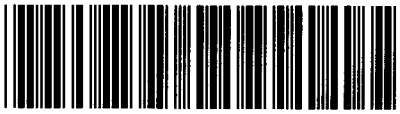

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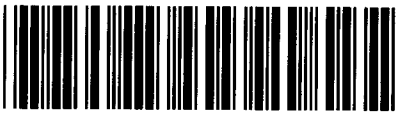

Item Number: 164

Addendum StartPage: 0

State Office of Administrative Hearings

Cathleen Parsley
Chief Administrative Law Judge

September 30, 2015

TO: **Stephen Journeay, Director**
Commission Advising and Docket Management
William B. Travis State Office Building
1701 N. Congress, 7th Floor
Austin, Texas 78701

Courier Pick-up

RE: **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

Enclosed is the Proposal for Decision (PFD) in the above-referenced case. By copy of this letter, the parties to this proceeding are being served with the PFD.

Please place this case on an open meeting agenda for the Commissioners' consideration. There is no deadline in this case. Please notify me and the parties of the open meeting date, as well as the deadlines for filing exceptions to the PFD, replies to the exceptions, and requests for oral argument.

Sincerely,

William G. Newchurch

William G. Newchurch
Administrative Law Judge

WGN/Ls
Enclosure
xc: All Parties of Record

164

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

TABLE OF CONTENTS

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**

PROPOSAL FOR DECISION

I. INTRODUCTION

Travis County Municipal Utility District No. 12 (TCMUD 12), on behalf of itself and Travis County Municipal Utility District Nos. 11 and 13 (TCMUDs 11 and 13), asks the Public Utility Commission of Texas (PUC or Commission) to find that the rates (Protested Rates) they are charged by West Travis County Public Utility Agency (WTCPUA) pursuant to a contract for wholesale water treatment service adversely affect the public interest. TCMUD 12 asks the Commission, after making that finding, to remand this case to the Administrative Law Judge (ALJ) for further hearing so that the Commission can set the rates TCMUDs 11, 12, and 13 should pay WTCPUA for the service.

The other parties contend that TCMUD 12 has failed to prove that the Protested Rates adversely affect the public interest. They ask the Commission to dismiss TCMUD 12's petition. The ALJ agrees with the other parties and recommends that the Commission dismiss the petition with prejudice to refiling.

II. PARTIES

The following are the parties in this case:

PARTY	REPRESENTATIVE
TCMUDs 11, 12, and 13 (collectively, TCMUD 12)	Kay Trostle & Miguel Huerta
WTCPUA	David Klein, Georgia Krump, & Melissa Long
City of Bee Cave, Texas (Bee Cave)	Jim Haley
Hays County, Texas (Hays County)	Mark D. Kennedy
West Travis County Municipal Utility District No. 5 (District 5)	Randy Wilburn
PUC Staff	Jessica Gray & Sam Chang
Texas Commission on Environmental Quality (TCEQ), Office of Public Interest Counsel (OPIC)[1]	Rudy Calderon

III. PROCEDURAL HISTORY

The following are the major procedural events in this case:

DATE	EVENT
March 6, 2014	TCMUD 12's petition filed with TCEQ
April 11, 2014	WTCPUA response to petition
April 28, 2014	TCEQ referral to SOAH
May 9, 2014	TCEQ notice of preliminary hearing[2]
June 11, 2014	Preliminary hearing by SOAH for TCEQ
July 14, 2014	Discovery began
August 15, 2014	Deadline for requests for disclosure
September 1, 2014	Jurisdiction transferred from TCEQ to PUC
September 11, 2014	Prehearing conference to consider necessary adjustments due to transfer of jurisdiction
September 12, 2014	TCMUD 12 Motion Amending Jurisdictional Claim & TCEQ Executive Director's Motion to Withdraw

[1] This case was originally filed with the Texas Commission on Environmental Quality (TCEQ). OPIC was admitted as a party when the TCEQ had jurisdiction and has not moved to withdraw as a party.

[2] Executive Director (ED) Ex. B.

DATE	EVENT
September 18, 2014	SOAH Order 4 – Memorializing PHC, Granting Motion to Amend Jurisdictional Claim, and Granting Motion to Withdraw
September 30, 2014	SOAH Order 6 – Granting In Part & Denying in Part Motion to Compel
October 10, 2014	TCMUD 12's Interim Appeal of SOAH Order No. 6
October 17, 2014	WTCPUA Response to TCMUD 12's Interim Appeal of SOAH Order No. 6
October 31, 2014	TCMUD 12's direct case evidence filed
November 5, 2014	SOAH Order 9 – Ruling on Motions to Determine Sufficiency and Motion to Compel
November 24, 2014	PUC Order Granting TCMUD's Appeal of SOAH Order No. 6
December 19, 2014	WTCPUA Direct Testimony Filed
February 6, 2015	PUC Staff Direct Testimony Filed
March 6, 2015	Discovery on TCMUD 12 direct case ends
March 6, 2015	WTCPUA Motion for Partial Summary Decision
March 18, 2015	TCMUD 12 Response to WTCPUA Motion for Partial Summary Decision
March 18, 2015	Staff Response to WTCPUA Motion for Partial Summary Decision
March 24, 2015	TCMUD Rebuttal Testimony filed
March 25, 2015	SOAH Order 13 – Granting Part & Denying Part of Motion for Partial Summary Disposition
April 13, 2015	Prehearing Conference
April 15, 2015	SOAH Order 15 – Granting Revised Motion to Compel and Ruling on Objections to Prefiled Evidence
April 17, 2015	SOAH Order 16 – Ruling on Objections to Prefiled Rebuttal Evidence
April 21-23, 2015	Hearing on the Merits
May 1, 2015	SOAH Order 17 – Setting out Post-Hearing Schedule and Briefing Outline
June 26, 2015	Initial Closing Briefs due date
August 3, 2015	Reply Briefs due date

IV. BACKGROUND

To understand the current dispute, one must first understand a complex set of entities and their relationships, contracts, and actions. These are described below.

TCMUDs 11, 12, and 13 are conservation and reclamation districts created and functioning under article 16, section 59 of the Texas Constitution and chapters 49 and 54 of the

Texas Water Code.[3] They are also "retail public utilities" because they are "operating, maintaining, or controlling in this state facilities for providing potable water service or sewer service, or both, for compensation."[4] All three provide retail water service to geographically distinct areas within a larger area in Travis County, Texas, known as "The Highlands."[5] TCMUD 11 also serves an adjacent area, known as "Rough Hollow."[6]

WTCPUA is a Texas public utility agency, a political subdivision of the state of Texas organized under chapter 572 of the Texas Local Government Code.[7] It was formed by Bee Cave, Hays County, and District 5 (collectively, "Participants").[8] WTCPUA is governed by a five-member board of directors.[9] The board of directors consists of one person appointed by each of the Participants and two additional directors appointed by Participants' appointees.[10] In keeping with a series of contracts as described below, WTCPUA diverts raw water owned by TCMUD 12 from Lake Austin in Travis County, Texas, and transports, treats, and delivers the treated water to TCMUD 12, in that same county.[11]

On September 25, 2008, TCMUD 12 and the Lower Colorado River Authority (LCRA) entered into a contract (Raw Water Contract) under which LCRA provided up to 1,680 acre-feet of raw water per year to TCMUD 12 for municipal use by TCMUDs 11, 12, and 13 within their service areas.[12] Additionally, in October 2009, TCMUD 12 and LCRA entered into a separate wholesale water services agreement (Water Services Agreement).[13] In that agreement, LCRA

[3] TCMUD 12 Ex. 1 at 4.

[4] Tex. Water Code § 13.002(19).

[5] TCMUD 12 Ex. 1 at 4, Ex. 6.

[6] TCMUD 12 Ex. 1 at 4.

[7] Tex. Water Code § 572.052(c)(2).

[8] WCTPUA Ex 1, attach. D at 51, 54–55, 59–60, 63–64.

[9] WCTPUA Ex 1, attach. D.

[10] WCTPUA Ex 1, attach. D at 57.

[11] There is no evidence or contention that any law, other than contract law, requires WTCPUA to provide water service to TCMUD 12.

[12] TCMUD 12 Ex. 1 at 4–5 & JAD Ex. 2 at 67, 135.

[13] TCMUD 12 Ex. 1 at JAD Ex. 4.

agreed to divert, transport, and treat, as needed, the raw water that TCMUD 12 had purchased from LCRA under the Raw Water Contract and to deliver that treated water to TCMUD 12 at a specified delivery point.[14] In the Water Services Agreement, TCMUD 12 agreed to pay LCRA:

- a one-time connection fee per each living unit equivalent (LUE) for each new retail customer that connected to the TCMUD 11, 12, or 13 systems;[15]
- a monthly charge for each calendar month;[16] and
- a monthly volumetric rate for diversion, transportation, treatment, and delivery of the actual amount of water delivered to TCMUD 12 during the month.[17]

The connection fee was designed to recover all or part of LCRA's costs for capital improvements or facility expansions intended to serve new development in LCRA's service area.[18] The monthly charge was designed primarily to recover TCMUD 12's allocable share of LCRA's capital-related costs of the system used to provide service (West Travis County System) that were not recovered through the connection fee.[19] The volumetric rate was designed primarily to recover LCRA's operation and maintenance costs, together with LCRA's other costs not recovered through the connection fee or the monthly charge.[20] The connection fee was initially set at $4,120 per LUE, the monthly charge was initially set at $9,430 per month, and the volumetric rate was initially set at $2.40 per 1,000 gallons.[21] The Water Services Agreement provided that LCRA could modify the connection fee, monthly charge, and volumetric rate to recover TCMUD 12's proportionate, just, reasonable, nondiscriminatory, fair, and equitable cost share of the costs of the West Travis County System.[22]

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[14] TCMUD 12 Ex. 1 at JAD Ex. 4 at 146.

[15] TCMUD 12 Ex. 1 at JAD Ex. 4 at 149.

[16] TCMUD 12 Ex. 1 at JAD Ex. 4 at 150.

[17] TCMUD 12 Ex. 1 at JAD Ex. 4 at 151.

