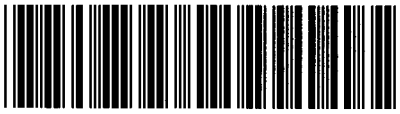

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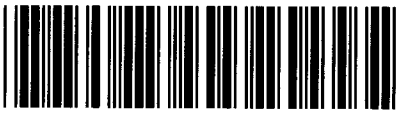

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SOAH DOCKET NO. 473-14-5144.WS
PUC DOCKET NO. 42866

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**

WEST TRAVIS COUNTY PUBLIC UTILITY AGENCY'S RESPONSE TO THE INITIAL BRIEFS AND CLOSING ARGUMENTS

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ATTORNEYS FOR WEST TRAVIS COUNTY
PUBLIC UTILITY AGENCY

August 3, 2015

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TO THE HONORABLE ADMINISTRATIVE LAW JUDGE:

COMES NOW, the West Travis County Public Utility Agency ("WTCPUA") and files this Response to the Initial Briefs and Closing Arguments in accordance with the Administrative Law Judge's ("ALJ") Order No. 17 in this matter.

I. INTRODUCTION

On June 26, 2015 the parties filed their Initial Briefs and Closing Arguments concerning Travis County Municipal Utility District No. 12's ("TCMUD 12") petition appealing the rates adopted by the Board of Directors of WTCPUA on November 21, 2013 (the "Protested Rates") and charged to TCMUD 12 under the Wholesale Water Services Agreement Between Lower Colorado River Authority ("LCRA") and TCMUD 12 ("2009 Agreement") as amended by the Agreement regarding Transfer of Operations of the West Travis County System from the LCRA to the WTCPUA ("2012 Amendment") for diverting, treating, and delivering TCMUD 12's raw water supply ("wholesale water treatment services"). WTCPUA submits this Response to the parties' Initial Briefs and Closing Arguments.

TCMUD 12 has failed to meet its burden of proof under 16 Tex. Admin. Code ("TAC") §§ 24.133(a)(3)(A) and (C) in this matter. Therefore, the Protested Rates, which are the lowest rates that WTCPUA and LCRA have ever charged TCMUD 12 since the parties entered into the 2009 Agreement, cannot be found to adversely affect the public interest.

TCMUD 12 has failed to prove that the WTCPUA, and LCRA before it, holds monopoly power in the provision of wholesale water treatment services to TCMUD 12. The circumstances under which TCMUD 12 selected the LCRA as its sole-source provider of these services in 2008-2009 are germane to the inquiry as to whether the WTCPUA is *now* the holder of monopoly power. TCMUD 12 chose to ignore those historical circumstances and focus only on its academic discussion of monopoly power. The inability of TCMUD 12 to address the 2008-2009 time frame, and its failure to examine the underpinnings of the current relationship (*i.e.*, the 2009 Agreement), as discussed herein and in WTCPUA's Initial Brief, significantly hindered the presentation of its case, and is one of the reasons why TCMUD 12 failed to meet its burden of proof.

In addition to failing to carry its burden vis-à-vis the existence of a monopoly, TCMUD 12 has wholly failed to establish that the Protested Rates evidence any abuse of such alleged monopoly power. Constrained by Order No. 13, TCMUD 12's burden was to show that the Protested Rates evidenced an abuse of claimed monopoly power by establishing the disparate bargaining power of the parties, or that the WTCPUA changed the computation of the revenue requirement or rate from one methodology to another. TCMUD 12 has not carried this burden.

With regard to alleged disparate bargaining power, TCMUD 12's allegations and contentions ignore the obvious fact that alternatives existed in 2009 and exist today, they fail to provide credible evidence regarding the costs of obtaining alternative service, and they invent non-existent problems in obtaining alternative wholesale water treatment services. Further,

TCMUD 12 had and has disparate or at the very least, equal, bargaining power over WTCPUA in 2009 and when the WTCPUA Board of Directors adopted the Protested Rates. TCMUD 12 itself provided evidence of its superior bargaining power in 2008-2009, noting that LCRA had unused capacity in its existing water treatment plant when TCMUD 12 was searching for a water treatment services provider.

All of the WTCPUA's efforts to collaborate with its wholesale customers, including TCMUD 12, in the development of rates through the Wholesale Customer Committee and the 2013-2014 opportunity to amend their existing contracts have been vilified by TCMUD 12. The old adage, "no good deed goes unpunished," certainly rings true here. TCMUD 12 has intentionally twisted and misinterpreted these efforts of the WTCPUA in this case, and it particularly has mis-cast the purpose of the WTCPUA's decision in 2013 to work with all of its wholesale customers and provide them with an opportunity to reconsider and potentially amend their wholesale agreements. Contrary to TCMUD 12's misinterpretation, the purpose of the contract amendments offered in 2013 (which extended into 2014, *after* the adoption and effective date of the Protested Rates), was for the wholesale customers to reconsider and revise (up or down) their respective quantity of reserved wholesale water treatment capacity and living unit equivalent uptake schedules, if necessary.[1] To this end, the outcome of the six Wholesale Customer Committee meetings held in the first half of 2013 was a consensus of the wholesale customers on a formula that they recommended that WTCPUA use in order to allocate costs to the wholesale customers for the upcoming rate order. The impact of including such consensus-based formula in the 2013-2014 contract amendments was to memorialize how the costs would be allocated as of the effective date of the amendment.[2] In any event, TCMUD 12 elected to

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[1] Direct Testimony of Donald G. Rauschuber, P.E., WTCPUA Ex. 1 at 25:6-14 and 24:9-20.

[2] As will be discussed further herein, several wholesale customers decided to amend their contracts *after* the Protested Rates had gone into effect, an opportunity available to, but rejected by, TCMUD 12.

reject the opportunity to increase or decrease the quantity of wholesale water treatment capacity and living unit equivalent uptake schedule, and the contract amendments of 2013 (and continuing into 2014) are not relevant to the Protested Rates, and do not evidence any abusive conduct on the part of WTCPUA. To the contrary, these events show that WTCPUA provided TCMUD 12 (and its other wholesale customers) with choices. Ultimately, the record is void of testimony and exhibits that the Protested Rates evidence an abuse of alleged monopoly power.

Additionally, TCMUD 12 has failed to show that WTCPUA changed either its revenue requirement methodology or rate methodology. TCMUD 12's entire argument for a change in methodology relates to the WTCPUA's allocation of costs, which is part of the cost of service examination that is prohibited in this proceeding pursuant to 16 TAC § 24.133(b). Even if TCMUD 12 were able to show that a change in methodology occurred, TCMUD 12 has failed to provide evidence of any abuse that occurred as a result of such a change. Despite the fact that future rates have been determined to be irrelevant to this proceeding, TCMUD 12 blindly claims that the possible future increase in rates is abusive. TCMUD 12 also mischaracterizes WTCPUA's allocation methodologies as being applied as a term of the contract amendments some customers entered into; however, as noted above, those cost allocation methodologies were always intended to apply to all of the wholesale customers pursuant to each customer's existing contract.

II. DOES THE PROTESTED RATE EVIDENCE WTCPUA'S ABUSE OF MONOPOLY POWER?

A. The WTCPUA is Not a Monopoly.

1. Reply to TCMUD 12.

a. TCMUD 12 ignores the facts.

The WTCPUA is not a monopoly and does not operate as a monopoly, as set forth in great detail in the WTCPUA's Initial Brief. The WTCPUA addressed therein the failure of

TCMUD 12, through its witness Dr. Jay Zarnikau ("Zarnikau"), to pay any attention to the specific facts or to the contractual provisions governing the relationship between WTCPUA and TCMUD 12. Instead, Zarnikau's generalized academic analysis, as repeated in TCMUD 12's Initial Brief and based upon no experience in the water industry,[3] is really an argument that the WTCPUA has created a "situation" that compels oversight of its rates by the regulatory authority. The "situation" is described by TCMUD 12 as "where a supplier has a sustainable ability to control prices or the quantities supplied in a market."[4]

TCMUD 12's misplaced reliance on this non-specific analysis is insufficient to prove either the existence of a monopoly or an abuse of any such alleged power on the part of the WTCPUA. The Public Utility Commission of Texas ("Commission") may not look only at "the situation," but is bound by case law and its rules to examine the facts regarding whether a monopoly exists. The rates that result from the examined facts must then be reviewed to determine whether the protested rates themselves evidence any abuse of monopoly power. TCMUD 12 improperly conflates the two-step process, and argues that "the situation" itself is sufficient to require oversight and regulation by the Commission.[5]

TCMUD 12 erroneously claims that "WTCPUA is the only provider of services for diversion, treatment, and delivery of wholesale water within the water service area of TCMUD 12."[6] The claim is based upon the statement of its witness Zarnikau to that same effect. This statement is simply not true–TCMUD 12 owns the water distribution pipes and all related facilities within its service area, and in fact is the retail utility provider for the subdivisions

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[3] Tr. at 226:24-228:19 (Zarnikau Cross) (Apr. 21, 2015); Tr. at 277:23-278:10; Tr. at 301:15-303:8 (Zarnikau ReCross) (Apr. 22, 2015).

[4] TCMUD 12's Initial Brief at 18 (June 26, 2015). (TCMUD 12's Initial Brief).

[5] *Id.*

[6] *Id.* at 21.

within its service area.[7] Also, a portion of TCMUD 11 (Rough Hollow Subdivision), which is adjacent to TCMUD 12 and uses the same raw water supply as TCMUD 12, is actually provided wholesale treated water services by another provider–Lakeway Municipal Utility District ("Lakeway MUD").[8] WTCPUA merely brings the treated water to the boundaries of TCMUD 12 where the water is metered, and has no involvement in the delivery of water within the water service area of TCMUD 12.

In its Initial Brief, TCMUD 12 followed the same strategy as its witness Zarnikau, to-wit: present a wholly academic argument that fails to address the realities presented by the 2009 Agreement. As revealed at the hearing, Zarnikau was willfully unfamiliar with the 2009 Agreement, which is the written contract that governs the relationship between WTCPUA and TCMUD 12. In fact, he considered the contract to be irrelevant to the fundamental issue in the proceeding, and had no knowledge of the key provisions of this agreement.[9] TCMUD 12's Initial Brief also ignores these contractual provisions. Zarnikau's theory of monopoly is the round hole into which the square peg of reality will not fit.

b. TCMUD 12 has failed to prove that the WTCPUA is the only supplier of services.

In support of its argument that the WTCPUA is a monopoly, TCMUD 12 asserts that the WTCPUA is presently the only supplier of services related to the diversion, treatment, and delivery of water "within the retail water service area of The Highlands."[10] As noted above, the WTCPUA does not provide *any* services within the retail water service area of The Highlands. The fact that the WTCPUA is presently the only supplier of services related to the diversion,

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[7] Direct Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 1 at 5:16-17.

[8] Tr. at 39:9-15 (DiQuinzio Cross) (Apr. 21, 2015).

[9] *See*, Initial Brief of West Travis County Public Utility Agency at 19 (June 26, 2015). (WTCPUA's Initial Brief) and citations included therein.

