added to the Lakeway Regional Raw Water System should suffice for TCMUD 12.

had not engaged in discussions with anyone other than LCRA or WTCPUA for "water treatment services."[150]

In order to be an alternative wholesale water service provider for The Highlands, in addition to acquiring and putting into place either a new barge or adding to the pumps on the current barge, Hurst Creek MUD and the other owners of the Lakeway Regional Raw Water System would also have to expand the capacity of the existing system to serve The Highlands, which would include building a new transmission system, constructing and operating a new water treatment plant, and building a new storage facility in order to provide wholesale water service to The Highlands.[151] If all of those facilities could be built by Hurst Creek MUD, it would be the equivalent of constructing at Hurst Creek, the new Water Treatment Plant and facilities that LCRA researched for The Highlands in 2008 and ultimately rejected because LCRA determined it was financially impractical.

Hays County's suggestion that HCMUD could be transformed into an alternative wholesale water service provider ignores the economic investment such an undertaking would require for either Hurst Creek MUD or TCMUD 12.[152] Hays County's argument that the construction that would have been necessary to make Hurst Creek MUD a viable alternative wholesale water service provider for The Highlands in 2009, or in 2013–14,[153] rests on speculation and selective and incomplete evidence. The only *evidence* concerning the Hurst Creek MUD scenario is set out above, which demonstrates that HCMUD is *not* a viable wholesale water service alternative provider for The Highlands. Hays County cannot transform Hurst Creek MUD into an alternative wholesale water services provider by believing it could be true, and the aligned parties' cross-examination *questions* are not evidence that HCMUD is or could become an alternative wholesale water service provider. WTCPUA's characterization of the Lakeway Regional Raw Water barge as an "option" does not make it one,[154] for each of the reasons provided in Mr. DiQuinzio's thorough testimony on this issue. TCMUD 12's burden of proof does not extend to rebuffing every hypothetical scenario dreamed up by Respondents, no

[150] WTCPUA Brief at 46 (subsection (d)).

[151] Tr. at 126:1-9.

[152] Tr. at 126:1-9.

[153] Hays Brief at 12.

[154] WTCPUA Brief at 48 ("Failing to consider an option does not mean that a viable option does not exist.")

matter how impractical or costly, but Mr. DiQuinzio's testimony on cross-examination about the Lakeway Regional Raw Water System (Barge) effectively debunks each hypothetical, and is credible, persuasive and was not refuted.

Bee Cave joins the refrain that TCMUD 12 should have looked to Lakeway MUD as a viable alternative provider because, the Bee Cave claims, LMUD has a diversion point already constructed and TCMUD 12 would be authorized to divert from that location.[155] While it is true that LMUD has a diversion point and TCMUD 12 is authorized to divert water from Lake Travis and Lake Austin under its LCRA Raw Water Contract,[156] the remainder of the City's argument is not supported by any credible evidence. Instead, the evidence establishes that the Wholesale Water Services Agreement identifies the Point of Delivery for The Highlands on Highway 71, which is not connected to any facilities that extract raw water from Lake Travis. The Highlands and Rough Hollow are not hydrologically connected[157] and the emergency interconnection constructed by TCMUD 12 has neither been used nor authorized for use by WTCPUA or LMUD, and if that authorization materializes someday in the future, it could provide only temporary emergency service. Bee Cave seems to concede the speculative nature of its argument on this point by stating: "This, *arguably,* could be the beginning of interconnectivity that could provide an alternative for MUD 12."[158] Bee Cave also acknowledges that the Respondents' position concerning the emergency interconnect is not supported by evidence, and does not identify any evidence to contradict Mr. DiQuinzio's explanation that Lakeway MUD will not allow the emergency interconnect to be used.[159] In fact, the City agrees that without permission from LMUD and WTCPUA, the hypothetical connection between The Highlands (served by

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[155] Bee Cave Brief at 3-4.

[156] The 2008 Raw Water Contract (TCMUD 12 Exhibit No. 1 at JAD Exhibit 2), terminated a previous raw water contract that TCMUD 11 had with LCRA, as reflected in Section IV.B. (Raw Water Contract page 16) and confirmed by TCMUD 11's Consent (Raw Water Contract Page 22). The portion of TCMUD 11 that is Rough Hollow was served by that previous Raw Water Contract, from the Lakeway Raw Water Intake depicted on page 23 of JAD Exhibit 2 the Raw Water Contract.

[157] Tr. 72:6-9, referring to and explaining TCMUD 12 Exhibit No. 1 at 85 (JAD Exh. 2, p. 23).