[18] TCMUD 12 Ex. 1 at JAD Ex. 4 at 150.

[19] TCMUD 12 Ex. 1 at JAD Ex. 4 at 150.

[20] TCMUD 12 Ex. 1 at JAD Ex. 4 at 151.

[21] TCMUD 12 Ex. 1 at JAD Ex. 4 at 149–51.

[22] TCMUD 12 Ex. 1 at JAD Ex. 4 at 151.

Subsequently, in January 2012, LCRA and WTCPUA entered into a utilities installment purchase agreement (Utilities Purchase Agreement)[23] by which LCRA sold the West Travis County System, which included certain water and wastewater utility facilities in western Travis and Hays County, to WTCPUA. These included the facilities that LCRA had used to serve TCMUD 12, under the Water Services Agreement, and other water utilities. On March 19, 2012, after assuming operational control of the West Travis County System, WTCPUA adopted the monthly charge and volumetric rate that LCRA had charged (Initial Rates), including the rates charged to TCMUD 12.[24] Accordingly, WTCPUA's initial monthly charge to TCMUD 12 was $9,430 per month and the volumetric rate was $2.40 per 1,000 gallons,[25] the same as LCRA had charged.

In June 2012, LCRA, TCMUD 12, and WTCPUA entered into an agreement (Transfer Agreement), retroactively effective to March 19, 2012, regarding transfer of the operations of the West Travis County System.[26] In that agreement, LCRA assigned to the WTCPUA all obligations and duties of the LCRA under the Water Services Agreement, WTCPUA assumed those obligations and duties, and WTCPUA consented to the assignment and assumption.[27]

On November 15, 2012, the WTCPUA Board of Directors adopted an order increasing its wholesale water treatment service rates, including those charged to TCMUD 12, by 15.5% effective January 2013 (Prior Rates).[28] Specifically, the Prior Rates increased TCMUD 12's monthly charge from $9,430 to $10,891.65 and the volumetric rate from $2.40 to $2.77 per 1,000 gallons.[29] The Prior Rates were not appealed by TCMUD 12.

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[23] TCMUD 12 Ex. 1 at JAD Ex. 8.

[24] WTCPUA Ex. 1 at 15–16.

[25] WTCPUA Ex. 1 at 32.

[26] TCMUD 12 Ex. 1 at JAD Ex. 5.

[27] TCMUD 12 Ex. 1 at JAD Ex. 5 at 168–70.

[28] WTCPUA Ex. 3 at attach. F at 202.

[29] WTCPUA Ex. 3 at attach. F at 202.

Subsequently, on November 21, 2013, the WTCPUA Board of Directors adopted a rate order revising the wholesale water treatment service rates charged to TCMUD 12, effective January 1, 2014 (Protested Rates).[30] As compared to the Prior Rates, the Protested Rates decreased TCMUD 12's monthly charge from $10,891.65 to $8,140.89 and decreased its volumetric rate from $2.77 to $2.11 per 1,000 gallons.[31] TCMUD 12's petition in this case appeals the Protested Rates.

V. JURISDICTION

TCMUD 12 filed its petition[32] with TCEQ on March 6, 2014, and asserted TCEQ had jurisdiction under Texas Water Code §§ 11.036, 11.041, 12.013 and 13.043(f), and Texas Local Government Code § 572.061(d). TCEQ referred the case to SOAH for hearing and issued notice of a preliminary hearing.[33] At the June 11, 2014 preliminary hearing, the ALJ concluded that TCEQ had jurisdiction over the petition under Texas Water Code §13.043(f) and did not rule on other claimed, but disputed, jurisdictional bases because there was no need to do so at that time.[34]

On September 1, 2014, jurisdiction over certain functions was transferred from the TCEQ to the PUC.[35] Included within that transfer was jurisdiction under Texas Water Code §§ 12.013 and 13.043(f).[36] Jurisdiction under §§ 11.036 and 11.041 remains with TCEQ. To simplify matters in this case, TCMUD 12 moved to amend its petition to withdraw its claim of

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[30] WTCPUA Ex. 3 at attach. G; TCMUD 12 Ex. 1 at JAD 13 at 399.

[31] *Compare* WTCPUA Ex. 3 at attach. F at 202 *to* WTCPUA Ex. 3 at attach. G at 205–06 & TCMUD 12 Ex. 1 at JAD 13 at 399.

[32] ED Ex. A.

[33] ED Ex. B.

[34] SOAH Order No. 1 (Jun. 12, 2014).

[35] Acts 2013, 83rd Leg., R.S., Ch. 170 (H.B. 1600), eff. Sept. 1, 2013; Acts 2013, 83rd Leg., R.S., Ch. 171 (S.B. 567), eff. Sept. 1, 2013.

[36] H.B. 1600, §§ 2.07, 2.15; S.B. 567, §§ 7, 15.

jurisdiction under §§ 11.036 and 11.041, the TCEQ's ED moved to withdraw as a party, and the ALJ granted the motions.[37]

The PUC now has jurisdiction over the petition under Tex. Water Code § 13.043(f), which provides: "A retail public utility that receives water or sewer service from another retail public utility or political subdivision of the state . . . may appeal to the utility commission a decision of the provider of water . . . service affecting the amount paid for water . . . service." As set out above, TCMUDs 11, 12, and 13 are retail public utilities and WTCPUA is a political subdivision of the state. While WTCPUA does not sell water to TCMUD 12, it does provide "wholesale water service" to TCMUD 12, because the definition of "service" is extremely broad. Under Chapter 13 of the Texas Water Code:

> "Wholesale water . . . service" means potable water . . . service . . . provided to a person, political subdivision, or municipality who is not the ultimate consumer of the service.[38]
>
> "Service" means any act performed, anything furnished or supplied, and any facilities or lines committed or used by a retail public utility in the performance of its duties under this chapter to its patrons, employees, other retail public utilities, and the public, as well as the interchange of facilities between two or more retail public utilities.[39]

TCMUD 12 claims that the PUC also has jurisdiction under Texas Local Government Code § 572.061(d) and Texas Water Code § 12.013. That is incorrect. Texas Local Government Code § 572.061(d) does not grant jurisdiction to the PUC. Instead, it reserves rate-regulation jurisdiction that the state otherwise has. Texas Water Code § 12.013 authorizes the PUC to "fix reasonable rates for the furnishing of raw or treated water;" however, WTCPUA does not furnish water to TCMUD. Instead, it treats raw water furnished, or sold, to TCMUD 12 by LCRA.

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[37] SOAH Order No. 4 (Sep. 17, 2014).

[38] Tex. Water Code § 13.002 (25).

[39] Tex. Water Code § 13.002 (21).

VI. BURDEN OF PROOF

The parties agree that, as the petitioner, TCMUD 12 has the burden of proving that the Protested Rates are adverse to the public interest.[40]

VII. THE PUBLIC INTEREST DETERMINATION

A. Requirement for an Initial Public Interest Determination

The PUC has adopted rules to govern petitions and appeals concerning wholesale water and sewer service.[41] The rules "[s]et forth substantive guidelines and procedural requirements concerning . . . an appeal pursuant to [Texas Water Code] § 13.043(f)."[42] The PUC forwards an appeal to review a rate charged pursuant to a written contract to SOAH to conduct an evidentiary hearing to determine whether the protested rate adversely affects the public interest.[43] After the hearing, the ALJ prepares a Proposal for Decision (PFD) and order with proposed findings of fact and conclusions of law concerning whether the protested rate adversely affects the public interest, and submits that recommendation to the PUC.[44]

If the Commission determines the protested rate does not adversely affect the public interest, the Commission will deny the petition or appeal by final order.[45] On the other hand, if the Commission determines the protested rate does adversely affect the public interest, the Commission will remand the matter to SOAH for a second evidentiary proceeding on the rate.[46] No later than 90 days after the remand, the seller must file a cost of service study and other

[40] 16 Tex. Admin. Code § 24.136.

[41] 16 Tex. Admin. Code ch. 24, subch. I.

[42] 16 Tex. Admin. Code § 24.128(2).

[43] 16 Tex. Admin. Code §§ 24.131(c), .132(a).

[44] 16 Tex. Admin. Code § 24.132(c).

[45] 16 Tex. Admin. Code § 24.134(a).

[46] 16 Tex. Admin. Code § 24.134(b).

information that supports the protested rate.[47] After the second hearing, the ALJ prepares and submits to the Commission a second PFD and order with proposed findings of fact and conclusions of law recommending a rate, and the Commission sets a rate consistent with the ratemaking mandates of chapter 13 of the Texas Water Code.[48]

B. Determining Whether Public Interest Is Adversely Affected

The Commission has adopted a rule (Public Interest Rule)[49] specifying how it will determine if a protested rate adversely affects the public interest. The rule reads:

> (a) The commission shall determine the protested rate adversely affects the public interest if after the evidentiary hearing on public interest the commission concludes at least one of the following public interest criteria have been violated:
>
> (1) the protested rate impairs the seller's ability to continue to provide service, based on the seller's financial integrity and operational capability;
>
> (2) the protested rate impairs the purchaser's ability to continue to provide service to its retail customers, based on the purchaser's financial integrity and operational capability;
>
> (3) the protested rate evidences the seller's abuse of monopoly power in its provision of water or sewer service to the purchaser. In making this inquiry, the commission shall weigh all relevant factors. The factors may include:
>
> (A) the disparate bargaining power of the parties, including the purchaser's alternative means, alternative costs, environmental impact, regulatory issues, and problems of obtaining alternative water or sewer service;
>
> (B) the seller's failure to reasonably demonstrate the changed conditions that are the basis for a change in rates;
>
> (C) the seller changed the computation of the revenue requirement or rate from one methodology to another;
>
> (D) where the seller demands the protested rate pursuant to a contract, other valuable consideration received by a party incident to the contract;
>
> (E) incentives necessary to encourage regional projects or water conservation measures;
>
> (F) the seller's obligation to meet federal and state wastewater discharge and drinking water standards;

[47] 16 Tex. Admin. Code § 24.134(c).