[10] TCMUD 12's Initial Brief at 22.

treatment, and delivery of water *to* the boundary of The Highlands is the result of TCMUD 12's conscious decision, in 2009, to cast its lot with the LCRA and make the LCRA its sole-source provider of the contracted services. The evidence shows that nothing required either TCMUD 12 or the LCRA to enter into the 2009 Agreement, and nothing required TCMUD 12 to consent to the assignment of the 2009 Agreement to the WTCPUA. As detailed in the WTCPUA's Initial Brief, the LCRA was not the only option for the provision of wholesale water treatment services to TCMUD 12 in 2009, and TCMUD 12 wholly failed to meet its burden of proving the contrary to be the case.[11]

c. TCMUD 12 ignores the 2009 Agreement; WTCPUA does not exercise sole control over the supply of services.

The second factor cited by TCMUD 12 in its brief is its allegation that the WTCPUA exercises sole control over the supply of wholesale water services that TCMUD 12 must obtain in order to provide potable water to its end-use customers.[12] Again, this is simply not the case. Zarnikau's unfamiliarity with the 2009 Agreement caused him to make these erroneous statements upon which the brief is based. The 2009 Agreement:

- requires the LCRA/WTCPUA to treat as much raw water as TCMUD 12 chooses to provide to the treatment facility (Sec. 3.01.a. and 3.03.a);
- does not require TCMUD 12 to obtain all of its raw water treatment services from the LCRA/WTCPUA (Sec. 3.03.c.);
- requires the LCRA/WTCPUA to expand and improve the system as necessary in order to provide adequate services to TCMUD 12 (Recital #6);
- allows TCMUD 12 to seek additional water services elsewhere (beyond the level provided in the agreement) (Sec. 3.03.c.); and

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[11] WTCPUA's Initial Brief at 23-25.

[12] TCMUD 12's Initial Brief at 22 and 24, citing Direct Testimony of Dr. Jay Zarnikau, TCMUD 12 Ex. 3 at 7-8, and 13.

- declares that the LCRA/WTCPUA will be in default if it cannot deliver the services as agreed, and allows TCMUD 12 to go elsewhere to receive the services in that event (Sec. 3.03.c.).[13]

Had Zarnikau paid any attention at all to the contents of the 2009 Agreement–the governing document–he would have discovered that, in fact, TCMUD 12 exercises a great deal of control over the supply of wholesale water services to its area and its customers.[14]

d. TCMUD 12 had, and still has, an opportunity to avoid the Protested Rates.

The only provision of the 2009 Agreement mentioned by TCMUD 12 with regard to its argument on monopoly is Section 3.03.c. Characterized by TCMUD 12 as a "right of first refusal,"[15] this section requires the LCRA/WTCPUA to meet the contractually agreed-upon needs of TCMUD 12, and allows WTCPUA the option of meeting additional needs, as follows:

> c. If the demands of District No. 12 for Wholesale Water Services ever exceed the amount specified in this Agreement, then District No. 12 shall notify LCRA of such shortage and the amount of additional potable water needed. If LCRA is unable to provide the additional water required by District No. 12, District No. 12, at its option, may acquire water from other sources. Further, if at any time LCRA is unable to provide the amount of Wholesale Water Services required by this Agreement, then LCRA will be in default and District No. 12, at its option, may acquire water from other sources, subject to the default provisions of this Agreement provided that District No. 12 has adopted and is enforcing the conservation plan and drought contingency plan required by Section 6.02.[16]

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[13] Direct Testimony of Donald G. Rauschuber, P.E., WTCPUA Ex. 1 at 67 (Attachment G).

[14] The cursory nature of Zarnikau's analysis is thrown into stark relief when compared to the detailed analyses he undertook in the preparation of his testimonies in electric matters. Tr. at 308:5-310:20 (Zarnikau Rebuttal ReCross) (Apr. 22, 2015).

[15] TCMUD 12's Initial Brief at 24.

[16] Direct Testimony of Donald G. Rauschuber, P.E., WTCPUA Ex. 1 at 74 (Attachment G at 8).

TCMUD 12 interprets this provision as essentially capturing TCMUD 12 within the clutches of WTCPUA, when it does nothing of the sort. After a year of extended negotiations, the parties entered into the arms-length agreement in 2009 for a term to run concurrent with TCMUD 12's raw water contract with the LCRA–forty (40) years.[17] If, during that term, TCMUD 12's needs outran the ability of LCRA/WTCPUA to meet them, TCMUD 12 could obtain additional services elsewhere. The fact that TCMUD 12 chose the LCRA as its long-term provider of wholesale water treatment services, and that TCMUD 12 entered into a 40-year contract for a specified level or amount of those services, does not now mean that the WTCPUA is a monopolist provider of wholesale water treatment services. Of course the parties contemplated in 2009 that the LCRA would "continue in that role"[18] as provider of services to TCMUD 12–that was the whole reason for entering into the 2009 Agreement. That is why the WTCPUA is now contractually required until 2048 to meet its service obligations to TCMUD 12 and its other wholesale customers. WTCPUA is not the only provider of these services; it is the only provider that is *contractually obligated* to provide these services. TCMUD 12's attempt to portray WTCPUA as the boogie man because both parties decided to enter into a long-term relationship is insupportable and wrong.

TCMUD 12 argues that the above-quoted contractual provision "would not have permitted TCMUD 12 to seek an alternative supplier of wholesale services when WTCPUA changed the wholesale service rates in 2014, because TCMUD 12's demand for wholesale water service was not anywhere close to the amount specified in the Agreement."[19] TCMUD 12 correctly notes that this same provision exists in other wholesale water agreements transferred to

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[17] *Id.* at 85 (Attachment G at 19, § 7.13), and Direct Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 1 at 71 (JAD Exhibit 2 at 9, § II.A).

[18] TCMUD 12's Initial Brief at 24.

[19] *Id.*

or assigned to WTCPUA, but it is not correct in its broad interpretation of the reach of this provision.[20]

The fact is, every wholesale customer of the WTCPUA, including TCMUD 12, was offered the opportunity to partially or wholly avoid the Protested Rates by reducing their maximum-day reservations with WTCPUA, and look to other providers for these services. WTCPUA witness Mr. Donald Rauschuber ("Rauschuber"), General Manager of the WTCPUA, described this offer on pages 25-26 of his Direct Testimony.[21] Rauschuber noted that as of the date of his testimony (December 19, 2014) six of the 13 wholesale customers had chosen to do so.

Entity	Original Max Day Reservation	Amendment Date	Current Amended Max Day Reservation
Hays County WCID No. 1[22]	345,600 mgd	September 26, 2013	1,221,120 mgd
Hays County WCID No. 2[23]	618,624 mgd	August 14, 2014	1,166,170 mgd
Reunion Ranch WCID[24]	553,000 mgd	March 28, 2014	603,692 mgd
Senna Hills MUD[25]	907,000 mgd	*[26]	575,000 mgd
Lazy 9 MUD[27]	5,068,000 mgd	January 16, 2014	2,080,000 mgd
Barton Creek West WSC[28]	965,952 mgd	March 18, 2014	679,000 mgd

This offer from the WTCPUA was not limited to the time period before the Protested Rates were adopted or became effective, which is what TCMUD 12 would have the Commission

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[20] *Id.* at 24, and fn. 98.

[21] Direct Testimony of Donald G. Rauschuber, P.E., WTCPUA Ex. 1 at 25-26.

[22] TCMUD 12 Ex. 7, 8 and 9. Hays County WCID No. 1 has amended its contract twice. The intermediary amendment occurred on April 1, 2004, increasing the max day reservation to 1,843,200 mgd.

[23] TCMUD 12 Ex. 10, 11, and 12. Hays County WCID No. 2 has amended its contract three times. The intermediary amendment occurred on September 26, 2013, increasing the max day reservation to 1,137,024 mgd.

[24] TCMUD 12 Ex. 14 and 15.

[25] TCMUD 12 Ex. 16 and 17.

[26] Although the contract is not dated, it is uncontested that the contract was entered into after November 21, 2013. Tr. at 485:16-486:10 (Rauschuber Cross) (Apr. 23, 2015).

[27] TCMUD 12 Ex. 18 and 19.

[28] TCMUD 12 Ex. 20 and 21.

believe. Instead, that offer was wide open; it had no expiration date, and it had no limitations on the amount of reduction or increase a customer could request. In fact, the evidence shows that most of the customers who chose to take advantage of this opportunity did so *after* the effective date of the Protested Rates (*i.e.*, January 1, 2014). These customers chose to reduce their maximum capacity reservations armed with the knowledge of what the new rates were, and how the new rates would impact them financially:

- Lazy Nine MUD No. 1A executed the First Amendment to Wholesale Water Services Agreement with the WTCPUA on *January 16, 2014*;[29]
- Barton Creek West Water Supply Corporation executed the First Amendment to the First Revised and Amended Water Services Agreement with the WTCPUA on *March 18, 2014*;[30]
- Reunion Ranch WCID executed the Second Amendment to Water Services Agreement with the WTCPUA on *March 28, 2014*;[31]
- Hays County WCID No. 2 executed the Third Amendment to Water Service Agreement with the WTCPUA as late as *August 14, 2014*;[32] and
- Senna Hills MUD executed the First Amendment to Wholesale Water Services Agreement with the WTCPUA *after November 21, 2013*.[33]

TCMUD 12 had this same opportunity, yet chose to reject it. Having seen the Protested Rates adopted on November 21, 2013, and even after receiving invoices based on the Protested Rates after January 1, 2014, TCMUD 12 still turned up its nose at the offer. TCMUD 12 potentially could have reduced its contracted maximum capacity, and because WTCPUA held no exclusive right to provide wholesale treated water services to any area or any customer, TCMUD 12 would have been free to seek out alternative providers for any amount of treated water

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29 TCMUD 12 Ex. 18.

30 TCMUD 12 Ex. 20.

31 TCMUD 12 Ex. 15.

32 TCMUD 12 Ex. 12.

33 TCMUD 12 Ex. 16; Tr. at 485:16-486:10 (Rauschuber Cross) (Apr. 23, 2015).

services. TCMUD 12's decision to stay the course with WTCPUA and with the capacity reservation identified in 2009 does not thereby render WTCPUA a monopoly.[34]

e. TCMUD 12 has failed to prove the existence of formidable barriers to entry.

TCMUD 12 claims there are "formidable barriers to entry" for alternative wholesale suppliers that could serve The Highlands.[35] The only basis for this statement is Zarnikau's misunderstanding of the Participant Agreement.[36] Having cherry-picked the Participant Agreement as the *only* contract he cared to review, Zarnikau then proceeded to draw completely erroneous conclusions from the document in order to find some support for his "formidable barriers" argument. Zarnikau cited provisions prohibiting the participants (*i.e.*, the City of Bee Cave, Hays County, and WTCMUD No. 5) from allowing competing systems, from reselling water to third-party wholesalers, and from entering into contracts with any other entity other than the WTCPUA for the supply of water during the term of the acquisition agreement.[37] But most importantly, despite the fact that these are the provisions that form the only foundation for his "formidable barriers" argument, Zarnikau had no idea whether any of these contractual

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[34] Nor does it provide any evidence of any abuse of alleged monopoly power, as discussed *infra.*

[35] TCMUD 12's Initial Brief at 22.

[36] Direct Testimony of Dr. Jay Zarnikau, TCMUD 12 Ex. 3 at 8:28-9:13.