[158] Bee Cave Brief at 4 (emphasis added).

[159] Bee Cave Brief at 4: – The City re-states a question asked during the hearing, but concedes that Mr. DiQuinzio did not answer that question, which means there is no evidence on the point raised by the question. In addition, Bee Cave cites to Mr. DiQuinzio's testimony at Tr. 92 that supports the determination that LMUD would not allow the interconnect to be used. No evidence in support of Bee Cave's position is cited in its Brief because none exists.

WTCPUA) and LMUD is not possible.[160] Mr. DiQuinzio was unequivocal that LMUD would not agree to using the emergency interconnection, even in an emergency situation.[161] While TCMUD 12 also never submitted a "written request" to WTCPUA for permission to open the valve on the WTCPUA's side of the interconnection, WTCPUA failed to present evidence in its prefiled testimony to dispute Mr. DiQuinzio's testimony on this point. [162] There is no evidence to support an assumption that WTCPUA would give permission allowing TCMUD 12 to open the emergency interconnection and letting water flow out of WTCPUA's service area, into Rough Hollow.[163]

Bee Cave also muses that it is "left to wonder" why its hypothetical arrangement in which TCMUD 12's emergency interconnect would serve as a permanent alternative for wholesale water service to The Highlands isn't viable.[164] One of the primary reasons is, as reflected earlier in Bee Cave's brief – neither wholesale provider (WTCPUA or LMUD) has consented to that arrangement.[165] In addition, TCMUD 12 does not have the infrastructure to divert raw water from Lake Austin; and neither LMUD nor HCMUD have treatment capacity to treat TCMUD 12's raw water, *if* TCMUD 12 could transmit its raw water to their treatment facilities.

Neither the Lakeway Regional Raw Water System, its Barge, its owners, or TCMUD 12's emergency interconnection, individually or in combination, can provide an alternative water service for The Highlands. The hypothetical scenarios related to each of those facilities therefore do not obviate WTCPUA's disparate bargaining power.

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[160] Bee Cave Brief at 4 ("The only think that's keeping MUD 12 from connecting to Lakeway MUD is getting permission from both entities.")

[161] Add citation to Tr and then: Cf. WTCPUA Brief at 46 (in the middle of its discussion about the emergency interconnect, WTCPUA notes that TCMUD 12 never asked LMUD for additional water services (Tr. 65-66), which does not negate Mr. DiQuinzio's testimony that LMUD refused to grant permission for TCMUD 12 to open the valves of the emergency interconnection.

[162] TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at

[163] WTCPUA Brief at 46-47.

[164] Bee Cave Brief at 5.

[165] Bee Cave Brief at 4.

iv. Problems with TCMUD 12 Construction of its Own Wholesale Water System as An Alternative to WTCPUA

a. TCMUD 12's Rationale for Not Constructing Its Own Water Services System

WTCPUA's argument notwithstanding,[166] the evidence demonstrates that TCMUD 12 did not bury its head in the sand, but based upon the following imminently reasonable considerations decided that constructing its own water services system (intake facilities, transport facilities, water treatment plant, storage, etc.) was not feasible:

- in 2008-09 LCRA had researched the possibility of constructing a new system at The Highlands and determined it would not be financially feasible for the Agency to construct those facilities;
- in 2008-09, The Highlands had no tax base and thus could not have issued bonds to pay for the construction of a new water service system;
- the Districts that serve The Highlands had no ability to make the Developer guarantee the cost of construction for a new water services system;
- once it entered into the Wholesale Water Services Agreement with LCRA in 2009, it was financially invested in the West Travis County Water System and never had a dispute with LCRA that would lead it to explore constructing its own water services system;
- when WTCPUA acquired the West Travis County Water System, TCMUD 12 satisfied itself that its rights under the Wholesale Water Services Agreement would be protected through execution of the Transfer Agreement, and there was not any need to consider constructing its own water services system in 2012;
- in 2013 when WTCPUA changed the methodology for calculating its wholesale rates and revenue requirement for the 2014 rates, that abuse of monopoly power did not change any of the limitations on TCMUD 12's ability to construct its own water services facilities as an alternative to continuing to take service from WTCPUA under the Wholesale Water Services Agreement.

b. The Cost for TCMUD 12 to Construct Its Own System is a Problem that Renders it a Nonviable Alternative

WTCPUA argues that there is no credible estimate of what it would cost for TCMUD 12 to build its own water system.[167] This argument goes to the weight to be given to Mr. DiQuinzio's estimate, but fails to acknowledge the supporting documentation that explained Mr.

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[166] WTCPUA Brief at 47 -48.