[48] 16 Tex. Admin. Code § 24.134(e).

[49] 16 Tex. Admin. Code § 24.133.

> (G) the rates charged in Texas by other sellers of water or sewer service for resale;
>
> (H) the seller's rates for water or sewer service charged to its retail customers, compared to the retail rates the purchaser charges its retail customers as a result of the wholesale rate the seller demands from the purchaser;
>
> (4) the protested rate is unreasonably preferential, prejudicial, or discriminatory, compared to the wholesale rates the seller charges other wholesale customers.
>
> (b) 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.

Of these many factors, TCMUD 12 alleges only that WTCPUA has disparately greater bargaining power than TCMUD 12 and changed its methodologies for computing its revenue requirement and rates, thereby abusing its monopoly power. TCMUD 12 concedes that it has not pleaded or presented evidence concerning the other public interest factors. The ALJ granted WTCPUA's motion for partial summary judgement, concluding that the Protested Rates do not adversely affect the public interest when judged by the unpleaded criteria set out in subsections (a)(1), (2), (3)(B) and (D)–(H), and (4) of the Public Interest Rule.[50]

VIII. ALLEGED ABUSE OF MONOPOLY POWER

In this case, TCMUD 12 claims that WTCPUA has monopoly power and abused it because: (1) WTCPUA has disparately greater bargaining power than TCMUD 12, and (2) WTCPUA changed its methodologies, to the long-term disadvantage of TCMUD 12, when it computed the Protested Rates and the revenue requirement underlying them. Based on those alleged abuses of monopoly power, TCMUD 12 contends that the Protested Rates adversely affect the public interest.

The other parties believe that TCMUD 12 has not proven that the Protested Rates adversely affect the public interest. They insist that TCMUD 12 has failed to prove that WTCPUA changed its revenue-requirement or rate computation methodologies. They also argue that TCMUD 12 failed to prove that WTCPUA, or LCRA before it, has or had disparately

[50] SOAH Order No. 13 (Mar. 24, 2015).

greater bargaining power than TCMUD 12 or that WTCPUA or LCRA has or had monopoly power or abused monopoly power if it existed. Moreover, they contend that TCMUD 12 seeks to improperly rely on a cost-of-service analysis to prove its case, contrary to the prohibition in the Public Interest Rule.

The ALJ agrees with the parties other than TCMUD 12. He concludes that TCMUD 12 failed to prove that WTCPUA has or abused monopoly power or that the public interest is affected by the Protested Rates.

A. Bargaining Power of the Parties

The Public Interest Rule specifies five factors to be considered when determining if the parties to a contract have disparate bargaining power: (1) purchaser's alternative means, (2) purchaser's alternative costs, (3) environmental impact, (4) regulatory issues, and (5) problems of obtaining alternative water service.[51] TCMUD 12 does not argue that it and WTCPUA have disparate bargaining power due to environmental impact or regulatory issues. Instead, it contends that the other three factors show it has less bargaining power than WTCPUA. The other parties contend that TCMUD 12 has failed to prove that.

1. Alternative Means of Service and Problems in Obtaining Alternative Service

a. TCMUD 12 Is Free To Seek An Alternative

The ALJ concludes that TCMUD 12 was and is free to reduce the quantity of water services it receives from WTCPUA and obtain that service elsewhere. TCMUD 12 claims that a provision of the Water Services Agreement does not permit it to seek an alternative supplier of wholesale water service because its demand does not exceed the amount specified in the

[51] 16 Tex. Admin. Code § 24.133(a)(3)(A).

agreement.[52] However, WTCPUA looks at the same provision and notes that it does not require TCMUD 12 to obtain all of its raw-water treatment services from the LCRA.[53] Accordingly, WTCPUA has stipulated that TCMUD 12 is free to use an alternative even if its demand for treatment does not exceed the amount specified in the agreement.

To the extent there might still be doubt, WTCPUA removed it by offering TCMUD 12 a conditional option of amending the Water Services Agreement and reducing its reserved capacity in the WTCPUA system. Under the Water Services Agreement, TCMUD 12 is entitled to receive treatment from WCTPUA for a maximum flow of 3,980,000 gallons per day (gpd) of water, which is TCMUD 12's maximum reserved capacity in WTCPUA's system.[54] In a December 17, 2013 notice of the Protested Rates to take effect January 1, 2014, WTCPUA offered to allow TCMUD 12 to amend its contract to reduce its maximum reserved capacity in WTCPUA's West Travis County Facilities.[55]

TCMUD 12 contends that the offer was illusory and manipulative because it was only open for 10 days during the winter holiday season.[56] But the evidence shows that the offer was sincere and WTCPUA has left it open. WTCPUA made the same offer to its 13 other wholesale customers. As of December 19, 2014, approximately one year after WTCPUA made the offer, the following six had chosen to amend their agreements and change their maximum reserved capacities, as detailed below:

Entity	Original Max. Day Reservation	Amendment Date	Amended Max. Day Reservation
Hays County WCID No. 1	345,600 gpd[57]	Sept. 26, 2013	1,221,120 gpd
Hays County WCID No. 2[58]	618,624 gpd	Aug. 14, 2014	1,166,170 gpd

[52] TCMUD 12 Initial Brief at 24 (citing TCMUD 12 Ex. 1 at JAD Ex. 4, § 3.03.c).

[53] WTCPUA Initial Brief at 15.

[54] TCMUD 12 Ex. 1 at JAD Ex. 4 at 147.

[55] TCMUD 12 Ex. 1 at 11 & JAD Ex. 13.

[56] TCMUD 12 Initial Brief at 38 (citing TCMUD 12 Ex. 1 at 12 & JAD Ex. 13).

[57] Million gallons per day.

[58] TCMUD 12 Exs. 10, 11, 12.

Reunion Ranch WCID[59]	553,000 gpd	Mar. 28, 2014	603,692 gpd
Senna Hills MUD[60]	907,000 gpd	After Nov. 21, 2013[61]	575,000 gpd
Lazy 9 MUD[62]	5,068,000 gpd	Jan. 16, 2014	2,080,000 gpd
Barton Creek West WSC[63]	965,952 gpd	Mar. 18, 2014	679,000 gpd

b. Treatment Capacity Needed

Nevertheless, TCMUD 12 argues that voluntarily surrendering part of its reserved capacity in the WTCPUA would have been foolish because it is a very young district, the population in its service area is growing, and it expects to need its all of its reserved capacity between 2022 and 2025.[64] Under the Water Services Agreement, WTCPUA is obligated to provide TCMUD 12 with treatment services for approximately 1,640 retail water connections, or close to 2,125 LUEs.[65] That is the same number of LUEs that could be served with the maximum flow of 3,980,000 gpd that TCMUD 12 is entitled to have treated under the Water Services Agreement.[66]

WTCPUA contends that TCMUD 12's Raw Water Contract with LCRA limits the amount of water it could feasibly divert and ask WTCPUA to treat, but TCMUD 12 disagrees. Their disagreement is a complex dispute over the meaning of the Raw Water Contract and the Water Services Agreement, which the Commission has no jurisdiction to decide. For that reason, the ALJ sees no need to address it.

WTCPUA also claims TCMUD 12 is grossly overstating its projected need for water treatment capacity. Joseph A. DiQuinzio, Jr. is president of JadCo Management, Inc., which is

[59] TCMUD 12 Exs. 14, 15.

[60] TCMUD 12 Exs. 16, 17.

[61] The contract is not dated, but it was entered into after November 21, 2013. Tr. at 485–86.

[62] TCMUD 12 Exs. 18, 19.

[63] TCMUD 12 Exs. 20, 21.

[64] WTCPUA Ex. 53.

[65] TCMUD 12 Ex. 1 at JAD Ex. 4 at 145; WTCPUA Exs. 51, 52.

[66] Tr. at 90–91, 587–89; TCMUD 12 Ex. 1 at JAD Ex. 4 at 147.

the general manager of TCMUD 12.[67] He has 32 years of general water supply experience in the geographical area where TCMUD 12 serves.[68] In a discovery response for this case, Mr. DiQuinzio stated that the full buildout of TCMUDs 11, 12, and 13 combined is 2,125 LUEs,[69] but at the hearing on the merits, he testified that TCMUDs 11, 12, and 13 "at this point are very much unsure as to how quickly they will build out and to what degree they will build out."[70] TCMUD 12 has never served close to 2,125 LUEs and, as the following table demonstrates, the increase in its number of customers or connections has been very modest:

Date	Number of Customers[71]
January 1, 2008	0
January 1, 2009	0
January 1, 2010	less than 10
January 1, 2011	10
January 1, 2012	23
January 1, 2013	48
January 1, 2014	132

Given that evidence, the ALJ concludes that replacing all or part of its reserved water treatment capacity in the WTCPUA system was a viable alternative available to TCMUD 12. TCMUD 12 argues that the cost of that option made it unacceptable. That argument is considered later in the PFD.

c. Available Alternatives

TCMUD 12 believes that service from LCRA was its only option when it entered into the Water Services Agreement with LCRA, and service from WTCPUA was its only option after WTCPUA acquired the West Travis County System from LCRA. WTCPUA disputes that.

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[67] TCMUD Ex. 1 at 3.

[68] TCMUD Ex. 4 at 10.

[69] WTCPUA Ex. 52; WTCPUA Ex. 53.

[70] Tr. at 107.

[71] WTCPUA Exs. 43, 44.

The ALJ concludes that building its own facilities to transport, treat, and deliver the raw water it purchases from LCRA is a viable alternative available to TCMUD 12 to serve itself and TCMUDs 11 and 13. There is no evidence that TCMUD 12 is legally barred from building its own facilities to treat the raw water it purchases from LCRA to potable standards for its customers and the customers of TCMUDs 11 and 13 to use. To the contrary, as municipal utility districts, TCMUDs 11, 12, and 13 have statutory authority to construct and operate water treatment facilities.[72] TCMUD 12 claims that building its own facilities is a cost-prohibitive alternative. Alternative cost arguments are considered later in the PFD.