[37] *Id.* As further indication that Zarnikau missed the boat completely in his review of the Participant Agreement, he failed to notice that Section 7.07(h) of the Participant Agreement (the "non-compete" provision cited on pages 8-9 of his Direct Testimony, TCMUD 12 Ex. 3), addresses competing facilities "which might be used as a substitute for *such Participant's System's facilities*." Section 1.01 of the Participant Agreement defines "Participant's System," in pertinent part, as "a Water Participant's waterworks distribution system." (*See*, Direct Testimony of Dr. Jay Zarkinau, TCMUD 12 Ex. 3 at 34 (JZ Exhibit 2 at 5). This non-compete provision applies only to competing distribution (*i.e.*, retail) systems, and prohibits the Participants from franchising or otherwise authorizing any third party, such as an investor-owned utility, from providing retail water utility service within the Participant's boundaries. This provision does not speak at all to the wholesale "System," defined in the Participant Agreement as "the Supply and Treatment Components and the Distribution and Collection Components purchased from LCRA pursuant to the Purchase Contract, and all future extensions, improvements, enlargements, and additions thereto approved by the PUA Board." Direct Testimony of Dr. Jay Zarkinau, TCMUD 12 Ex. 3 at 36 (JZ Exhibit 2 at 7).

prohibitions were legitimate or enforceable.[38] TCMUD 12 has failed to prove the existence of any barriers to entry, formidable or otherwise.

TCMUD 12 attempts to make much of the fact that in 2008-2009, the LCRA was the only wholesale water services provider to TCMUD 12.[39] This fact is the natural result of TCMUD 12 choosing the LCRA as the sole-source provider of such services to TCMUD 12. However, one cannot read into the language of the 2009 Agreement the "understanding" of the parties to the contract as suggested by TCMUD 12 in its Initial Brief, when there is no record evidence in support of that claimed understanding.[40]

f. The HHI is inapplicable and inappropriate.

The Herfindahl-Hirschman Index ("HHI"), much-touted by TCMUD 12, provides no insight into the issues to be determined by the Commission. An after-the-fact application of the HHI to the sole-source provider circumstance resulting from the 2009 Agreement will *necessarily* and unavoidably show a highly concentrated market, a concentration created by the parties' agreement. The HHI is inapplicable to the current facts and TCMUD 12's reliance on this Index is misplaced and inappropriate, as it does not control for the conditions created by contract by the parties.[41]

g. The ability to control rates is limited by contract.

TCMUD 12 witness Zarnikau also refused to address the contractual provisions that dictate how the WTCPUA may set rates, and the limitations on the rates that can be set. TCMUD 12 alleges that WTCPUA has greater control over prices because of the price-

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[38] Tr. at 249:9-251:4 (Zarnikau Cross) (Apr. 21, 2015); Tr. at 518:22-24, 537:4-10 (Zarnikau Rebuttal) (Apr. 23, 2015). *See*, generally, WTCPUA's Initial Brief at 19-21.

[39] TCMUD 12's Initial Brief at 24.

[40] *Id.*

[41] Direct Testimony of Richard A. Baudino, WTCPUA Ex. 2 at 28:6-13.

inelasticity exhibited in this case.[42] Undermining this argument are the actual provisions in the 2009 Agreement (a document never analyzed by Zarnikau) that significantly limit the WTCPUA's ability to change, or control, the rates charged to TCMUD 12 and all the other wholesale customers: the rates must be based on the WTCPUA's costs;[43] the rates must be nondiscriminatory and just and reasonable;[44] and (as admitted by TCMUD 12) the WTCPUA does not have the unilateral right to change rates charged to TCMUD 12 or any other wholesale customer.[45]

h. TCMUD 12 has failed to prove the existence of a monopoly.

TCMUD 12 has not met its burden of proving that WTCPUA operates as a monopoly. A long-term sole-source provider contract was the vehicle chosen by the parties to provide and receive the wholesale treated water services; it was not imposed by the LCRA in 2009, but was negotiated at arms-length.[46] TCMUD 12 failed to prove that the LCRA was the only available provider of the treated water services it desired.[47] TCMUD 12 failed to prove that the LCRA and WTCPUA controlled the prices and quantities of wholesale water treatment services.[48] Finally, TCMUD 12 failed to prove the existence of formidable barriers to entry in the market of

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42 TCMUD 12's Initial Brief at 25 and citations therein.

43 Tr. at 40:16-19 (DiQuinzio Cross) (Apr. 21, 2015); Tr. at 349 (Baudino Cross) (Apr. 22, 2015).

44 *Id.*; Tr. at 40:8-15 (DiQuinzio Cross) (Apr. 21, 2015).

45 Tr. at 292:10-294:13 (Zarnikau Cross) (Apr. 22, 2015); WTCPUA Ex. 78; WTCPUA Ex. 79.

46 *See*, WTCPUA's Initial Brief at 18-19 for a discussion of the negotiation process in 2008-2009 and the significant involvement of TCMUD 12 in that process.

47 *See* WTCPUA's Initial Brief at 23-25 for a detailed discussion of LCRA's failure to reasonably explore other options that were available to TCMUD 12 in 2009 and thereafter.

48 *See* WTCPUA's Initial Brief at 25-29 for a detailed discussion of the evidence that WTCPUA is not a price maker with complete control over prices and quantities.

wholesale water treatment services in TCMUD 12's service area.[49] As a result, TCMUD 12 has failed to prove that WTCPUA is a monopoly.

2. Reply to Commission Staff.

The WTCPUA does not provide retail water utility services to TCMUD 12, nor to any of its other wholesale water treatment service customers. Both TCMUD 12 and Commission Staff argue that the Texas Water Code's designation of retail public utilities as monopolies, by definition, also means that the WTCPUA is a monopoly.

Staff asserts that the WTCPUA is a monopoly, and likely operates as such, without providing any reasoning or basis for this statement other than references to Texas Water Code ("TWC") § 13.002(19), which includes in the definition of retail public utilities those entities providing potable water service for compensation, and § 13.001(b)(1), which states that "retail public utilities are by definition monopolies in the areas they serve."[50] However, it is improper and illogical to conclude that wholesale water treatment services provided under contract are the same as retail water utility services provided to an exclusive service area pursuant to a water or sewer certificate of convenience and necessity ("CCN"). The elevation of form over substance, in this case to mandate a conclusion that a provider of wholesale treated water service is, *ipso facto*, a monopoly, reaches a wholly erroneous result.

The imposition of a comprehensive regulatory scheme over *retail* water utility service as a substitution for competition, as noted in TWC § 13.001(b)(3), is accomplished both by the rate regulations and the exclusive service territory provisions in Chapter 13. However, this comprehensive regulatory scheme does not apply to *wholesale* water service providers, and the regulatory provisions of Chapter 13 of the Texas Water Code are not applied to the provision of

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[49] *See* WTCPUA's Initial Brief at 29-36 for a detailed discussion of evidence regarding barriers to entry, or lack thereof.

[50] Commission Staff's Initial Brief at 11 (June 26, 2015). (Staff's Initial Brief).

wholesale water treatment services. If that were to be the case, then what would be the reason for separately and independently dealing with appeals of rates charged under wholesale water contracts in 16 TAC, Chapter 24, Subchapter I? And, why would the courts have so specifically instructed the state agencies that the wholesale *contracts* must be deferred to, and rates charged thereunder disturbed only in very specific, and compelling, circumstances?[51]

More specifically, what would be the point of the public interest criteria found in 16 TAC § 24.133 if a wholesaler who also happens to be a retail public utility is a monopoly "by definition"? If wholesale providers are *by definition* monopolies, with exclusive service areas and captive customers, then what is the point of examining the bargaining power of the parties (no one bargains with the entity that provides potable water to one's home), and what is the point of examining the purchaser's alternative means if, by definition, a monopoly already exists?[52]

The overly-simplistic interpretation of TWC § 13.001 by Staff (and also in passing by TCMUD 12)[53] ignores the reality of how wholesale water contracts come into being and the differences between wholesale service and retail service. If an entity intends to provide *retail* water services, unless it is specifically exempted by law from the water CCN requirements, it must obtain a CCN from the Commission in order to do so.[54] Because a water CCN is a grant of monopoly status in a specific area (hence the "by definition" phrase in TWC § 13.001(b)(1)), the applicant for a CCN must prove its worthiness to obtain such a monopoly by showing through a detailed application process (and potentially through a contested case proceeding) that it

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[51] *High Plains Natural Gas Co. v. R.R. Comm'n of Tex.*, 467 S.W.2d 532 (Tex. Civ. App.—Austin 1971, writ ref'd, n.r.e.); *Tex. Water Comm'n v. City of Fort Worth*, 875 S.W.2d 332 (Tex. App.—Austin 1994, writ denied).

[52] 16 TAC § 24.133(a)(3)(A).

[53] TCMUD 12's Initial Brief at 26. The illogical nature of the position regarding the classification of the WTCPUA as a retail public utility in its provision of wholesale services is amply illustrated by TCMUD 12 witness Zarnikau's confused inability to explain the import of the classification, and his conclusion that it really means not much at all. Tr. at 229:10-231:23 (Zarnikau Cross) (Apr. 21, 2015).

[54] Tex. Water Code Ann. §§ 13.242, 13.243 (West 2008 & Supp. 2014) (TWC).

possesses the financial, managerial, and technical capability to provide continuous and adequate service.[55] An entity intending to provide *wholesale* water services is under no such scrutiny–it must only have the means to provide the service and the ability to negotiate the terms under which such service is offered to its customers, who are not the end-use consumers of the water services.

It is the award of a water CCN by the Commission that creates the monopoly "by definition," by granting to the water CCN holder the exclusive right to provide retail water utility services to the territory that is specifically identified in the CCN. Detailed maps of the proposed water CCN area must be filed, in both digital and hard-copy formats, before an application for a new CCN or an amended CCN will even be accepted for filing.[56] The mapping of retail water service areas is highly detailed and meticulous. Once the water CCN is awarded, the CCN holder may stave off all retail competition in its CCN territory, and may call upon the full authority of the state to enforce its exclusivity.[57] Wholesale providers of water services are under no comparable requirements, and in fact have no service territories at all; they serve contractual customers, not an "area."

The CCN-created monopoly is the reason that the state steps in to regulate such a monopoly as a substitution for competition. The regulatory authority, be it the Commission or a municipality exercising its original jurisdiction, must approve rate increases before they go into

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55 TWC § 13.241(a).

56 TWC § 13.244; 16 TAC § 24.105 (Contents of CCN Applications).

57 TWC § 13.252 authorizes the Commission to issue a cease and desist order prohibiting the construction or extension of a line, plant, or system, or the provision of service, if the Commission determines that such construction or provision of service interferes with a retail public utility that has been granted, or that is not required to possess, a CCN.

effect.[58] No such prior approval is required for wholesale rates, even those charged by entities that might also fit within the definition of "retail public utilities."