[167] WTCPUA Brief at 49 – 51.

DiQuinzio's estimate was contained in one of WTCPUA's exhibits.[168] As discussed above, WTCPUA Exhibit No. 19 was admitted without objection and under TRE 802 "Inadmissible hearsay admitted without objection shall not be denied probative value merely because it is hearsay." WTCPUA's argument in characterizing Mr. Rauschuber's cost estimate as "refuting" Mr. DiQuinzio's high-level cost estimate is also misguided.[169] At a minimum, Mr. Rauschuber's estimate that it would cost $13.5 million to construct a 4.0 MGD water service system at The Highlands[170] demonstrates there would be a *significant* cost associated with that alternative, which is why TCMUD 12 did not and could not undertake that construction.

Next, WTCPUA argues that it is wrong to examine the cost of a 4.0 MGD water service system because TCMUD 12 does not *currently* need 4 MGD of capacity.[171] This argument is illogical. First, WTCPUA's disparate bargaining power exists in large part because of the long-term Wholesale Water Services Agreement with all of the rights, obligations and limitations discussed previously, including TCMUD 12's right to a maximum daily flow of 3.98 MGD from WTCPUA. Second, The Highlands is a young, but rapidly growing development, meaning what its "current" demand at the time of the hearing, has undoubtedly already increased. So, WTCPUA's argument that the only alternative cost consideration must be based on TCMUD 12's current maximum daily demand, requires ignoring the 30 years remaining on the Agreement, and would require evidence – that is not in the record – for a water service system that is too small to serve the growing demand of The Highlands.

In addition, TCMUD 12 prepaid the Connection Fee totaling $1,500,000 as required by the Wholesale Water Services Agreement which entitles it to a small, but significant to TCMUD 12, portion of the capacity in the West Travis County (PUA) Water System.[172] The cost for TCMUD 12 to construct its own Water Treatment Plant and associated facilities is either $13,500,000 or $25,520,000, depending on whether it was WTCPUA's engineer or TCMUD

[168] WTCPUA Brief at 50; WTCPUA Exhibit No. 19.

[169] WTCPUA Brief at 50.

[170] WTCPUA Exhibit No. 1 at 29.

[171] WTCPUA Brief at 51.

[172] TCMUD 12 Exhibit No. 4 (DiQuinzio Rebuttal) at 6:7-21; TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 4, Section 4.01.a. and Exhibit C.

12's engineer estimating the cost for a 4 MGD plant and the associated facilities.[173] Comparing the cost for TCMUD 12's construction of its own alternative water services system, to the investment TCMUD 12 has already made in the West Travis County (PUA) Water System that is required to provide a daily flow of 3.98 MGD,[174] demonstrates the "build it yourself" alternative would be much more expensive than continued use of the PUA Water System. As in the *Corsicana* case, [175] there is no evidence that *if* the build-it-yourself was an alternative, the cost would be less than continuing to buy water services from WTCPUA, and therefore this is not a viable alternative.

Turning next to Bee Cave's Brief, it mis-states PUC Staff Witness Graham's testimony and position concerning her evaluation of the cost for TCMUD 12 to construct its own WTP for The Highlands.[176] In fact, Ms. Graham's testimony was that Mr. DiQuinzio's prefiled direct testimony failed to provide any documentation to support his estimated cost for constructing a new WTP.[177] Her opinion was that without documentation she could not infer that the cost of obtaining alternative service was prohibitively expensive.[178] She also testified that *if there was supporting documentation* to show how Mr. DiQuinzio arrived at the $25.52M estimate she could consider supporting that.[179] However, even though TCMUD 12 provided that documentation in response to a discovery request from WTCPUA, Ms. Graham did not recall receiving any documentation about that estimate after she filed her testimony. That documentation, which explained the basis for Mr. DiQuinzio's $25.52 million cost estimate, is in

[173] TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 5:30; TCMUD 12 Exhibit No. 4 (DiQuinzio Rebuttal) at 7:18-20 and 23; WTCPUA Exhibit No. 19; WTCPUA Exhibit No. 1 (Rauschuber) at 29:12 – 30:7.

[174] WTCPUA Exhibit No. 1 (Rauschuber) at 31:4-5 ("WTCPUA is required to provide wholesale water services to TCMUD 12 up to a maximum daily flow rate of 3,980,000 gallons per day.")

[175] *See, Corsicana* Order at 7, FOF 37: "To the extent that the Ratepayers have alternatives, there is no evidence that the cost of those alternatives would be lower than buying water from Corsicana."