On the other hand, the ALJ does not conclude that TCMUD 12 has or had other available alternatives besides self-service. Mr. DiQuinzio testified, based on his experience, that LCRA was the only water service supplier capable of serving The Highlands (TCMUD 12's service area).[73] He admitted that from 2009 through 2014 no one on behalf of TCMUD 12 met with representatives of a provider of wholesale, treated-water services other than LCRA, but he insisted that "there were no other available wholesale water suppliers to meet with."[74] Apparently, Mr. DiQuinzio was referring, in part, to the time before October 2009 when TCMUD 12 entered into the Water Services Agreement with LCRA.[75] As to at least a portion of that time period, WTCPUA apparently agrees with him. WTCPUA's internet site describes LCRA as "monopolistic" in 2007,[76] before WTCPUA obtained the West Travis County System from LCRA in 2012. As to the period since early 2012 when WTCPUA assumed operation of the West Travis County System from LCRA, Mr. DiQuinzio testified that there is no centralized water treatment plant at The Highlands that might serve as an alternative to the one that WTCPUA now owns, and he noted that LCRA considered the possibility of building one and rejected that option between 2008 and 2009.[77]

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[72] Tex. Water Code § 54.201(b).

[73] TCMUD 12 Ex. 1 at 5–6, 13–15.

[74] Tr. at 61-63.

[75] TCMUD Ex. 1 at JAD Ex. 2.

[76] TCMUD 12 Ex. 4 at JAD Ex. R2 at 2.

[77] TCMUD 12 Ex. 4 at 4–5.

WTCPUA responds that TCMUD 12's evidence concerning alternative providers is conclusory and poorly supported, and TCMUD 12 has failed to adequately explore possible alternatives. According to WTCPUA, TCMUD 12 had at least four viable alternatives in 2009 when it entered into the Water Services Agreement with LCRA and in 2013 when it entered into the Transfer Agreement with LCRA and WTCPUA: (1) the City of Austin, (2) Lakeway Municipal Utility District (LMUD), (3) Hurst Creek Municipal Utility District (HCMUD), and (4) TCMUD 12, itself.

TCMUD 12's delivery point, near Highway 71 in Travis County, is not in the City of Austin's service area, and Austin's nearest water treatment plant, near the intersection of Ranch Road 620 and Ranch to Market Road 2222, is "extremely far" from TCMUD 12's point of delivery.[78] The ALJ concludes that service from the City of Austin is not a realistic alternative available to TCMUDs 11, 12, and 13.

TCMUD 11, on whose behalf TCMUD 12 has also petitioned, obtains wholesale water and treatment services to serve Rough Hollow from LMUD under a contract.[79] The contract limits service to 362,500 gpd.[80] Mr. DiQuinzio is the general manager of TCMUD 11.[81] Based on his routine dealings with LMUD, he testified, that there is no possibility of obtaining additional water service capacity from LMUD to serve The Highlands.[82] Additionally, he testified that the Rough Hollow Area, served by TCMUD 11, is not hydrologically connected to The Highlands area, served by TCMUD 12.[83] There is a 12-inch, emergency interconnection between the MUDs, but Mr. DiQuinzio testified that it is "valved off," and LMUD has refused permission to open that interconnection.[84]

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[78] Tr. at 108. The exact distance is not in evidence.

[79] TCMUD Ex. 1 at JAD Ex. 7.

[80] TCMUD Ex. 1 at JAD Ex. 7 at 4.

[81] WTCPUA Exs. 80 at 20, 81 at 16.

[82] TCMUD 12 Ex. 1 at 5.

[83] Tr. at 72.

[84] Tr. at 84–85, 92.

Moreover, other evidence shows why LMUD is not, and HCMUD likely would not be, willing to provide treated water to TCMUD 11 or 12. HCMUD, LMUD, TCMUD 11, and a homeowners association, Lakeway Rough Hollow South Community, Inc.,[85] purchased the Lakeway Regional Raw Water Transportation System (Lakeway Regional System) from LCRA in 2011.[86] They purchased the system because LCRA was divesting itself of a variety of water and sewer system infrastructures, including the West Travis County System that LCRA sold to WTCPUA.[87] The owners of the Lakeway Regional System entered into an operating agreement[88] that reflects the capacity of the existing system at an average lake level of 640 msl, and the four owners' percentage shares of the system.[89]

Mr. DiQuinzio is very familiar with the Lakeway Regional System and its ownership and operating agreement because he is the general manager of TCMUD 11, and signed the related contracts.[90] The system consists of facilities for withdrawing raw water from Lake Travis, which the system's four owners separately purchase from LCRA, and transporting that water to the owners.[91] The system does not include any water treatment facilities. Except for the indirect connection through LMUD discussed above, the Lakeway Regional System is not connected to any facilities that would allow it to serve The Highlands.[92] The system provides raw water for the Rough Hollow portion of TCMUD 11 and transports it to LMUD's water services facilities for treatment.[93]

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[85] Tr. at 619.

[86] WTCPUA Ex. 80.

[87] Tr. at 617–18.

[88] WTCPUA Ex. 81.

[89] WTCPUA Ex. 81 § 3.01 (LMUD: 59% (4.0 mgd); HCMUD: 32% (2.2 mgd); TCMUD 11: 2% (0.144 mgd); and Rough Hollow: 7% (0.468 mgd)). Total capacity is 6.812 mgd based on 4 existing raw water pumps.

[90] WTCPUA Exs. 80 at 20, 81 at 16.

[91] WTCPUA Ex. 80 at 1.

[92] Tr. at 619.

[93] Tr. at 618.

Mr. DiQuinzio testified that there are many impediments to TCMUD 12 using the Lakeway Regional System to serve The Highlands.[94] TCMUD 12 is not an owner,[95] and there is no evidence that it has any right to water from the system. TCMUD 11's ownership interest is only 2%, representing only 0.144 million gallons per day (mgd) at an average lake level of 640 msl, which would be insufficient as an alternative to the 3.98 mgd of treatment service that WTCPUA is obligated to provide to TCMUD 12.[96] The system owners would have to consent to TCMUD 12's use of the system, and if any owner wanted to sell some of its capacity, the other owners would have a right of first refusal to purchase that capacity.[97]

The entire capacity of the floating barge that the Lakeway Regional System uses to withdraw raw water is allocated to and needed by the system owners to transport raw water to them because they have no other access to raw water.[98] Under drought conditions, the effective capacity of the barge drops with the lake levels, and to achieve greater capacity, the barge would have to be moved farther out into the Lake, which would be physically limited and costly.[99] It is true that the Lakeway Regional System is designed to achieve a capacity of 9.0 mgd by adding two raw water pumps with associated electrical and other upgrades and improvements to the system; however, the barge may not be structurally capable of adding pumps without significant capital improvements, which may not be possible due to low lake levels.[100]

Even if TCMUD 12 could obtain its raw water through the Lakeway Regional System, the water would not be potable, like the water treated and delivered to TCMUD 12 by WTCPUA. LMUD, HCMUD, or TCMUD 12 would still need a water transmission system, treatment plant, and storage facility to provide potable water to The Highlands.[101] There is no

[94] Tr. at 597–615.

[95] WTCPUA Exs. 80–81.

[96] Tr. at 615; TCMUD 12 Ex. 1 at JAD Ex. 4, § 3.03.a.

[97] WTCPUA Ex. 81 at 8–9, art. VII, § 7.01(a), (e).

[98] Tr. at 602-03.

[99] Tr. at 600–01.

[100] Tr. at 615.

[101] Tr. at 126.

evidence that HCMUD or LMUD would be willing to take on that responsibility, cost, and risk. Given the hosts of problems and obstacles, the ALJ concludes that LMUD and HCMUD are not alternatives available to TCMUDs 11, 12, and 13 for water treatment services.

d. Costs of Alternatives

Next, the ALJ examines the costs associated with the two intertwined alternatives available to TCMUD 12: (1) reducing its treatment capacity reserved with WTCPUA and (2) building its own treatment facilities. TCMUD 12 contends that reducing its reserved capacity in the WTCPUA system would leave it unable to serve the 2,125 LUEs it expects at full buildout,[102] and building its own facilities to serve that many connections would cost it another $25,520,000 and potentially strand the $1.5 million it invested in the WTCPUA system through connection fees.[103] TCMUD 12 claims that these costs make reducing its reserve and building its own facilities cost-prohibited alternatives.

TCMUD 12 has paid $1.5 million in connection fees to LCRA. Under the Transfer Agreement, LCRA transferred the fees to WTCPUA, and TCMUD 12 is entitled to full credit for them.[104] WTCPUA claims that under the Water Services and Transfer Agreements TCMUD 12 may sell its investment in the WTCPUA system to TCMUDs 11 or 13 without WTCPUA's consent, or to a third party with WTCPUA's consent, which may not be unreasonably withheld or delayed.[105] However, there is no evidence that a market exists for TCMUD 12's connection rights. Another utility seeking wholesale treatment capacity could just as easily pay WTCPUA for connections.

The ALJ concludes that the $1.5 million that TCMUD 12 paid to connect to the West Travis County System is a sunk cost that could be stranded if TCMUD 12 chose to reduce its

[102] WTCPUA Ex. 19.

[103] Tr. at 96.

[104] TCMUD Ex. 1 at JAD Ex. 5 at 168.

[105] WTCPUA Ex. 1 at ex. G at 84.

reserved capacity and build its own treatment facilities. He also concludes that a pro rata share of that $1.5 million could be stranded if TCMUD 12 partially reduced its reserved capacity in the WTCPUA system.