When the public interest rules were initially adopted by the Texas Natural Resource Conservation Commission, the Preamble made it very clear that there is a bright-line difference between non-competitive retail utilities and contractually-based wholesale utilities:

> As is explained in the Water Code, the Legislature imposed a comprehensive regulatory system upon retail water and sewer utilities which are by definition monopolies in the areas they serve, and that the regulatory system is intended to serve as a substitute for competition. This system calls for rates based on the seller's cost of service. The circumstances of wholesale water and sewer service are not the same. The disputes concerning wholesale rates which have come before the commission concern parties who are in a position quite different than the typical retail customer. The purchaser is itself a utility that is sophisticated in utility transactions, and the purchaser, generally, has had several options from which it may obtain water or sewer service, including self service.[59]

It is clear that one cannot simply refer to the definitions in the Texas Water Code, or to § 13.001(b)(1), to determine whether the WTCPUA exercises monopoly powers. Instead, one must examine the facts and apply commonly-accepted criteria to the facts, as discussed by WTCPUA witness Baudino in his testimony. Mr. Baudino's discussion and his conclusions are discussed in great detail in WTCPUA's Initial Brief at 12-36.

However, if the Commission is still inclined to believe that the WTCPUA is a monopoly "by definition," then consider the case of a landowner whose property is not within the CCN of any provider. Her property is outside the city limits of, but close to, the City of Goodwater, and she is also close to, but outside of, Clearwater MUD. Under the Texas Water Code, both the

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[58] Effective September 1, 2015, utilities with fewer than 500 connections (Class C utilities), may obtain automatic rate adjustments pursuant to TWC § 13.1872, but every five years they must return to the regulatory authority for rate increase approvals.

[59] WTCPUA Ex. 76 at 6228, first column.

City and the MUD are defined as "retail public utilities," yet neither is required by law to obtain a CCN prior to providing retail utility service.[60] When this landowner decides that she wants to construct a home and is in need of retail water utility service, even though she is close to two alleged "monopolies by definition," she is free to choose whichever provider best meets her needs. She may choose on the basis of proximity, of price, or for any other reason. Her freedom to so choose exists because even though both providers are "retail public utilities," neither provider has a monopoly, because neither provider has a CCN. Without a CCN, there is no monopoly. In fact, in this example, the City of Goodwater could extend its facilities into the Clearwater MUD, or vice versa, and neither would be able to enforce the sanctity of their service areas because neither has a CCN.[61]

The lesson to be learned from this example is that one must not forget that it is a CCN that creates a monopoly by awarding an exclusive service area to the holder thereof. Retail public utilities without exclusive service areas are not monopolies. Therefore, the WTCPUA, in its provision of wholesale water treatment services, for which it does not hold a CCN, does not operate as a monopoly.

III. WTCPUA DOES NOT HAVE DISPARATE BARGAINING POWER AND THE PROTESTED RATES DO NOT EVIDENCE ANY ABUSE OF SUCH ALLEGED POWER

TCMUD 12 failed to meet its burden of proof under 16 TAC § 24.133(a)(3)(A) that the WTCPUA had disparate bargaining power over TCMUD 12 in its provision of wholesale water treatment services to TCMUD 12 at the time the parties entered into the 2009 Agreement, or

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60 TWC §§ 13.001(d) (including municipalities and political subdivisions within the definition of "retail public utility"), 13.001(23) (excluding from the definition of "water and sewer utility," "public utility," and "utility" municipal corporations and political subdivisions), 13.242 (prohibiting "a utility, a utility operated by an affected county, or a water supply or sewer service corporation" from rendering retail water or sewer utility service without first obtaining a CCN).

61 In order to obtain a cease and desist order from the Commission, a retail public utility must have a CCN. TWC § 13.252.

when the WTCPUA Board adopted the Protested Rates. An analysis of the purchaser's alternative means, alternative costs, and problems of obtaining alternative water service, is performed in order to determine whether there is disparate bargaining power between the parties, and thus whether the Protested Rates evidence an abuse of alleged monopoly power (herein referred to as the "alternatives analysis").[62] TCMUD 12 could not, and did not, provide any credible evidence that it did not have alternative wholesale water treatment service providers available between 2009 and 2013; TCMUD 12 could not, and did not, provide any credible evidence of the costs to receive wholesale water treatment services from an alternative providers between 2009 and 2013; and TCMUD 12 could not, and did not, provide any credible evidence of additional problems in obtaining wholesale water treatment services from an alternative provider between 2009 and 2013.

Additionally, between 2009 and 2013, the WTCPUA did not have disparate bargaining power over TCMUD 12 (in fact, TCMUD 12 had disparate or equal bargaining power over the WTCPUA), because the WTCPUA needed TCMUD 12 more than TCMUD 12 needed the WTCPUA. As testified by DiQuinzio, the LCRA/WTCPUA had capacity in 2009, and thus the LCRA/WTCPUA needed a customer at the same time that TCMUD 12 was searching for a wholesale water treatment services provider.[63] In other words, without TCMUD 12, the LCRA/WTCPUA was not using its reserved capacity and not generating any revenues, while it was also incurring debt service costs for such infrastructure.

Further, TCMUD 12 could not provide any evidence that the Protested Rates amounted to an abuse of any alleged monopoly power.

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62 16 TAC § 24.133(a)(3)(A).

63 Direct Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 1 at 6:12-13.

A. TCMUD 12 Failed to Meet Its Burden of Proof under the Alternatives Analysis

1. There is no credible evidence that alternatives do not exist.

TCMUD 12's allegations in its Initial Brief regarding the alternatives analysis in 16 TAC § 24.133(a)(3)(A) are premised upon TCMUD 12's complete failure to conduct any due diligence investigating the factors in the alternatives analysis either at the time TCMUD 12 entered into the 2009 Agreement, or upon the WTCPUA's adoption of the Protested Rates. Failing to ask alternative water providers for wholesale water treatment services is not a valid basis for determining that no alternative wholesale water treatment service providers exist, and, thus, it is not a means for TCMUD 12 to meet its burden of proof. In fact, a review of the record illustrates that alternatives did exist. Simply put, if you don't ask, you don't get.

The record is clear that TCMUD 12 *never* provided written requests for wholesale water treatment services to *any* third parties between 2009 and 2013.[64] Rather, TCMUD 12's position hinges solely on DiQuinzio's speculations, which are in turn based upon informal conversations with non-decision makers and consultants of several third parties.[65] This is mere conjecture, as DiQuinzio obviously does not know what a third party may or may not decide. Only the Board of Directors or a city council for that third party can make the decision to provide wholesale water treatment services.

This inaction by TCMUD 12's General Manager, Joe DiQuinzio, is like a patron who voluntarily decided to buy a ticket for a baseball game, and, while sitting in his seat in the stands, believes that he can *only* buy a soft drink if there is a vendor walking up and down the aisle who will then put the soft drink cup in his hand. He fails to acknowledge that if he got up from his

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[64] *See* WTCPUA Ex. 24 (showing no records of business dealings with Lakeway MUD regarding obtaining services from that entity); WTCPUA Ex. 25 (showing no written request for service was ever submitted to Lakeway MUD); and WTCPUA Ex. 4 at RFA No. 1-13 (admitting that TCMUD 12 did not send correspondence or documents to any entity other than the LCRA and the WTCPUA in the past ten years regarding the purchase of a wholesale treated water supply for TCMUD 12).

[65] Tr. at 80:9-18 (DiQuinzio Cross) (Apr. 21, 2015).

seat, walked to one of the dozen nearby commissaries, and asked a salesperson for a soft drink, then he would have an alternative location to purchase that soft drink, at a reasonable price, and without any other meaningful problems. In other words, TCMUD 12 is operating in a vacuum, ignoring the world in which it exists.

Additionally, TCMUD 12 has made the extreme, confused interpretation of the term "alternative" in 16 TAC § 24.133(a)(3)(A) to mean that to qualify as an alternative, the third party must be ready to provide the requested service at the very moment the request is made. Under such mistaken interpretation, in order to be a viable alternative the third party must have its water system already hydrologically connected to TCMUD 12, and must have a representative sitting by the phone, waiting for TCMUD 12 to call and request wholesale water treatment services. This is an unrealistic, unsupported interpretation.

The Merriam-Webster Dictionary defines an alternative as "offering or expressing a choice."[66] Under this appropriate definition, an alternative wholesale water treatment services provider could be an entity that is willing and able to provide the service, but must first construct additional water infrastructure, and it does not support TCMUD 12's narrow interpretation that the alternate provider needs to be ready to provide service instantaneously. This definition also supports the notion that an alternative is not an all-or-nothing proposition. Other possible alternatives could entail receiving service from more than one entity, or transitioning from one entity to another over a period of years. Accordingly, the evidence in the record demonstrates that TCMUD 12 did not truly investigate whether Lakeway MUD, Hurst Creek MUD, the City of Austin, itself, or a combination of these entities could provide wholesale water treatment services. In contrast, the WTCPUA provided independent evidence that such entities are real alternatives, either independently or together.

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[66] http://www.merriam-webster.com/dictionary/alternative (last visited July 30, 2015).

To rebut TCMUD 12's arguments in its Initial Brief regarding the alternatives analysis, WTCPUA reasserts its arguments from Section VII.B. of its Initial Brief, and provides the following additional points:

a. Lakeway MUD

Lakeway MUD is certainly a potential alternative wholesale water services provider to TCMUD 12, as the following facts are undisputed:

- TCMUDs 11, 12, and 13 obtain their raw water supply from LCRA under a single contract;[67]
- TCMUD 11 has an agreement with Lakeway MUD to treat a portion of such raw water supply to serve the Rough Hollow Subdivision;[68]
- WTCPUA, under the 2009 Agreement as amended, treats a portion of that same raw water supply for TCMUDs 11, 12, and 13 to serve The Highlands Subdivision;[69]
- But for the opening of a valve, the water system that serves the Rough Hollow Subdivision is hydrologically connected to the water system that serves The Highlands Subdivision;[70]
- On January 1, 2009, TCMUD 12 had no customers; on January 1, 2013, TCMUD 12 had 48 customers; and on January 1, 2014, TCMUD 12 had 132 customers;[71]
- The Rough Hollow and Highlands Subdivisions are currently physically connected through a 12 inch pipeline;[72] despite his years of experience in the industry, DiQuinzio admitted that he did not how much water flowed through a 12 inch pipeline;[73] and according to Lakeway MUD's living unit equivalency table, just an 8 inch meter is already capable of serving 126 residences (living unit equivalents).[74]

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67 Direct Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 1 at 63 (JAD Exhibit 2).

68 Direct Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 1 at 176 (JAD Exhibit 7).

69 Direct Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 1 at 15:11-13.

70 Tr. at 85:3-7 (DiQuinzio Cross) (Apr. 21, 2015).

71 WTCPUA Ex. 43 and 44.

72 Tr. at 628:21-22 (DiQuinzio Cross) (Apr. 23, 2015).

73 Tr. at 122:17-19 (DiQuinzio Cross) (Apr. 21, 2015).

74 Direct Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 1 at 221 (JAD Exhibit 7).

- Between 2009 and 2013 (before entering into the 2009 Agreement or the adoption of the Protested Rates), TCMUD 12 never filed a written request to Lakeway MUD for wholesale water treatment services for The Highlands Subdivision;[75] and
- TCMUD 12 could have amended the 2009 Agreement in 2013 or later to reduce its quantity of wholesale water treatment capacity and living unit equivalent uptake schedule, offsetting such decrease with the receipt of wholesale water treatment services from Lakeway MUD.