[176] Bee Cave Brief at 3: "Notably, the PUC Staff witness concluded that the supporting documentation provided for how that estimate was calculated was not sufficient to enable her [to] infer that this approach to obtaining alternative water service would be prohibitively expensive. Citation to Tr. 418.

[177] Tr. 418:6-10.

[178] Tr. 418:14-18.

[179] Tr. 418: 21-23.

evidence because WTCPUA offered it into evidence at the hearing, as WTCPUA Exhibit No. 19.[180]

PUC Staff also argues in its Brief that TCMUD 12 provided no corroboration for the $25.52 million estimate; that Dr. Zarnikau did not undertake a full engineering analysis; and then suggests that Mr. DiQuinzio did not personally develop the estimate to build a new system.[181] Staff's attempt to discredit the estimated cost is not persuasive for at least three reasons: As reflected in WTCPUA Exhibit 19 and explained in testimony at the hearing,[182] Mr. DiQuinzio requested the District's engineer to calculate the cost of a new 4 MGD system (although Ms. Graham didn't review that cost estimate); Mr. DiQuinzio as the General Manager for the Districts, is entitled to rely on the Districts' engineer for this type of analysis; and Dr. Zarnikau, an Economist, would not be qualified to perform a "full engineering analysis" as suggested by Staff. Finally, Staff's conclusion in this section of its brief that "Mr. DiQuinzio admitted that the estimate provided to build a new system was a high-end estimate"[183] misquotes Mr. DiQuinzio's prefiled testimony in which he explains the $25.52 million was a "high-level" estimate.[184]

Ms. Graham's testimony dismissing TCMUD 12's cost estimate is entitled to no weight because she lacks the expertise to opine on the matters to which she testified. She received a bachelor's degree in Mechanical Engineering in 1988, but at the time of her testimony in April 2015 she was not a registered professional engineer.[185] More specifically, on cross examination Ms. Graham agreed that she has absolutely no experience or expertise in: (1) construction costs

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[180] WTCPUA Exhibit No. 19. TCMUD 12's engineer provided the $25.52M estimate assuming a cost of $5 per gallon/day for a 4 MGD Plant (=$20,000,000), plus 15 feet of raw water pipe at $80 a linear foot ($1.2 M), and $2,000,000 for a new barge, and 10% for engineering and permitting. WTCPUA lodged a hearsay objection and moved to strike Mr. DiQuinzio's Rebuttal at JAD Exhibit R1,which is the same document as WTCPUA Exhibit No. 19 (TCMUD 12's response to WTCPUA's RFI 2-24.) After obtaining a favorable ruling on that objection, WTCPUA then offered and had admitted into evidence the exact same discovery response that explained how TCMUD 12 arrived at its $25.52M estimated cost to construct a new WTP and associated facilities. There was no objection to the admission of WTCPUA Exh. 19 and pursuant to TRE 802 "Inadmissible hearsay admitted without objection shall not be denied probative value merely because it is hearsay."

[181] PUC Staff Brief at 11-12.

[182] Tr. 96 – 98.

[183] PUC Staff Brief at 13.

[184] TCMUD 12 Exhibit No. 4 (DiQuinzio Rebuttal) at 7: 18-20 and 23.

[185] Tr. 427.

associated with a new water treatment plant or an intake structure;[186](2) evaluating the original cost of a WTP;[187] or (3) the reasonableness of the cost of intake structures, although she recalled reviewing plans for an intake structure on an unidentified river for an unidentified utility.[188] She also did not respond to a discovery request from TCMUD 12 asking her to identify any water rate application or water cost of service application or appeals she had worked or provided assistance on, because her work over approximately 8 years at TCEQ did not involve any contested cases or other matters that would have been responsive to the request.

c. TCMUD 12's Inability to Finance Construction of Its Own System

TCMUD 12 was not in 2013–14 (at the time that WTCPUA changed and implemented the rates protested here) and is still not in any position to shoulder the cost for alternative water service facilities.[189] The Highlands is highly successful and one of the fastest growing developments in Travis County, but its tax base is so small that it could not support a bond issuance of the size that would be needed to construct even a $13.5 million water service system, which is the lower cost estimate for a new WTP as calculated by WTCPUA's general manager. TCMUD 12 and 13 were only recently able to sell their *first* bonds ($2.7 million and $3.0 million, respectively). This illustrates two important points: First, TCMUD 12 would not have been able to issue bonds in 2008–09 to fund the construction of its own WTP because it had no tax base to support issuance of bonds. Second, it is indisputable that if those recently issued bonds were available to fund a new water services system, which they are not, their combined total would not be sufficient to enable TCMUD 12 to fund the construction of a new water services system, even if it cost *only* $13.5 million as estimated by WTCPUA, instead of $25.52 million, as estimated by TCMUD 12.[190]

TCMUD 12 has an authorized maximum allowable bond issuance amount of approximately $84 million.[191] But that "authorized maximum allowable bond issuance" does not mean TCMUD 12 could have built its own WTP and associated facilities in 2009 or in 2013/14.