However, the ALJ does not conclude that it would cost TCMUD 12 approximately $25.52 million to build its own facilities to transport, treat, and store the water it purchases from LCRA. Mr. DiQuinzio testified that it would cost that much,[106] but he did not personally calculate the figure. Instead, TCMUD 12's engineer,[107] apparently Douglas Rummel, Jr.,[108] contacted an engineer who works for the City of Cedar Park, Kenneth Wheeler.[109] Neither Mr. Rummel nor Mr. Wheeler testified, and Mr. Wheeler has done little work on treatment plants.[110] Nevertheless, Mr. Wheeler offhandedly estimated, in an email to Mr. Rummel, that a treatment plant would cost $5 per gallon of capacity, but he was not sure if that figure could be used.[111] Also, an unidentified person developed a spreadsheet that shows a total cost of $25.52 million for a "WATER PLANT," which includes $20 million for a "4 MGD Plant," and other costs.[112] The source and support for the estimate in the spreadsheet are not in evidence. As discussed later in the PFD, Jay Zarnikau, Ph.D., TCMUD 12's expert on monopoly power, concluded TCMUD 12 had no available alternative to service from WTCPUA by relying in part on an estimate by Mr. DiQuinzio that it would cost TCMUD 12 approximately $25 million to build its own facilities.[113]

The ALJ assigns no evidentiary weight to the fragmentary, unsupported estimate that it would cost TCMUD 12 approximately $25.52 million to build a water treatment plant to serve its

[106] TCMUD 12 Ex. 1 at 5.

[107] Tr. at 96.

[108] WTCPUA Ex. 19 at 30.

[109] WTCPUA Ex. 19 at 30; Tr. at 489–90.

[110] WTCPUA Ex. 19 at 30.

[111] WTCPUA Ex. 19 at 30.

[112] WTCPUA Ex. 19 at 32.

[113] Tr. at 290–91, 314–15.

needs. He further finds that no expert, including Dr. Zarnikau, could reasonably rely on such a manifestly unreliable estimate.[114]

In response to TCMUD 12's $25.52 million estimate, WTCPUA's Mr. Rauschuber referred in his testimony to a recent cost analysis undertaken by WTCPUA.[115] His testimony leads TCMUD 12 to alternatively claim that its cost to build its own facilities would be at least $13.5 million.[116] The cost estimate to which Mr. Rauschuber referred is included in WTCPUA's approved Capital Improvements Plan,[117] and was prepared and sealed by a professional engineer.[118] The estimate is $13.5 million for a 5.0 mgd water treatment plant.[119] Mr. Rauschuber testified that Mr. DiQuinzio's $25.52 million estimate is nearly double, on a cost-per-mgd basis, to WTCPUA's projected cost of $13.5 million.[120] Extrapolating from the Rauschuber estimate, a 4.0 mgd plant to serve TCMUDs 11, 12, and 13 would cost approximately $10.8 million,[121] not $13.5 million.

The ALJ does not, however, find that a 4.0 mgd water treatment plant to serve TCMUDs 11, 12, and 13 would cost $10.8 million. TCMUDs 11, 12, and 13 certainly did not offer evidence to prove that, and Mr. Rauschuber did not testify that it would cost that. Instead, when read in context, his testimony shows only that TCMUD's $25.52 million estimate is unreliably high.

Moreover, even if the evidence included a reasonable cost estimate for a 4.0-mgd plant, TCMUDs 11, 12, and 13 do not currently need treatment for that much raw water.[122] They likely

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[114] *See* Tex. R. Evid. 405(b).

[115] WTCPUA Ex. 1 at 29–31 & attach. Ex. V

[116] TCMUD 12 Reply Brief at 43–47.

[117] WTCPUA Ex. 1 at 29–31 & attach. Ex. V.

[118] WTCPUA Ex. 1, attach. Ex. V at 251.

[119] WTCPUA Ex. 1, attach. Ex. V at 270.

[120] WTCPUA Ex. 1 at 31.

[121] $13.5 million * (4.0 mgd / 5.0 mgd) = $10.8 million.

[122] Tr. at 68.

would need a 4.0 mgd plant if they were using 3.98 mgd of raw water, the maximum under the Water Services Contract,[123] but they would only need to treat 3.98 mgd of raw if they had 1,640 retail water connections, or close to 2,125 LUEs.[124] As of January 1, 2014, after six years of operation, however, TCMUD 12 only had 132 connections,[125] and Mr. DiQuinzio was not sure of the speed or degree of buildout in the future.[126]

Given the gaps in and problems with the evidence as described above, the ALJ concludes that TCMUD 12 has failed to prove what the alternative, self-service option available to it would cost, much less that the monthly cost of that alternative would be prohibitively more expensive than service from WTCPUA under the Protested Rates. Accordingly, the ALJ does not find the self-service option was or is prohibitively costly.

2. Other Bargaining Power Factors

a. Connection Fee in Prior Rates

TCMUD 12 contends that other evidence shows that it has less bargaining power than WTCPUA. It claims that WTCPUA, on November 1, 2012, changed TCMUD 12's connection fee from $4,120 to $5,992 per LUE when it adopted the Prior Rates,[127] contrary to the express terms of the Transfer Agreement. TCMUD 12 claims the Transfer Agreement limited WTCPUA's authority concerning the connection fees to the *collection*, but not the *setting* of the connection fee.[128]

WTCPUA contends that the 2012 change to the connection fee does not pertain to the Protested Rates, which were adopted in November 2013. Moreover, it notes that the Water

[123] Tr. at 90-91, and 587-589.

[124] WTCPUA Ex. 51 (1,640 retail water service connections); WTCPUA Ex. 52 (close to 2,125 LUEs).

[125] WTCPUA Exs. 43, 44.

[126] Tr. at 107.

[127] TCMUD 12 Ex. 1 at 11 & JAD Ex. 11.

[128] TCMUD 12 Ex. 1 at 10 & JAD Ex. 5 at 3.

Services Agreement expressly gave LCRA authority to change the connection fee "from time to time,"[129] and TCMUD 12 expressly agreed in the Transfer Agreement to LCRA's assigning its rights under the Water Services Agreement to WTCPUA.[130]

The ALJ concludes that the 2012 change in the connection fee under the Prior Rates is not evidence that WTCPUA has disparately greater bargaining power than TCMUD 12. The Prior Rates were not appealed and are not at issue in this case. The ALJ concludes that they were not unreasonable because they were not appealed. Moreover, TCMUD 12's claim that the connection fee change evidences unequal bargaining power rests on the assumption it was contrary to the Transfer Agreement, which WTCPUA disputes. The Commission has no jurisdiction to resolve the contract dispute between the parties.

b. Option to Amend Contract

TCMUD 12 also claims that WTCPUA's offer to reduce TCMUD 12's maximum reserved capacity when WTCPUA adopted the Protested Rates shows in four ways that WTCPUA has greater bargaining power than TCMUD 12. First, WTCPUA gave TCMUD 12 only 10 days, including the Christmas holidays,[131] to respond to the offer. Second, reducing TCMUD 12's maximum day capacity reservation under the Water Services Agreement would have been problematic and foolish because TCMUD 12 is a very young district and expects to need the full capacity between the years 2022 and 2025.[132]

Third, reducing the reservation would have potentially stranded TCMUD 12's $1.5 million investment, through connection fees, in the WTCPUA system. Fourth, the contract amendment would have replaced the provisions in the Water Services Agreement that

[129] TCMUD 12 Ex. 1 at JAD Ex. 4 at 149.

[130] TCMUD 12 Ex. 1 at JAD Ex. 5 at 168.

[131] TCMUD 12 Ex. 1 12 & JAD Ex. 13.

[132] WTCPUA Ex. 53.

established the methodology for setting the monthly charge[133] and the volumetric rate[134] and replaced them with the methodologies underlying the Protested Rates.

Although TCMUD 12 declined WTCPUA's offer to amend the Water Services Agreement, WTCPUA still adopted the Protested Rates, which according to TCMUD 12 imposed the same new rate methodology. Dr. Zarnikau, who had no direct knowledge and did not point to a source for the information, testified that WTCPUA ignored one wholesale customer's expressed concerns about changing the rate methodology.[135]

Below in the PFD, the ALJ considers and rejects TCMUD 12's claim that the Protested Rates and the underlying revenue requirement were computed based on changed methodologies. That is a separate factor that the Public Interest Rule requires to be considered in determining whether a seller abused monopoly power in providing water service.[136] In this portion of the PFD, there is no reason to redundantly consider TCMUD 12's claim that WTCPUA changed methodologies.

As to TCMUD 12's other arguments, WTCPUA responds that the fact that it offered to allow wholesale customers, including TCMUD 12, to reduce their capacity reservation and lower their rates shows WTCPUA did not have greater bargaining power. It notes that it did not attempt to unilaterally reduce TCMUD 12's reserved capacity, but instead offered a reduction option that TCMUD 12 was free to reject. Additionally, WTCPUA argues that TCMUD 12's rejection of the proposed amendments to the Water Services Agreement shows that WTCPUA does not have greater bargaining power than TCMUD 12.

The ALJ fails to see how conditionally offering to allow TCMUD 12 to reduce its reserved treatment capacity shows that WTCPUA had disparately greater bargaining power than

[133] TCMUD 12 Ex. 1 at JAD Ex. 4 at 150–51, § 4.01.d; WTCPUA Ex. 2, attach. Q at 212–213.

[134] TCMUD 12 Ex. 1 at JAD Ex. 4 at 151, § 4.01.e; WTCPUA Ex. 2, attach. Q at 212–213.

[135] Tr. at 271.

[136] 16 Tex. Admin. Code § 24.133(a)(3)(C).

TCMUD 12. Obviously, TCMUD 12 did not like the offer and chose not to take it, which proves that WTCPUA could not compel TCMUD 12 to take the offer.

c. Input before Protested Rates Implemented

TCMUD 12 claims that WTCPUA gave it no meaningful opportunity to provide input before adopting the Protested Rates. TCMUD 12 notes that the method for calculating the Protested Rates did not change between May 14, 2013, as reflected in WTCPUA's "draft contract amendment,"[137] and November 21, 2013, when the WTCPUA Board adopted a resolution authorizing contract amendments to reduce reserved capacity and the Protested Rates.[138]

Before May 2013, however, WTCPUA hosted six meetings with its wholesale customers to obtain their input on WTCPUA's allocation of it costs.[139] A TCMUD 12 representative attended four of the six meetings.[140] Also, before the rates were adopted, WTCPUA's representative met with Mr. DiQuinzio and Jay Joyce, for TCMUD 12, on three other occasions to discuss the Protested Rates and receive written input from them.[141] Ultimately, on April 9, 2013, a committee of the wholesale customers proposed an allocation of WTCPUA's debt, operations, and maintenance costs in the monthly charge, which formed the basis for the monthly charge in the Protested Rates that was presented to and adopted by the WTCPUA board on November 21, 2013.[142] Sign-in sheets and minutes do not indicate that anyone for TCMUD 12 attended the board meeting to protest the Protested Rates.[143]

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[137] WTCPUA Ex. 1, attach. P.