Further, the fact that TCMUD 12 has characterized the connection between the Rough Hollow and Highlands Subdivision as an "emergency interconnection"[76] is irrelevant and intended to distract the finder of fact. The purpose of an interconnection can be changed by the parties, and the characterization of the interconnection is in name only. The actual, physical connection between two systems is unquestionable. Here, the interconnection is a 12–inch pipe,[77] capable of serving The Highlands Subdivision during 2009 to 2014. The failure to submit a formal request to Lakeway MUD for wholesale water treatment services is an obvious and fatal oversight, because if TCMUD 12 had performed any due diligence whatsoever, it would have requested wholesale water treatment services from Lakeway MUD, an alternative wholesale water treatment services provider that is physically connected and closer in proximity to TCMUD 12 than LCRA/WTCPUA.[78] Said another way, WTCPUA is not the only entity with infrastructure that can divert TCMUD 12's raw water from Lake Travis, treat such water and deliver it to TCMUD 12.

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[75] *See* WTCPUA Ex. 24 (showing no records of business dealings with Lakeway MUD regarding obtaining services from that entity); WTCPUA Ex. 25 (showing no written request for service was ever submitted to Lakeway MUD); and WTCPUA Ex. 4 at RFA No. 1-13 (admitting that TCMUD 12 did not send correspondence or documents to any entity other than the LCRA and the WTCPUA in the past ten years regarding the purchase of a wholesale treated water supply for TCMUD 12).

[76] Direct Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 1 at 13:26-28.

[77] Tr. 628:21-22 (DiQuinzio ReCross) (Apr. 23, 2015).

[78] Direct Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 1 at 85 (JAD Exhibit 2 at 23).

Therefore, there is no evidence that Lakeway MUD could not provide wholesale water treatment services to the Highlands in 2009 or 2013. Again, if you don't ask, you don't get.

b. Lakeway MUD, Hurst Creek MUD, TCMUD 11, and Lakeway Rough Hollow South Community, Inc.

Four entities–Lakeway MUD, Hurst Creek MUD, TCMUD 11, and Lakeway Rough Hollow South Community, Inc.–can help TCMUD 12 and/or enable Hurst Creek MUD/Lakeway MUD to provide wholesale water treatment services to TCMUD 12. These four entities purchased a water barge on Lake Travis and related facilities to divert and transport such water from LCRA under the Purchase Agreement for the Lakeway Regional Raw Water Transportation System ("Barge Contract"), enabling those entities to divert raw water (in a location authorized under TCMUD 12's Raw Water Contract), and pump it to the shore for treatment.[79] These four entities also entered into a Joint Ownership and Operating Agreement for the Lakeway Regional Raw Water Transportation System ("Operating Agreement") providing for the operations and maintenance of the barge and related facilities. [80]

When initially questioned about Hurst Creek MUD's barge on Lake Travis, DiQuinzio first testified that the capacity in the barge was unavailable to TCMUD 12 because it was already spoken for.[81] However, when he was presented the Barge Contract and Operating Agreement, DiQuinzio contradicted this initial testimony and admitted that, in fact, the capacity of the barge in May 2012 was 6.812 mgd at an average lake level of 640 mean sea level, but it could be expanded to 9.7 mgd at an average lake level of 640 mean sea level.[82] This additional capacity is available because barge is designed to install *two additional water pumps*.[83]

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79 WTCPUA Ex. 80.

80 WTCPUA Ex. 81.

81 Tr. at 121:1-18 and 123:7-13 (DiQuinzio ReCross) (Apr. 21, 2015); WTCPUA Ex. 81 at 2-3.

82 Tr. at 599:10-600:9 (DiQuinzio ReCross) (Apr. 23, 2015).

83 WTCPUA Ex. 80 at Ex. A.

This contradiction in DiQuinzio's testimony, along with the additional following described discrepancies therein, raises a suspicion concerning the reliability and credibility of DiQuinzio's testimony and speculations regarding alternatives, about TCMUD 12's ability to provide wholesale water treatment services, and about his testimony in general:

- DiQuinzio failed to remember how much water flows through a 12-inch pipeline;[84]
- DiQuinzio failed to remember emails he received from WTCPUA representatives;[85]
- Despite his alleged 30 years of knowledge and experience as a general manager and land developer *in central Texas*,[86] DiQuinzio admitted that he didn't know how many public water suppliers have raw water intakes on Lake Travis;[87]
- Despite such alleged experience, DiQuinzio admitted that he didn't know how many water systems with raw water intakes on Lake Travis have their own surface water treatment plants;[88]
- DiQuinzio initially testified TCMUD 12 filed the petition on behalf of TCMUDs 11 and 12;[89] then testified that he was responsible for filing the Petition on behalf of TCMUDs 11, 12, and 13;[90] yet, he failed to prove that the Board of Directors of TCMUD 11 or 13 took formal action authorizing him to represent TCMUDs 11 and 13 in this matter;[91]
- DiQuinzio testified that TCMUD 12 did not object to the adoption of the WTCPUA rates adopted on November 15, 2012 (the "Prior Rates") that increased TCMUD 12's rates by 15.5%, because TCMUD 12 believed it would have a cooperative and fair relationship with the WTCPUA,[92] but once the WTCPUA lowered TCMUD 12's rates with the Protested Rates, TCMUD 12 protested such rates, claiming that such rates demonstrate an abuse of alleged disparate bargaining power; and

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84 Tr. at 122:17-19 (DiQuinzio Cross) (Apr. 21, 2015).

85 Tr. at 54-60 (DiQuinzio Cross) (Apr. 21, 2015).

86 Tr. 117:18-24 (DiQuinzio ReDirect) (Apr. 21, 2015).

87 Tr. at 79:5-13 (DiQuinzio Cross) (Apr. 21, 2015).

88 *Id.*

89 Direct Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 1 at 3:6-7.

90 Rebuttal Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 4 at 3:7-9.

91 WTCPUA Ex. 72 (RFI No. 3-16).

92 Tr. at 114:21-24 (DiQuinzio ReDirect) (Apr. 21, 2015).

- DiQuinzio *initially* testified that TCMUD 12 entered into the 2009 Agreement with LCRA "after an extended period of negotiations."[93] However, *after* the WTCPUA's witness Mr. Richard Baudino testified that the under the public interest test the analysis should look to the relationship of the parties when they initially entered into the 2009 Agreement, DiQuinzio changed his tune completely, testifying that "LCRA is an 800 pound gorilla, and you don't negotiate with them."[94]

c. TCMUD 12

As more fully discussed in WTCPUA's Initial Brief, TCMUD 12 itself is an alternative wholesale water treatment services provider. In its Initial Brief, TCMUD 12 argues that it is not an alternative service provider to itself because it would need to construct additional infrastructure to become its own wholesale water treatment service provider. However, such rationalization is fundamentally flawed for the following reasons:

- As a municipal utility district, TCMUD 12 has the authority to construct and operate water treatment facilities under Texas Water Code Chapters 49 and 54;
- TCMUD 12 does not need 3.98 mgd of wholesale water treatment services today- it only needs a small fraction of such amount (the 2009 Agreement is intended to serve 2,125 LUEs at full build-out, but in 2009 TCMUD 12 had zero LUEs, and in 2014 TCMUD 12 only had 132 LUEs);[95]
- TCMUD 12 acknowledged that such water treatment infrastructure can be phased in as TCMUD 12 continues to grow[96] (which can be done by one entity completely, by multiple entities, or temporarily by one entity and then replaced with another entity);
- TCMUD 12 is geographically located along the shores of Lake Travis, in close proximity to its authorized raw water diversion point, with undeveloped land where water treatment infrastructure could be built;[97]

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93 Direct Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 1 at 6:16-17.

94 Rebuttal Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 4 at 5:19-20.

95 WTCPUA Ex. 43 and 44; Tr. at 605:4-6 (DiQuinzio ReCross) (Apr. 23, 2015).

96 Tr. at 68:6-18 (DiQuinzio Cross) (Apr. 21, 2015).

97 Direct Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 1 at 85 (JAD Exhibit 2 at 23).

- As discussed above, Lakeway MUD, Hurst Creek MUD, TCMUD 11, and Lakeway Rough Hollow South Community, Inc., have almost 3 mgd of capacity in their raw water barge, pumps, and pipelines to divert and transport TCMUD 12's raw water out of Lake Travis for treatment;[98] and
- TCMUD 12 and Rough Hollow Development, Ltd. had entered into a Utility Construction Agreement, whereby Rough Hollow Development, Ltd. agreed to provide advances to the District construct water infrastructure, in return for the District reimbursing the company through the issuance of ad valorem tax bonds, when the District was able to do so.[99]
- TCMUD 12 did not provide any evidence that there were legal or regulatory hurdles to construct its own facilities or work with other alternative providers, in whole or in part; and TCMUD 12 did not provide any evidence of issues arising by commingling its raw water supply with TCMUD 11's raw water supply that is treated by Lakeway MUD.

d. City of Austin

Contrary to TCMUD 12's misguided contention in its Initial Brief, the City of Austin is also an alternative provider. The record contains evidence that the City of Austin has a water treatment plant on Lake Travis,[100] and the fact that the City of Austin's water treatment plant is "extremely far away" (in DiQuinzio's words)[101] has no bearing on whether the City has or does not have water infrastructure in the vicinity of TCMUD 12.

Again, since TCMUD 12 never performed any due diligence of alternative providers, it is uncertain whether Austin has installed water infrastructure nearby TCMUD 12. As to proximity, the WTCPUA's water treatment plant is also far from TCMUD 12. On cross examination, DiQuinzio acknowledged that TCMUD 12's raw water that is treated by the WTCPUA travels approximately eight miles before reaching the delivery point at The Highlands Subdivision.[102] Additionally, the fact that The Highlands Subdivision is not in the City of Austin's water CCN

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98 WTCPUA Ex. 81 at 2.

99 WTCPUA Ex. 70 at 1-7.

100 Tr. at 79:14-16 (DiQuinzio Cross) (Apr. 21, 2015).

101 Tr. at 108:11-12 (DiQuinzio ReDirect) (Apr. 21, 2015).

102 Tr. at 73:8-13 (DiQuinzio Cross) (Apr. 21, 2015).

service area is equally irrelevant. The wholesale water treatment services provided by WTCPUA to TCMUD 12 are on a wholesale basis, and a CCN is a license granted by the Commission to provide retail water service to *end users* located within a specific geographic boundary.

TCMUD 12's Initial Brief does not refute these critical pieces of evidence. It just attempts to ignore them. TCMUD 12's claims that LCRA was the only provider of wholesale water services with the ability to divert, treat, and transmit the potable water needed to serve The Highlands[103] ignores these facts; and such claims are purely based upon DiQuinzio's testimony, which has been refuted.