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[186] Tr. 421.

[187] Tr. 431 (concerning the recent appeal of the City of Austin's water rates in which she testified).

[188] Tr. 428.

[189] WTCPUA argues to the contrary in its Brief at 55 – 57.

[190] TCMUD 12 Exhibit No. 4 (J. DiQuinzio Rebuttal) at 8:19-26.

[191] Tr. at 32; 589 – 591; 623-626 (DiQuinzio Cross and Redirect).

First, the Districts' current ability to issue bonds is best represented by the $5.7 million of combined bonds that Districts 12 and 13 recently issued[192], which is well below the cost of a new water services system for The Highlands. Second, under the Water Code, the combined tax rate in Travis County may not exceed $1.20, and the Districts have a adopted a combined tax rate limit of $0.7725 for both O&M and debt service.[193] Therefore, as Mr. DiQuinzio explained, based on the hypothetical scenario constructed by Mr. Klein, TCMUD 12 could not have issued bonds to pay for a $25.52 million water system because the resulting tax rate would have been $8/$100 assessed value; and if the new water system cost *only* $13.5 million, TCMUD 12 could not have issued that amount of debt either because the resulting tax rate would have been $4.78/$100. Both of those tax rates which would have greatly exceeded the Travis County allowable rate by a considerable amount.[194]

PUC Staff also urges rejection of the evidence that TCMUD 12 could not have paid for a new Water Services System because, Staff argues: TCMUD 12 "invested significant funds in constructing the interconnection with Lakeway MUD"[195] and "invested $1.5 million in the West Travis County Water and Wastewater System . . . money that could have been put toward construction of its own system."[196] First, TCMUD 12's paid $377,000 to design and construct of the emergency interconnect between The Highlands and Lakeway MUD, hardly a significant investment in comparison to the cost of a new water services system.[197] Second, there is no evidence that supports the argument that the $1.5 million invested in the West Travis County Water System, even if combined with the $377,000 for the emergency interconnect, would have been enough to allow TCMUD 12 to construct its own system. Mr. Rauschuber testified that a new TCMUD 12 Water Service System would have cost $13.5 million. However, as Mr. DiQuinzio testified, the $1.5 million that was paid by Rough Hollow Development, Ltd., under the Wholesale Water Service Agreement, would not begin to cover the cost of a new water services system and TCMUD 12 had no ability to require the Developer to invest in any

[192] Tr. 83.

[193] Tr. 625.

[194] Tr. 625-626.

[195] PUC Staff Brief at 12, citing to Tr. at 92:16-25.

[196] Staff Brief at 12.

[197] Tr. 68 – 69.

facilities, let alone to commit the *additional* $12 million that would be necessary to build a Rauschuber-style WTP and associated equipment.[198] Nor could TCMUD 12 have issued bonds to cover the cost of a new water system to serve The Highlands in 2009 based on Travis County Appraisal District's assessed value at that time ($18.5 million) because the resulting tax rate would have been about $8 per $100, well above the Travis County limit of $1.20, and far above the combined tax rate of the Districts ($0.7725).[199] Based on the evidence, there is no support for Staff's conclusion that "These decisions to invest in other possibilities show that TCMUD 12 may not have lacked the money to construct its own system, but that it made business decisions to use its money on other options." Staff's argument rests on both a misunderstanding of the facts of project financing and pure speculation, and cannot be reconciled with the evidence in the record about the practical and legal limitations on TCMUD 12's ability to fund its own water treatment system.

v. Section 3.03c of the Wholesale Water Services Agreement Limits TCMUD 12's Ability to Acquire Wholesale Water Service from a Third Party

Another obstacle for TCMUD 12 obtaining an alternative 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.[200] If TCMUD 12's demand for wholesale water services ever exceeds that amount, 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.[201] 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. 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

[198] Tr. 585 – 587.

[199] Tr. 624 – 626.

[200] TCMUD 12 Exhibit No. 1 (J. DiQuinzio Direct) at JAD Exhibit 4, Section 3.03.a.

[201] TCMUD 12 Exhibit No. 1 at JAD Exhibit 4, Section 3.03.c.