[138] WTCPUA Ex. 1, attach. Q, attach. R at 224–26.

[139] WTCPUA Ex. 1 at 22–26.

[140] WTCPUA Ex. 1 at 28.

[141] WTCPUA Ex. 1 at 29.

[142] WTCPUA Ex. 1 at 24–27.

[143] WTCPUA Ex. 1 at 28 & attach. L & T.

Also, as previously discussed, WTCPUA gave TCMUD 12 and all of its wholesale customers the opportunity to amend their contracts to change their reserved treatment capacity.[144] The monthly charge TCMUD 12 pays under the Protested Rates would have been reduced if TCMUD 12 had accepted WTCPUA's offer to reduce its maximum reserved treatment capacity in the WTCPUA system.[145] The Protested Rates monthly charge was developed using a 7-step formula.[146] This same formula is reflected in WTCPUA's FY 14 Minimum Bill Analysis for TCMUD 12,[147] the contract amendments WTCPUA offered to all of its wholesale customers,[148] and the contract amendments accepted by six wholesale customers.[149]

The ALJ concludes that WTCPUA gave TCMUD 12, and its other wholesale customers, a meaningful opportunity to provide input before implementing the Protested Rates.

d. WTCPUA's Risk of Losing TCMUD 12 as a Customer

DiQuinzio testified that LCRA had excess capacity in 2009, thus LCRA needed a customer at the same time that TCMUD 12 was searching for a wholesale water treatment service provider.[150] In other words, without TCMUD 12, LCRA would not have been generating revenue on that excess capacity. WTCPUA argues that from 2009 through 2013 losing TCMUD 12 as a wholesale customer would have left LCRA, and later WTCPUA, with an excess supply of water treatment capacity, which gave TCMUD 12 significant bargaining power when negotiating with LCRA and WTCPUA. The ALJ agrees. The fact that LCRA had excess capacity in 2009 constitutes some evidence that LCRA, and by extension WTCPUA, did not

[144] TCMUD 12 Ex. 1 at 11 & JAD Ex. 13; TCMUD Ex. 23 at 775–82; WTCPUA Ex. 1 at attach. Q.

[145] TCMUD 12 Ex. 1 at JAD Ex. 13 at 399.

[146] TCMUD 12 Ex. 2 at JJJ-11 at 37.

[147] TCMUD 12 Ex. 2 at JJJ-15 at 14.

[148] WTCPUA Ex. 1 at attach. Q.

[149] TCMUD 12 Exs. 7, 10, 13, 16, 18, 20.

[150] TCMUD 12 Ex. 1 at 6.

have disparate bargaining power over TCMUD 12 to compel TCMUD 12 to enter the Water Service Agreement in 2009.

e. ALJ's Conclusion Concerning Disparate Bargaining Power

The ALJ does not conclude that TCMUD 12 had significantly less bargaining power than: (1) LCRA in October 2009 when LCRA and TCMUD 12 entered into the Water Services Agreement; (2) WTCPUA in June 2012 when TCMUD 12, WTCPUA, and LCRA entered into the Transfer Agreement; or (3) WTCPUA in November 2013 when WTCPUA adopted the Protested Rates.

The evidence shows that in 2009 LCRA had excess treatment capacity and TCMUD 12 wanted treatment services. They voluntarily entered into the Water Services Agreement for LCRA to provide services to TCMUD 12 and specified the rates that TCMUD 12 would initially pay for the services. The contract allowed LCRA to subsequently adjust the rates, but only so the rates would cover TCMUD 12's proportionate, just, reasonable, nondiscriminatory, fair, and equitable share of the costs of the West Travis County System.[151] After LCRA decided to cease providing treatment services and transfer the West Travis County Facilities to WTCPUA, TCMUD 12 agreed to the transfer. On the surface, nothing about those agreements suggests TCMUD 12 had less bargaining power than LCRA or WTCPUA.

It does appear that TCMUD 12 had only one viable alternative to obtaining treatment services from LCRA, and subsequently WTCPA: TCMUD 12 could have built its own treatment facilities. The evidence does not show that TCMUD 12 was or is either legally or contractually prohibited from building its own facilities. TCMUD 12 contends that building its own facilities would have been cost-prohibitive, but it failed to prove that.

[151] TCMUD 12 Ex. 1 at JAD Ex. 4 at 151.

It is true that TCMUD 12 paid $1.5 million in connection fees to LCRA 2009 when they entered into the Water Services Agreement. That investment could be partially or wholly stranded if TCMUD 12 chose to build its own facilities, but untangling a complex set of contractual agreements can be costly to all involved. The evidence also shows that LCRA, and later WTCPUA, for some period after 2009 would have had unused treatment capacity if TCMUD 12 were not purchasing treatment service. This suggests that TCMUD 12 would have had significant leverage over LCRA and WTCPUA. The ALJ does not conclude that TCMUD 12 has disparate bargaining power just because it might lose the value of the connection fees it paid if it chose to serve itself.

Nor does the ALJ conclude from the evidence concerning the post-contract conduct of LCRA and WTCPUA that either had greater bargaining power than TCMUD 12. LCRA never raised the rates to which TCMUD 12 had agreed in October 2009. WTCPUA kept those same rates after TCMUD 12 agreed in June 2012 to the transfer of LCRA's rights and obligations under the Water Services Agreement to WTCPUA. WTCPUA raised the rates by 15.5% in November 2012, but TCMUD 12 did not appeal that increase, which suggests it was unobjectionable.

Subsequently, WTCPUA adopted the Protested Rates, which decreased TCMUD 12's monthly charge from $10,891.65 to $8,140.89 and its volumetric rate from $2.77 to $2.11 per 1,000 gallons. The rate change was based on a consultant's study recommending a change. WTCPUA's representatives repeatedly offered to and did meet with representatives of its wholesale customers to discuss their concerns about the increase. TCMUD 12 was invited to and participated in some of those discussions. WTCPUA eventually decreased the monthly charge based on a formula that the wholesale customers who participated in the talks recommended. WTCPUA gave all of its wholesale customers, including TCMUD 12, the option of amending their contracts to adjust their reserved treatment capacity, which would have allowed TCMUD 12 to further reduce its monthly charge.

The evidence does not show that TCMUD 12 had or has disparately less bargaining power than LCRA or WTCPUA. The Protested Rates TCMUD 12 pays, a monthly charge of

$8,140.89 and a volumetric rate $2.11 per 1,000 gallons, are even lower than the Initial Rates that TCMUD 12 agreed to in the 2009 Water Services Agreement, a monthly charge of $9,430 and a volumetric rate of $2.40 per 1,000 gallons.[152] If anything, the evidence suggests that TCMUD 12 has greater bargaining power than WTCPUA.

B. Methodologies for Computation of Revenue Requirement and Rates

TCMUD 12 claims that in computing the Protested Rates WTCPUA changed the rate-setting methodologies it had used to set the Prior Rates and that the methodological changes show WTCPUA has abused its monopoly power over TCMUD 12. The other parties contend that WTCPUA did not change its methodologies and that TCMUD 12's arguments to the contrary are based on an analysis of WTCPUA's cost of service, which may not be considered in this public interest phase of the case. The ALJ agrees on both counts with the parties other than TCMUD 12.

1. Alleged Change in Revenue-requirement Computation Methodology

Jay Joyce holds a bachelor's degree in finance and a master's degree in business administration, has extensive professional experience as a water utility rate consultant, and testified as TCMUD 12's expert witness.[153] Mr. Joyce testified that WTCPUA changed the method used to compute its revenue requirement.[154] He believes the methodology changed because the following costs of service items were allocated significantly differently for the Protested Rates than for the Prior Rates:[155]

[152] TCMUD 12 Ex. 1 at JAD Ex. 4 at 150–51.

[153] TCMUD 12 Ex. 2 at 3–5 & JJJ-1.

[154] TCMUD 12 Ex. 2 at 5, 7–9, 11–18.

[155] TCMUD 12 Ex. 2 at 11–18 & JJJ-10.

(1) Irrigation, or untreated, water costs were allocated to potable water customers, when they were not before;

(2) Repair and maintenance costs were allocated as "Common-to-All" and "Retail Only," rather than just "Retail Only";

(3) Some bookkeeper, and financial manager costs were allocated to "wholesale rate analysis," when they were not before;

(4) Operation and maintenance costs were allocated differently to functional components, meaning water and wastewater, than they were before;

(5) Some expenses were allocated differently as base, extra capacity, and customer costs than they were before;

(6) Revenue offsets were allocated 8% "Common-to-All" and 92% "Retail Only," rather than 100% "Common-to-All" as under the Prior Rates; and

(7) Wholesale customers were not given credit for capital recovery coverage.

2. Computation Methodology and Cost-of-Service Analysis

The Public Interest Rule provides that a seller's changing "the computation of the revenue requirement or rate from one methodology to another" is one factor to be considered in determining whether a protested rate evidences the seller's abuse of monopoly power.[156] But the rule also provides: "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."[157] Reconciling the requirement with the prohibition is very challenging, and TCMUD 12 and the other parties disagree about how they should be reconciled.

Underlying the disagreement are complicated disputes about the meaning of key terms in the Public Interest Rule, including "cost of service," "revenue requirement," and "computation . . . methodology." Words and phrases in the Commission's rules must be read in context and

[156] 16 Tex. Admin. Code § 24.133(a)(3)(C).