2. There is no credible evidence regarding alternative costs.

TCMUD 12 has not provided any evidence demonstrating that TCMUD 12 knew between 2009 and 2013 what its costs were to obtain wholesale water treatment services for its raw water supply from an alternative provider or from itself. As discussed in the WTCPUA's Initial Brief, the only evidence provided by TCMUD 12 was unsupported, non-expert testimony from DiQuinzio, prepared two days before DiQuinzio's prefiled testimony was filed, which was ultimately refuted by the WTCPUA's capital improvements plan, and which was sealed by an engineer.[104]

Further, although TCMUD 12 did not provide any evidence of the alternative costs at the time it entered into the 2009 Agreement or at the time the Protested Rates were adopted, there is no requirement in the Commission's alternatives analysis in 16 TAC § 24.133(a)(3)(A) that the rates charged by the alternative provider must be cheaper than (or even reasonably close to) the rates that are being challenged. TCMUD 12 failed to provide any evidence as to what TCMUD 12's rates would need to be to recover its costs of building its own infrastructure. In other words,

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[103] Direct Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 1 at 6:12-13.

[104] Tr. 66-67 (Apr. 21, 2015); Direct Testimony of Donald G. Rauschuber, P.E., WTCPUA Ex. 1 at 29:7-31:10 and Attachment V at 269-270.

if TCMUD 12 had built its own system, it is unknown if such costs would result in a rate that is cheaper or more expensive than the Protested Rates.

It is critical in the alternatives analysis, and was overlooked by TCMUD 12, that TCMUD 12, as "a very young district",[105] will pay for water treatment infrastructure necessary to treat its raw water supply, regardless of whether TCMUD 12 or the WTCPUA (or any third party) builds such facilities. For each LUE of wholesale water treatment services that WTCPUA provides TCMUD 12 under the 2009 Agreement, TCMUD 12 pays the WTCPUA a Connection Fee. Specifically, as contemplated in Section 4.01.c. of the 2009 Agreement, the Connection Fee "has been designed to fund or recover all or a part of the Costs of the LCRA System for capital improvements or facility expansions intended to serve 'new development'" (namely, the WTCPUA's barge, water pump, pipelines, water treatment facilities, and other related capital improvements) for each LUE.[106] The bottom line here is that regardless of whether the WTCPUA or TCMUD 12 is providing wholesale water treatment services, TCMUD 12 is paying for the central water treatment infrastructure in either case. Further, since TCMUD 12's reservation of capacity is guaranteed by the 2009 Agreement, it has a transferrable investment in the WTCPUA system, and it can avoid paying for both the WTCPUA and its own system by selling its capacity in the WTCPUA system.[107]

B. TCMUD 12 Fails to Demonstrate that WTCPUA Otherwise Has Disparate Bargaining Power

"'[D]isparity of bargaining power exists when one party has no real choice in accepting the terms of the agreement. Conversely, disparity in bargaining power does not exist where a

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105 Tr. 90:24-25 (DiQuizio Cross) (Apr. 21, 2015).

106 Direct Testimony of Donald G. Rauschuber, P.E., WTCPUA Ex. 1 at 76 (Attachment G at 10).

107 *Id.* at 75 and 85.

claimant has freedom of choice in entering into the agreement.'"[108] Said another way, which party needs the other more? The following analysis rebuts TCMUD 12's Initial Brief and confirms that TCMUD 12, not WTCPUA, had disparate bargaining power in 2009 and 2013.

1. 2009 Agreement demonstrates that TCMUD 12 has disparate or equal bargaining power over WTCPUA, which continued beyond 2009.

As discussed in the alternatives analysis above and in the WTCPUA's Initial Brief, TCMUD 12 had the freedom of choice in entering into the 2009 Agreement, and an analysis of the 2009 Agreement reveals that the WTCPUA needed TCMUD 12 more than TCMUD 12 needed the WTCPUA. In addition to the arguments previously made by the WTCPUA in its Initial Brief, this critical distinction is even apparent in TCMUD 12's Initial Brief, where it argues that "TCMUD 12 was able to obtain wholesale water services from LCRA because: LCRA's West Travis County Regional WTP had capacity to treat the water needed to serve The Highlands . . ."[109] Fatal to TCMUD 12's position, TCMUD 12 admits that it was looking for a wholesale water treatment services provider, and LCRA could be that provider because LCRA already had the system and needed a customer!

As a public utility agency, the WTCPUA has the powers set forth in Chapter 572 of the Texas Local Government Code,[110] which means that it can only generate revenue from rates (a public utility agency does not have the authority to tax). Thus, if it has no customers, then it is not generating rate revenue to pay its costs.

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[108] *Dillee v. Sisters of Charity of Incarnate Word Health Care Sys.*, 912 S.W.2d 307, 309 (Tex. App. — Houston [14th Dist.] 1995, no pet.); *Allright, Inc.v. Elledge*, 515 S.W.2d 266, 267 (Tex. 1974), cited *In Re: Appeal of Multi-County Water Supply Corporation to Review the Wholesale Water Rate Increase Imposed by the City of Hamilton*, TCEQ Docket No. 2009-0048-UCR, PFD at 12 (Apr. 13, 2010). A copy of this PFD was attached to the WTCPUA's Initial Brief as Attachment D.

[109] TCMUD 12's Initial Brief at 30.

[110] Direct Testimony of Donald G. Rauschuber, P.E., WTCPUA Ex. 1 at 9:8-9, 15-17.

As noted in *In Re: Appeal of Multi-County Water Supply Corporation to Review the Wholesale Water Rate Increase Imposed by the City of Hamilton*, TCEQ Docket No. 2009-0048-UCR; SOAH Docket No. 582-09-2557, the bargaining history of the parties may shed light on disparate bargaining power.[111] Here, there was no disparate bargaining power by LCRA at inception of 2009 Agreement and there certainly was no coercion to enter into the 2009 Agreement. Specifically, TCMUD 12's Firm Water Contract with LCRA does not require TCMUD 12 to utilize LCRA/WTCPUA for wholesale water treatment services.[112] TCMUD 12 had the freedom to choose. However, as discussed in the alternatives analysis above, TCMUD 12 chose not to seek out other options.

In fact, similar to the wholesale customer in *Multi-County*, TCMUD 12 entered into the 2009 Agreement on its own free will after due consideration, including the advice of an attorney and with full knowledge that other sources were available. Specifically, DiQuinzio testified that TCMUD 12 only entered into the 2009 Agreement after an extended period of negotiations with LCRA.[113]

After diving into the terms of the 2009 Agreement, which WTCPUA already addressed in Section VII.A.1 of its Initial Brief, it is clear that the 2009 Agreement was a negotiated, arms-length contract. Again, to highlight that analysis, the 2009 Agreement establishes constraints on WTCPUA's ratemaking authority, where the rates must be charged as a Monthly Charge and flat Volumetric Rate, based upon the Costs of the LCRA System–a list of allowable items.[114] This 2009 Agreement also requires the WTCPUA to have capacity available in its system to provide wholesale water treatment services to TCMUD 12, but TCMUD 12 has the freedom to request

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111 TCEQ Docket No. 2009-0048-UCR, PFD at 11 (WTCPUA's Initial Brief, Attachment D).

112 Direct Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 1 at 63 (JAD Exhibit 2).

113 Direct Testimony of Joseph A. DiQuinzio, Jr., TCMUD 12 Ex. 1 at 6:16-20.

114 Direct Testimony of Donald G. Rauschuber, P.E., WTCPUA Ex. 1 at 68 and 75-77 (Attachment G).

wholesale water treatment services on an as-needed basis.[115] Plus, TCMUD 12 negotiated a non-terminating right to capacity in WTCPUA's facilities, which can be sold and transferred to third parties.[116] Further, TCMUD 12 was represented by counsel in those negotiations.[117] Clearly, such negotiated terms in the 2009 Agreement reveal that in 2009, either (1) the LCRA/WTCPUA needed TCMUD 12 more than TCMUD 12 needed the LCRA/WTCPUA; or (2) TCMUD 12 and the LCRA/WTCPUA had essentially the same level of bargaining power. Either way, WTCPUA, at a minimum, did not have disparate bargaining power over TCMUD 12.

Once the parties entered into the 2009 Agreement, the status of their respective levels of bargaining power did not change. As noted in *Multi-County*, a seller's need to keep a customer is reasonable, and is not an exploitation of disparate bargaining power.[118] Further requiring a party to stand by its contractual obligations would not be considered disparate bargaining power.[119] The mere fact that the WTCPUA implemented the Protested Rates does not suggest any disparate bargaining power on the part of the WTCPUA.[120] The negotiated 2009 Agreement affords the WTCPUA the right to revise the rates and, in this instance, to lower the rates to an all-time low in accordance with the Costs of the LCRA System. There is no evidence in the record that the Protested Rates seek to recover costs that are not Costs of the LCRA System.

WTCPUA expert witness Baudino also testified that the 2012 Amendment further demonstrates that WTCPUA, after entering into the 2009 Agreement, still did not have disparate bargaining power over TCMUD 12. Baudino notes that the fact that TCMUD 12 was able to negotiate additional considerations from the LCRA and WTCPUA in the 2012 Amendment

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115 *Id.* at 71-73 (§§ 1.03, 3.01.a., and 3.03.a.).

116 *Id.* at 85.

117 *See* WTCPUA's Initial Brief at 18 (fn. 33).

118 TCEQ Docket No. 2009-0048-UCR, PFD at 15 (WTCPUA's Initial Brief at Attachment D).

119 *Id.*

120 Direct Testimony of Richard A. Baudino, WTCPUA Ex. 2 at 29:13-15.

shows that it had substantial bargaining power.[121] A detailed discussion of those additional considerations is provided in Section VII.A.2.b. of WTCPUA's Initial Brief, and is reasserted herein.[122]

2. WTCPUA's voluntary, optional contract amendment in 2013 demonstrates that WTCPUA still does not have disparate bargaining power over TCMUD 12.

TCMUD 12 had the freedom of choice to revise its maximum reserved quantity and build-out schedule in the 2013 option. So much freedom, in fact, that it decided to reject that offer. As discussed in the WTCPUA's Initial Brief, WTCPUA's offer in 2013 to all of its wholesale water customers to amend their wholesale water agreements provides clear evidence that the WTCPUA did not have disparate bargaining power over TCMUD 12. Mr. Rauschuber explained the purpose of such offer as follows:

> The WTCPUA Board of Directors provided the wholesale customers with the opportunity to amend their wholesale contracts with the WTCPUA to revise their quantity of wholesale water treatment capacity and living unit equivalent uptake schedule. I believed that enabling our wholesale customers to update their individual reserved capacity would enable them to reduce (or increase) their individual impact on the System and to more accurately reflect the amount of water treatment capacity needed from WTCPUA over time. In other words, WTCPUA gave its wholesale customers an opportunity to reduce or increase their contractual obligation with WTCPUA, which would consequently impact their rates as well.[123]

In other words, the WTCPUA, after taking over control of the LCRA System and holding Wholesale Customer Committee meetings, opted to work with its wholesale customers so they could revise these capacity reservations and projections if they wanted to. The WTCPUA does

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[121] Tr. at 335:22-336:11 (Baudino Cross) (Apr. 22, 2015).

[122] WTCPUA's Initial Brief at 33.

[123] Direct Testimony of Donald G. Rauschuber, P.E., WTCPUA Ex. 1 at 25:6-14 and 22-24.

not have the authority to unilaterally amend the quantity of wholesale water treatment capacity or the living unit equivalent uptake schedule established under the 2009 Agreement.[124] However, WTCPUA does have the ability to amend the wholesale water treatment service rates, so long as they adhere to the methodology in the 2009 Agreement. In other words, WTCPUA's inclusion of the formula for allocating costs in the proposed contract amendments has no bearing on the ability of the WTCPUA to set rates, or on the November 21, 2013 Order of the Board of Directors adopting the Protested Rates, which utilized such formula. Thus, WTCPUA intended for these allocations to apply to all of the WTCPUA's wholesale customers system-wide, and including such formula in the amendment contracts memorializes how the costs would be allocated as of the effective date of the amendment.