[157] 16 Tex. Admin. Code § 24.133(b).

construed according to the rules of grammar and common usage unless they have acquired a technical or particular meaning by legislative definition or otherwise.[158]

The meaning of rate is clear. For purposes of the Commission's water and sewer service rules, "rate" is defined as follows:

> Rate--Includes every compensation, tariff, charge, fare, toll, rental, and classification or any of them demanded, observed, charged, or collected, whether directly or indirectly, by any retail public utility, or water or sewer service supplier, for any service, product, or commodity described in [Texas Water Code] § 13.002(23), and any rules, regulations, practices, or contracts affecting any such compensation, tariff, charge, fare, toll, rental, or classification.[159]

The Commission's Cost Of Service Rule states that "[t]he two components of cost of service are allowable expenses and return on invested capital."[160] The rule lists expenses that are allowed and not allowed and describes how return on capital is determined.[161] Among the allowed items are operations and maintenance expense incurred in furnishing normal utility service and in maintaining utility plant used by and useful to the utility in providing such service.[162]

The phrase "revenue requirement" is not defined and is mentioned only four times in the rules: (1) in the Public Interest Rule, where its meaning is not clarified;[163] (2) in the Alternative Rate Methods Rule;[164] (3) in the definition of "Cash Basis calculation of cost of service;"[165] and

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[158] Tex. Gov't Code §§ 311.002(4), .011.

[159] 16 Tex. Admin. Code § 24.3(38).

[160] 16 Tex. Admin. Code § 24.31(a).

[161] 16 Tex. Admin. Code § 24.31(b), (c).

[162] 16 Tex. Admin. Code § 24.31(b)(1)(A).

[163] 16 Tex. Admin. Code § 24.133(a)(3)(C).

[164] 16 Tex. Admin. Code § 24.34(c)(1)(A).

[165] 16 Tex. Admin. Code § 24.129(3). This is sometimes referred to as the "cash-needs method."

(4) in the definition of "Utility Basis calculation of cost of service."[166] The last two definitions state:

> Cash Basis calculation of **cost of service**--A calculation of the **revenue requirement** to which a seller is entitled to cover all cash needs, including debt obligations as they come due. Basic revenue requirement components considered under the cash basis generally include operation and maintenance expense, debt service requirements, and capital expenditures which are not debt financed. Other cash revenue requirements should be considered where applicable. Basic revenue requirement components under the cash basis do not include depreciation.[167]
>
> Utility Basis calculation of **cost of service**--A calculation of the **revenue requirement** to which a seller is entitled which includes a return on investment over and above operating costs. Basic revenue requirement components considered under the utility basis generally include operation and maintenance expense, depreciation, and return on investment.[168]

As illustrated by the bold words above, "revenue requirement" is used in the definitions as a synonym for "cost of service." The Alternative Rate rule also uses "revenue requirement" and "cost of service" similarly and indistinguishably.[169] If "revenue requirement" and "cost of service" mean the same thing, as the rules indicate, the Public Interest Rule, oddly, seems to both require consideration of evidence of a change in a revenue requirement computation methodology while prohibiting its consideration because the evidence would be a cost of service analysis.

To resolve that seeming conflict, the ALJ considered the meaning of the word "methodology." "Methodology" is not defined in the Commission's rules; however, the context of the rules sheds light on the meaning of "methodology." Other wholesale water and sewer service rules refer to "methods of establishing rates,"[170] including "the cash needs method"[171] or

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[166] 16 Tex. Admin. Code § 24.129(4). This is sometimes referred to as the "utility-basis method."

[167] 16 Tex. Admin. Code § 24.129(3) (emphasis added).

[168] 16 Tex. Admin. Code § 24.129(4) (emphasis added).

[169] 16 Tex. Admin. Code § 24.34(b)(1)(A), (c)(2)

[170] 16 Tex. Admin. Code § 24.34(a).

[171] 16 Tex. Admin. Code § 24.34(b), (d).

"the cash basis . . . methodology,"[172] the "phased or multi-step rate method,"[173] the "utility method"[174] or "utility basis . . . methodology,"[175] and "reasonable methodologies set by contract which identify costs of providing service and/or allocate such costs in calculating the cost of service."[176] Thus, from the references in the rules, it is clear that there are at least four computational methodologies: (1) cash-needs, (2) utility-basis, (3) phased, and (4) contractual.

According to the Commission's rules quoted above, the cash-needs method[177] and the utility-basis method[178] are used to calculate "cost of service," or "revenue requirement." Despite the complex web of rules and meanings, every party agrees that a change from the cash-needs method to the utility-basis method, or vice versa, for determining revenue requirement would be relevant to determining whether a wholesale seller abused monopoly power. But all of the pertinent testifying experts agreed that WTCPUA used the cash-needs method for both the Prior Rates and Protested Rates.[179] Moreover, no evidence indicates WTCPUA used a phased methodology or one set out in a contract when it set the Prior Rates and the Protested Rates.

District 5 claims that WTCPUA used no method to compute its revenue requirement for the Prior Rates and set them arbitrarily; hence, no matter the method used to determine the revenue requirement underlying the Protested Rates, there could not have been a change in methodology. The evidence shows, however, that WTCPUA based its Prior Rates on a recommendation by its consultant who used the cash-needs method to determine revenue requirement, and WTCPUA chose to adopt only one-half of the rate increase that the consultant

[172] 16 Tex. Admin. Code § 24.135(b).

[173] 16 Tex. Admin. Code § 24.34(c)(1).

[174] 16 Tex. Admin. Code § 24.34(d)(5).

[175] 16 Tex. Admin. Code § 24.135(b).

[176] 16 Tex. Admin. Code § 24.135(a).

[177] The cash-needs basis is more formally titled "Cash Basis calculation of cost of service". 16 Tex. Admin. Code § 24.129(3).

[178] 16 Tex. Admin. Code § 24.129(4).

[179] WTCPUA Ex. 3 (Stowe) at 11-15; Staff Ex. 1 (Graham) at 9; Tr. at 198–99 (Joyce).

recommended.[180] Given that evidence, the ALJ concludes that the Prior Rates were based on an adjusted cash-needs methodology.

Though the rules specifically refer only to cash-needs, utility, phased, and contractual methodologies, nothing in the rules indicates that the meaning of "methodology," as used in the Public Interest Rule, is confined to those four. One common meaning of "methodology" is "[a] body of practices, procedures, and rules used by those who work in a discipline or engage in an inquiry; a set of working methods."[181] The American Water Works Association publishes a manual on water utility rates (M1 Manual), also known as *Principles of Water Rates, Fees, and Charges.*[182] According to the M1 Manual:

> [T]he generally accepted rate-setting methodology includes three categories of analysis[:]
>
> Revenue Requirement analysis[:] Compares revenues of the utility to its operating and capital costs to determine the adequacy of existing rates to recover the utility's costs[;]
>
> Cost-of-service analysis[:] Allocates the revenue requirements to the various customer classes of service in a fair and equitable manner[; and]
>
> Rate design analysis[:] Considers both the level and structure of the rate design to collect the distributed revenue requirements from each class of service[.][183]

Jack Stowe holds a bachelor's degree in accounting, has extensive experience as a water utility rate consultant, and testified as WTCPUA's expert.[184] Since 2014, Heidi Graham has been employed by the PUC to review, process, and testify concerning water and sewer utility

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[180] WTCPUA Ex. 1, attach. L at 152–53 & attachs. M, N; WTCPUA Ex. 3 at 11-15; Staff Ex. 1 at 9; Tr. at 19899.

[181] methodology. (n.d.) *American Heritage® Dictionary of the English Language, Fifth Edition.* (2011). Retrieved August 20, 2015 from http://www.thefreedictionary.com/methodology.

[182] WTCPUA Ex. 73.

[183] WTCPUA Ex. 73, ch. I.1 at 4–5.

[184] WTCPUA Ex. 3 at 3–7, attach. A.

rate matters, and she previously worked in a similar capacity for TCEQ from 2006 to 2014.[185] Ms. Graham reviewed the petition in this case and testified as a witness for the PUC Staff.[186]

Experts on rate making in the water industry, including Mr. Stowe and Ms. Graham, often rely on the M1 Manual for guidance.[187] Mr. Joyce agrees that the M1 Manual and the above three-step analysis are generally accepted, and he does not disagree with them; though, he thinks that the manual does not use terminology consistently.[188]

The M1 Manual also states that there are two generally accepted approaches for establishing a utility's revenue requirement: the cash-needs approach and the utility-basis approach.[189] It also states that there are two generally accepted methods for conducting a cost-of-service analysis, by which it means an allocation of costs among customer classes: the base-extra capacity method and the commodity-demand methodology.[190] No Commission rule generally describes how costs should be allocated among customers. The Commission's Cost of Service Rule mentions allocation once, when discussing depreciation.[191] That is not relevant to this case because it concerns rates WTCPUA set using the cash-needs methodology, in which depreciation is not a component.[192]

The M1 Manual cannot be easily applied to analyze and resolve the seeming conflict between the Public Interest Rule's requirement to consider changes in the revenue-requirement computation methodology and its prohibition on considering cost-of-service analyses. Under the manual, a "[r]evenue [r]equirement analysis" determines operating and capital costs and

[185] Staff Ex. 1 at 3.

[186] Staff Ex. 1.

[187] WTCPUA Ex. 3 at 10; Staff Ex. 1 at 9; Tr. at 419

[188] Tr. at 157–58.

[189] WTCPUA Ex. 73, ch. 1.1 at 5.

[190] WTCPUA Ex. 73, ch. 1.1 at 6.

[191] 16 Tex. Admin. Code §§ 24.31(c)(2)(B)(ii).

[192] 16 Tex. Admin. Code § 24.129(3).

compares them to the utility's existing rate collections to decide the adequacy of the rates.[193] Also, under the manual, a "[c]ost-of-services" analysis would allocate the revenue requirement to various classes of service in a fair and equitable manner.[194] These meanings of the phrases "revenue requirement" and "cost of service" are different from the ways the phrases are used in the Commission's rules. Under the Commission's rules, "cost of service" and "revenue requirement" are synonymous[195] and consist of allowable expenses and return on invested capital.[196] No Commission rule uses the term "cost of service analysis" or a similar term to refer to allocation of the revenue requirement among classes, as does the M1 Manual.