In addition to Mr. Rauschuber's testimony, the evidence supports the contention that this amendment opportunity was an *option* for the customers, as only six of WTCPUA's wholesale customers chose to amend their agreements.[125] Further, WTCPUA expert witness Baudino testified that based upon his review of Rauschuber's testimony, the wholesale customers had bargaining power in this amendment process, noting that WTCPUA actually sought them out to do that.[126] Contrary to TCMUD 12's contention in its Initial Brief, the wholesale customers had ample time to consider the amendment option, as these six agreements were executed over a period of 10 months.[127]

As noted by TCMUD 12, it did not think it was a good idea to give up any of its reserved capacity, because doing so "in the time of the worst drought in this history of Texas would not be

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124 Direct Testimony of Donald G. Rauschuber, P.E., WTCPUA Ex. 1 at 83 (Attachment G at § 7.06).

125 TCMUD 12 Ex. 7, 10, 12, 15, 16, 18, and 20.

126 Tr. 340:2-10 (Baudino Cross) (Apr. 22, 2015).

127 *Id.*

a smart policy decision."[128] Accordingly, TCMUD 12 decided not to further amend the 2009 Agreement. That being said, the fact that TCMUD 12 decided not to further amend the 2009 Agreement in 2013 is additional evidence that WTCPUA does not have the power to control quantity or prices. Rather, this series of events is evidence that TCMUD 12 still has a choice, and contrary to TCMUD 12's Initial Brief, a party's power to accept or reject an offer is prima facie evidence that it has (at least) equal bargaining power as the offering party.

TCMUD 12's critiques of the 2013 amendment in its Initial Brief ignore the fact that this agreement was optional. WTCPUA's decision to provide a forum for TCMUD 12 (and its other wholesale customers) to consider whether or not to amend its 2009 Agreement is neither an example of disparate bargaining power or evidence of an abuse of alleged monopoly power.

C. Protested Rates Do Not Evidence an Abuse of Alleged Monopoly Power

TCMUD 12 has not demonstrated how the Protested Rates, in light of 16 TAC § 24.133(a)(3)(A), evidence an abuse of WTCPUA's alleged power. TCMUD 12 failed to provide evidence that could characterize the WTCPUA's decision to reduce the wholesale water treatment service rates charged to TCMUD 12 to *the lowest rates ever approved* (despite the ongoing growth of the TCMUD 12's system), as abusive. Rather, TCMUD 12 merely makes claims based upon issues unrelated to the Protested Rates, such as impact fees, the 2013 contract amendment that it rejected, and the Wholesale Customer Committee meetings that it did not even fully participate in.

1. Connection fees do not pertain to the Protested Rates and are irrelevant in this proceeding.

TCMUD 12's claim that WTCPUA inappropriately changed the amount of the Connection Fee in the 2009 Agreement is outside the bounds of the hearing and simply wrong.

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[128] Tr. at 90-91:15 (DiQuinzio Cross) (Apr. 21, 2015).

Rather, it is an issue to be litigated in District court. In any event, a review of the 2012 Amendment in its entirety reveals that TCMUD 12 has missed other critical terms of this Amendment refuting TCMUD 12's assertion that the WTCPUA does not have the authority to amend its Connection Fees. Specifically, Section 6 of the 2012 Amendment states "[b]y execution of this Agreement, the District expressly consents to the LCRA's assignment of all of its rights, title, interest, obligations, and responsibilities under the [2009 Agreement] to the [WTC]PUA . . ." Further, Section 4.01.a. of the 2009 Agreement provides that "[f]or the term of this Agreement, the Connection Fee will be the amount established from time to time in the LCRA Rate Schedule for the rate district in which the District Service Area is located." DiQuinzio's summary in his testimony, as cited by TCMUD 12 in its Initial Brief as an example of an abuse of monopoly power, fails to consider these critical contract provisions quoted above.

2. WTCPUA's Wholesale Customer Committee meetings do not demonstrate an abuse of alleged monopoly power.

TCMUD 12's critiques of the WTCPUA's Wholesale Customer Committee do not amount to WTCPUA abusing any monopoly power. Rauschuber's detailed testimony of the goals, events, and results of WTCPUA's six Wholesale Customer Committee meetings[129] rebuts TCMUD 12's contentions that there was no meaningful dialogue at such meetings (or at least the meetings that the TCMUD 12 representatives actually attended). WTCPUA conducted the Committee meetings over a nearly four-month period (January 28, 2013 to May 14, 2013), to gain input from its wholesale customers in the development of its allocation of costs, and TCMUD 12 did not present its critiques of the rates to WTCPUA until approximately six months after the conclusion of those meetings, just days before the Board of Directors of the WTCPUA considered amending the wholesale rates.

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[129] Direct Testimony of Donald G. Rauschuber, P.E., WTCPUA Ex. 1 at 22-24 and 33:6-31.

IV. WTCPUA DID NOT CHANGE THE METHODOLOGY FOR THE COMPUTATION OF THE REVENUE REQUIREMENT OR RATE, AND THE PROTESTED RATES DO NOT EVIDENCE AN ABUSE OF POWER

TCMUD 12's argument regarding a change in methodology hinges on its misinterpretation of the terms "cost of service" and a change in revenue requirement or rate "methodology" in the Commission's rules. TCMUD 12 posits an interpretation of cost of service that directly conflicts with the other experts in this case and the intent of Commission rule prohibiting a cost of service examination. Further, TCMUD 12's argument inappropriately concentrates on changes in allocations which fall within a cost of service examination that is not permitted in this proceeding. However, even if there was a change in revenue requirement or rate methodology, TCMUD 12 has failed to show that such a change evidences an abuse of power.

A. Cost of Service Analysis is not Relevant to Determining Whether There is a Change in Revenue Requirement Methodology.

As explained in WTCPUA's Initial Brief, the Commission's rules limit this proceeding to a determination of whether the Protested Rates are adverse to the public interest, and specifically state that 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*."[130] Despite the clear and unambiguous language in the rule, TCMUD 12 argues that an examination of the cost of service formula is allowed by the rule because it believes the terms "cost of service" and "revenue requirement" are interchangeable.[131] TCMUD 12's interpretation not only contradicts the plain language of the rule, but also the intent of the rule.

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[130] 16 TAC § 24.133(b) (emphasis added); WTCPUA's Initial Brief at 64-66.

[131] TCMUD 12's Initial Brief at 16.

1. TCMUD 12 misinterprets the meaning of the term "cost of service" in 16 TAC § 24.133(a)(3)(C).

Because they have the force and effect of statutes, administrative rules are construed the same as statutes.[132] The primary objective in the construction of statutes is to ascertain and give effect to the drafters' intent, which is determined from the ordinary meaning of the words.[133] If a statute is unambiguous, the interpretation supported by the plain language is adopted, unless the interpretation will lead to "absurd results."[134] However, "[w]ords and phrases that have acquired a technical or particular meaning, whether by legislative definition or otherwise, shall be construed accordingly."[135] Therefore, when technical terms are not defined, the term must be interpreted in light of the testimony of expert witnesses that are familiar with that particular art, science, or trade.[136] If technical or other specialized knowledge will assist the Commission in understanding the evidence or determining a fact in issue, a witness "qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise."[137]

a. The plain language of the term "cost of service" is inconsistent with TCMUD 12's interpretation.

Arguably, the term "cost of service" could be interpreted based on its ordinary meaning, literally, the cost to provide service to a particular customer. Under that interpretation, the cost of service or cost to serve each customer would also be characterized as the allocation of the

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[132] *AEP Texas Commercial & Indus. Retail Ltd. P'ship v. Pub. Util. Comm'n of Texas*, 436 S.W.3d 890, 905-06 (Tex. App.—Austin 2014, no. pet. h.) ("AEP Texas").

[133] *AEP Texas*, 436 S.W.3d at 906; Tex. Gov't. Code Ann. § 312.005 (West 2013).

[134] *AEP Texas*, 436 S.W.3d at 906.

[135] Tex. Gov't Code § 311.011(b) (West 2013).

[136] *Lloyd A. Fry Roofing Co. v. State*, 541 S.W.2d 639, 642-43 (Tex. Civ. App.—Dallas 1976, writ ref'd n.r.e.) *citing Order of Railway Conductors v. Swan*, 329 U.S. 520, 525-28 (1947); *Texas Alcoholic Beverage Comm'n v. Major Brands of Texas, Inc.*, 492 S.W.2d 616, 620 (Tex. Civ. App.—Austin 1973, no writ).

[137] Tex. R. Evid. 702.

utility's overall revenue requirement to individual customers. Therefore, the term "cost of service" cannot be synonymous with "revenue requirement," which is the total revenue required by a utility to cover the system costs of the utility to serve its entire customer base.

b. The technical interpretation of "cost of service" is inconsistent with TCMUD 12's position

If "cost of service" is determined to be a technical term, then it is uncontroverted by the TCMUD 12, WTCPUA, and Commission Staff expert witnesses who testified as to their interpretation of the terms "cost of service" and "revenue requirement" contained in the Commission rule, that the terms are *not* interchangeable. The WTCPUA presented Mr. Jack Stowe's ("Stowe") interpretation of these two terms, and he opined that, no expert in the utility ratemaking field would intentionally use those terms interchangeably.[138] Further, Stowe's interpretation is consistent with the American Water Works Association ("AWWA") M1 Manual,[139] a treatise relied upon by experts in the field of ratemaking.[140] Stowe and the AWWA M1 Manual consider the cost of service to be the second step in a three-step process to set rates based on the allocation of costs.[141] Ms. Graham also testified that the cost of service was distinct from the revenue requirement.[142] Even TCMUD 12 witness Mr. Jay Joyce ("Joyce"), is aligned with Stowe and Graham in this regard, as follows:

- Joyce conceded that he does not disagree with the AWWA M1 Manual;[143]
- Joyce admitted that the AWWA M1 Manual is certainly one of the accepted rate making methodologies;[144]

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138 *See* Rebuttal Testimony of Jay Joyce, TCMUD 12 Ex. 5 at 115 (Exhibit JJJ R23).

139 *See* WTCPUA's Initial Brief at 62-64; AWWA M1 Manual, WTCPUA Ex. 73, at 4.

140 Direct Testimony of Jack Stowe, WTCPUA Ex. 3 at 9:18-10:12.

141 WTCPUA's Initial Brief at 63-64.

142 Direct Testimony of Heidi Graham, Commission Staff Ex. 1 at 10:3-15.

143 Tr. 157:23-25 (Joyce Cross) (Apr. 21, 2015).

144 Tr. 157:23-158:5 (Joyce Cross) (Apr. 21, 2015).

- Joyce acknowledged that the AWWA M1 Manual provides a 3-step process, differentiating between the revenue requirement analysis and cost of service analysis;[145]
- Joyce admits that under the AWWA M1 Manual, the first step is the revenue requirement analysis; the second step is the cost of service analysis, and the third step is the rate design analysis;[146]
- Joyce admits that there is a difference between the revenue requirement and cost of service, where for a wholesale customer, there may be a revenue requirement for the whole system, and the cost of service is typically separating those costs or allocating those costs into various functions or customer classes;[147] and
- During the hearing, Joyce testified that the terms "revenue requirement methodology" and "cost of service methodology" *are not synonymous.*[148]

If the terms "revenue requirement" and "cost of service" are interchangeable (as asserted by TCMUD 12, despite Joyce's testimony to the contrary), an interpretation of 16 TAC § 24.133(a)(3)(C) with those terms used interchangeably will lead to absurd, unintended results. For example, 16 TAC § 24.133(b) would thus be read to say that the Commission shall not determine whether the protested rate adversely affects the public interest based on an analysis of the seller's *revenue requirement*. Such an interpretation would place 16 TAC § 24.133(b) in direct conflict with 16 TAC § 24.133(a)(3)(C), which specifically requires an examination of the revenue requirement *methodology* when determining whether rates are adverse to the public interest. TCMUD 12 cannot have it both ways.

c. TCMUD 12's interpretation of "cost of service" is inconsistent with the Commission rules.

The intent of the rule also indicates that cost of service was specifically taken off the table for consideration in a public interest examination. In the preamble to 16 TAC § 24.133, the Commission specifically concluded that "under the adopted bifurcated hearing procedure the

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145 Tr. 157:9-22 (Joyce Cross) (Apr. 21, 2015); and Tr. 158:8-14 (Joyce Cross) (Apr. 21, 2015).

146 Tr. 196:2-17 (Joyce Cross) (Apr. 21, 2015).

147 Tr. 196:18-197:4 (Joyce Cross) (Apr. 21, 2015).

148 Tr. at 153:4-7 (Joyce Cross) (Apr. 21, 2015).

commission should not consider cost of service in the determination on public interest."[149] While cost of service considerations concern the actual cost to serve a particular customer, wholesale agreements are based on a long-term contractual agreement between the parties, which does not necessarily detail the cost to serve the customer. The Commission recognized this fact in the preamble to 16 TAC § 24.133, explaining that the circumstances that justify cost of service ratemaking are not present in a public interest examination and that "disputes concerning wholesale rates which have come before the commission concern parties who are in a position quite different than the typical retail customer."[150] As addressed in WTCPUA's Initial Brief, the Preamble also explains that an analysis of cost of service is not appropriate because (1) the public interest criteria address the facts at the heart of the dispute, (2) cost of service is not a reliable mechanism for the public interest due to the subjective nature of the examination, and (3) cost of service would not give the appropriate deference to the contractual agreements between the seller and purchaser.[151]

TCMUD 12 also points to Your Honor's prior acknowledgement in the *Corsicana* case that the terms "cost of service" and "revenue requirement" were synonymous.[152] However, TCMUD 12 fails to cite the entirety of the conclusion reached in *Corsicana* and ignores the critical distinction between a cost of service study and a cost of service analysis, which was clarified by the testimony of the rate experts in this matter, including Mr. Joyce.[153] In *Corsicana*, Your Honor stated that the terms were synonymous based on an examination of 30 TAC

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149 WTCPUA Ex. 76 at 2.

150 *Id.*

151 WTCPUA's Initial Brief at 65; WTCPUA Ex. 76.

152 TCMUD 12's Initial Brief at 16 citing *Appeal of Navarro County Wholesale Ratepayers to Review the Wholesale Rate Increase Imposed by the City of Corsicana, Certificate of Convenience and Necessity No. 10776, in Navarro County*, SOAH Docket No. 582-10-1944; TCEQ Docket No. 2009-1925-UCR, PFD at 51 (Aug. 17, 2011).

153 Tr. at 153:8-13 (Joyce Cross) (Apr. 21, 2015).

§ 291.129(3) & (4).[154] The statement that the terms were synonymous was followed by the conclusion that the Cash and Utility Basis were the methods used to compute "cost of service" and "revenue requirement."[155] Thus, Your Honor and the rule use the term "cost of service" in the broader context of a "cost of service study." Even TCMUD 12 witness Joyce agrees that a "cost of service study" is different than "cost of service" and that a "cost of service study" has several parts to it.[156] Furthermore, the preamble to the Commission's rule indicates that the drafters believed "cost of service" to be distinct from "revenue requirement," specifically addressing whether a "cost of service" examination was appropriate during the public interest phase.[157]

As WTCPUA witness Stowe explained at the hearing, Joyce attempted to use a "holistic" approach to rate setting which encompasses not only the revenue requirement phase and the rate design phase, but also the cost of service process.[158] The cost of service process involves a series of allocations of the various components based on cost causal principles.[159] It is precisely this process of examining the cost causal principles that 16 TAC § 24.133(b) prohibits in considering whether the public interest was violated. Stowe believes Joyce's position regarding allocations to be a misinterpretation of the rule.[160] He explained that the rule was intended to determine only whether there was a change in the revenue requirement or the rate structure.[161]

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154 Now, 16 TAC § 24.129(3) & (4). *See* WTCPUA's Initial Brief at 97-98, Attachment A.

155 *Id.*

156 Tr. at 153:8-13 (Joyce Cross) (Apr. 21, 2015).

157 WTCPUA Ex. 76.

158 Tr. at 362:22-363:1 (Stowe Cross) (Apr. 22, 2015).

159 Tr. at 363:12-16 (Stowe Cross) (Apr. 22, 2015).

160 Tr. at 363:21-22 (Stowe Cross) (Apr. 22, 2015).

161 Tr. at 365:10-15 (Stowe Cross) (Apr. 22, 2015).

Consistent with Stowe's expert opinions, a review of Joyce's own list of utility projects that he has worked on indicates that he views revenue requirements, cost of service, and rate design to be distinct tasks (that he has performed).[162] Joyce further conceded that if there was only one customer class, then the revenue requirement and cost of service examinations would be the same because there are not separate customer classes to allocate the various costs to in the cost of service step.[163] Joyce incorrectly believes, however, the prohibition against a cost of service examination is limited to an examination of the "magnitude of the numbers that are used to set the rates."[164]

Under Joyce's misguided interpretation, he claims that he looks at all methodologies that are "used to set the rates" when he discusses a "change in methodology."[165] He believes that "changing the methodology means changing the components of the calculations."[166] However, Joyce could not definitively say whether a specific revenue requirement line item expense change, such as a consultant being replaced with an employee, would amount to a change in methodology.[167] Joyce also claimed that if there was a change in the dollar amount for an individual line item, that situation could be a change in methodology.[168] He argued that because certain costs were zero in 2013 and then larger numbers in 2014, there was a change in

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[162] Tr. at 162:1-164:10 (Joyce Cross) (Apr. 21, 2015); Direct Testimony of Jay Joyce, TCMUD 12 Ex. 2 at 33 (Exhibit JJJ-2).

[163] Tr. at 197:5-13 (Joyce Cross) (Apr. 21, 2015).

[164] Tr. at 572:2 (Joyce Rebuttal) (Apr. 23, 2015).

[165] Tr. at 134:6-136:13 (Joyce Cross) (Apr. 21, 2015).

[166] Tr. at 133:20-24 (Joyce Cross) (Apr. 21, 2015).

[167] Tr. at 138:18-139:2 (Joyce Cross) (Apr. 21, 2015).

[168] Tr. at 142:23-143:17 (Joyce Cross) (Apr. 21, 2015).

"methodology."[169] In direct contrast with Joyce's opinion, *Multi County* explained that a change in conditions or fluctuations within components is not a change in methodology.[170]

In further contrast to Joyce's position, Commission Staff witness Graham described the difference between methodology and components that feed into the revenue requirement. Graham explained that the methodology used to calculate depreciation is a set process and changing a service life is only one component of the overall methodology. Thus, a change in a service life of one line item or component would not be a change in the overall methodology used to calculate depreciation.[171] Similarly, WTCPUA witness Stowe's approach, which is consistent with Graham's, provides a "bright line rule and guidance" for the Commission and water utilities.[172]

Although not entirely clear, it appears that Joyce's interpretation requires an examination of the "major components" to determine if there was a change in methodology.[173] He further opined that whether there was a methodology change would "depend on the circumstances."[174] When asked by counsel for TCMUD 12 to state what he would advise his own clients, Joyce's explanation is unclear, at best. Joyce merely suggested that he would advise his clients to provide a "specific justification" for any change, but failed to articulate what changes would or would not be considered a change in methodology.[175] When pressed further by counsel for Commission Staff on how his interpretation could be applied in the future, Joyce asserted that the

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169 Tr. at 145:15-146:15 (Joyce Cross) (Apr. 21, 2015).

170 *See* WTCPUA's Initial Brief at 71, Attachment D.

171 Tr. at 405:23-406:4 (Graham Cross) (Apr. 22, 2015).

172 Tr. at 364:21-365:1 (Stowe Cross) (Apr. 22, 2015).

173 Tr. at 567:1-4 (Joyce Cross) (Apr. 23, 2015).

174 Tr. at 569:4-5 (Joyce Rebuttal) (Apr. 23, 2015).

175 Tr. at 569:24-570:2 (Joyce Rebuttal) (Apr. 23, 2015).

examination would "depend on [the] client" and "clients are different."[176] Attempting to provide an example, he claimed that building a new treatment plant would result in "minimal" risk, but adding two dozen new wholesale customers with different rate contracts would create "some risk."[177] Further complicating Joyce's interpretation, he conceded that another rate consultant could view the situation of a new treatment plant (that he believed to present "minimal risk") to be a change in methodology.[178] Joyce's interpretation is simply unworkable and provides no guidance or clarity going forward, either for utilities or the Commission. If TCMUD 12's interpretation is correct, each time a utility experiences a change in the appropriate allocation of costs to customers, a public interest hearing would be triggered. This would result in a public interest hearing *every time a wholesale rate was established.* Such an interpretation is unworkable and contrary to the intent of the Commission's rule.

TCMUD 12 also mistakenly claims that the Commission's ruling that the formulas and methodologies used to compute cost of service were *discoverable* makes a cost of service examination appropriate.[179] However, fatal to its claim, the Commissioners made no indication that they believed the information requested was actually *relevant* to or *admissible* in this proceeding. Rather, the Commission's ruling merely made the discovery of that evidence proper. As TCMUD 12 argued in its motion to compel, the "scope of discovery is wider than the scope of what is admissible at a hearing, so that discovery may be had of even inadmissible evidence if the information sought is 'reasonably calculated to lead to the discovery of admissible evidence.'"[180] Furthermore, TCMUD 12 specifically stated that its appeal of SOAH

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[176] Tr. at 575:10-11 (Joyce Rebuttal) (Apr. 23, 2015).

[177] Tr. at 575:12-19 (Joyce Rebuttal) (Apr. 23, 2015).

[178] Tr. at 575:21-576:1 (Joyce Rebuttal) (Apr. 23, 2015).

[179] TCMUD 12's Initial Brief at 17, citing Order on Appeal of SOAH Order No. 6 (Nov. 24, 2014).

[180] TCMUD 12's Motion to Compel the WTCPUA Responses to TCMUD 12's Third Requests for Information at 3 (Oct. 7, 2014).