3. Evidence Does Not Show WTCPUA Changed its Revenue Requirement Computation Methodology

The ALJ concludes that WTCPUA did not change its methodology for computing it revenue requirement for purposes of setting the Protested Rates.

It is true that on November 21, 2013, the WTCPUA Board adopted a resolution authorizing negotiations that might lead to standard amendments to its wholesale agreements and the resolution stated that the purpose of the proposed amendment was to "effect . . . capacity changes and *establish wholesale rate methodology.*"[197] At that same meeting, the Board also adopted the Protested Rates that were determined pursuant to a recommendation by the Board's rate consultant,[198] who in emails on May 14 and 21, 2013, had referred to her recommendation as "the proposed methodology."[199]

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[193] WTCPUA Ex. 73, ch. I.1 at 5.

[194] WTCPUA Ex. 73, ch. I.1 at 5.

[195] 16 Tex. Admin. Code §§ 24.34(c)(1)(A), 24.129(3), (4).

[196] 16 Tex. Admin. Code § 24.31.

[197] WTCPUA Ex. 1, attach. Q at 209

[198] WTCPUA Ex. 1, attach. R at 2544–46.

[199] TCMUD 12 Ex. 3 at JZ Ex. 5 at 95, 97.

Mr. Joyce's analysis of those and other documents[200] leads him, and TCMUD 12, to contend that WTCPUA changed the methodology used to compute its revenue requirement, because it changed the way it allocated certain costs to its customers.[201] But calling that a change in revenue-requirement computation methodology is not persuasive, and the ALJ recommends that the Commission reject it.

First, WTCPUA consistently used the cash-needs method to determine its revenue requirement for the Prior Rates and Protested Rates. That is one of the methods specifically defined in the Commission's rules,[202] and the M1 Manual describes it as one of the methods generally accepted for revenue requirement analysis.[203] The pertinent experts—Mr. Stowe, Ms. Graham, and Mr. Joyce—agreed that WTCPUA used the cash-needs method for both the Prior Rates and Protested Rates.[204]

Second, there is no evidence that WTCPUA ever used the utility-basis method, which is the only other method defined in the rules[205] and described by the M1 Manual as generally accepted for revenue requirement analysis.[206] Third, there is no evidence that WTCPUA ever used the only other two methods to which the Commission's rules specifically refer: phased[207] and contractual.[208] Fourth, the evidence does not show that there are any other generally recognized revenue-requirement computational methods, although the Commission's rules do not foreclose that possibility. Fifth, the ALJ does not find that the casual use of the word "methodology" by the WTCPUA Board and it consultant to describe how it set the Protested

[200] TCMUD 12 Ex. 2, attach. JJJ-3 through JJJ-16.

[201] TCMUD 12 Ex. 2 at 5, 7–22, JJJ-10, JJJ-15; WTCPUA Ex. 3 at attach. F at 202.

[202] 16 Tex. Admin. Code § 24.129(3).

[203] WTCPUA Ex. 73, ch. 1.1 at 5.

[204] WTCPUA Ex. 3 at 11-15; Staff Ex. 1 at 9; Tr. at 198–99.

[205] 16 Tex. Admin. Code § 24.129(4).

[206] WTCPUA Ex. 73, ch. 1.1 at 5.

[207] 16 Tex. Admin. Code § 24.34(c)(1).

[208] 16 Tex. Admin. Code § 24.135(a).

Rates means that the Commission intended the word "methodology" to have that same meaning in the Public Interest Rule.

Sixth, the evidence TCMUD 12 offered in an attempt to show WTCPUA changed its revenue-requirement computation methodology is cost-of-service evidence that may not be considered in determining whether the public interest is adversely affected by the Protested Rates.[209] In his testimony claiming WTCPUA changed methodologies, Mr. Joyce questions allocation of operation and maintenance expenses among customers, including costs of water, repair, maintenance, bookkeeping, financial management, utilities, and other expenses.[210] He also questions allocation of invested capital items, including debt service and capital recovery coverage.[211]

Mr. Joyce believes that his testimony does not raise cost-of-service issues because he does not recommend one allocation basis over another or an examination of the costs that flow from a particular allocation factor.[212] He claims that his analysis concerns only formulas used to make the computations, not the values used when performing the computations.[213] He contends WTCPUA changed the components of the revenue-requirement calculations, rather than simply changing inputs, and he only offered evidence to show changes in the allocation factors, not the underlying costs or inputs.[214] In the opinions of Mr. Stowe and Ms. Graham, however, Mr. Joyce's testimony and supporting exhibits alleging methodological changes are actually part of a prohibited analysis of WTCPUA's cost of service.[215]

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[209] 16 Tex. Admin. Code § 24.133(b). The ALJ erred on the side of caution and admitted this evidence to ensure a more complete evidentiary record because the issues are complicated and intertwined. Additionally, the Commission granted TCMUD 12's interim appeal of SOAH Order No. 6, which had denied TCMUD 12's request for discovery of information that the ALJ thought irrelevant because it concerned cost of service. That ruling suggested the possibility that the Commission might view the prohibition on consideration of cost-of-service analyses more narrowly than the ALJ.

[210] TCMUD 12 Ex. 2 at 12–14.

[211] TCMUD 12 Ex. 2 at 16–18, 21.

[212] TCMUD 12 Ex. 2 at 15.

[213] TCMUD 12 Ex. 2 at 15.

[214] TCMUD 12 Ex. 2 at 15.

[215] WTCPUA Ex. 3 at 23; Staff Ex. 1 at11.

The ALJ does not agree with Mr. Joyce's claim that he carefully walked the line but never strayed into a cost-of-service analysis. Clearly, the evidence Mr. Joyce sponsored concerns WTCPUA's "cost of service." Also, it is "analysis," which commonly means "[t]he separation of an intellectual or material whole into its constituent parts for individual study," and "[t]he study of such constituent parts and their interrelationships in making up a whole."[216] Thus, under the common definition of analysis and the meaning of "cost of service" derived from the Commission's Cost Of Service Rule, "an analysis of the seller's cost of service" is a separation of allowable utility expenses for operation, maintenance, and capital into constituent parts and the study of them individually and their interrelationships in making up a whole. That describes the evidence that Mr. Joyce sponsored.

The evidence Mr. Joyce sponsored would also be a cost-of-service analysis under the M1 Manual. Using the M1 Manual for guidance is problematic because the PUC rules use "revenue requirement" and "cost of service" as synonyms while the M1 Manual does not. Nevertheless, according to the manual, a "[c]ost-of-service analysis . . . [a]llocates the revenue requirements to the various customer classes of service in a fair and equitable manner."[217] The evidence Mr. Joyce sponsored nearly entirely concerned allocation of WTCPUA's costs among its customers, if not by classes through a comprehensive set of rates then among all wholesale customers through the rates specifically set for each of them.

Seventh, narrowly interpreting the Public Interest Rule's ban on considering "an analysis of cost of service" and broadly interpreting the phrase "changed the computation of the revenue requirement . . . methodology," as TCMUD 12 advocates, appears to be inconsistent with the intent of the state as previously expressed by the PUC's predecessor agency. When the PUC adopted the Public Interest Rule, it adopted the exact same wording that the rule had when it was originally adopted in 1994 by the PUC's predecessor agency, the Texas Natural Resource

[216] analysis. (n.d.) *American Heritage® Dictionary of the English Language, Fifth Edition.* (2011). Retrieved August 21, 2015 from http://www.thefreedictionary.com/analysis.

[217] WTCPUA Ex. 73, ch. I.1 at 4.

Conservation Commission (TNRCC).[218] In the preamble to the adoption of the original Public Interest Rule, TNRCC repeatedly and firmly indicated that it would avoid considering cost of service in determining whether protested wholesale rates affect the public interest and would hesitate to set rates for wholesale service obtained by contract:

> The commission concludes the public interest does not demand that a wholesale rate shall equal the seller's cost of providing service to the purchaser. . . . [T]he circumstances which justify cost of service ratemaking are not present here. . . . 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.
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> . . .
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> . . . [T]he use of cost of service to determine the public interest does not give sufficient deference to contractual agreements between the seller and the purchaser.
>
> . . .
>
> . . . [T]he commission favors a conservative approach when evaluating whether to cancel a rate which was set pursuant to a contract between utilities. . . .
>
> . . .
>
> . . . The adoption of these rules marks the end of past policy where the commission essentially automatically cancelled the rate set by contract and set a rate based on cost of service.[219]

There is no evidence that TNRCC or TCEQ ever interpreted "changed the computation of the revenue requirement . . . methodology" in the broad way that TCMUD 12 proposes, or that they narrowly interpreted the prohibition on considering cost-of-service analysis. There is no

[218] *Compare* 16 Tex. Admin. Code § 24.133 *to* 30 Tex. Admin. Code § 291.133 [19 Tex. Reg. 6227, 6231 (Aug. 9, 1994)]. On September 1, 2002, TNRCC formally changed its name and began doing business as TCEQ. http://www.tceq.state.tx.us/about/tceqhistory.html.

[219] WTCPUA Ex. 76 (preamble to adoption of 30 Tex. Admin. Code §§ 291.128-291.138, 19 Tex. Reg. 6227, 6228–29 (Aug. 9, 1994)).

indication in any PUC rule or the PUC's preambles to the proposal[220] and adoption[221] of the Public Interest Rule that the PUC intended to adopt an approach different from that of its predecessor agencies. In the absence of rule, guidance, or precedent to the contrary, the ALJ assumes that PUC, like TNRCC and TCEQ before it, wishes to use a conservative approach to canceling rates set pursuant to contract and broadly interpret the prohibition on consideration of cost-of-service analyses.

For all the above reasons, the ALJ concludes that TCMUD 12 has failed to prove that WTCPUD changed its revenue-requirement computation methodology when it adopted the Protested Rates.

4. Alleged Changes in Rate Computation Methodology

Mr. Joyce also testified that WTCPUA changed the method used to compute its rates.[222] As to the volumetric rate, Mr. Joyce claims that WTCPUA changed the methodology for computing it because WTCPUA's wholesale customers are no longer charged the same uniform rate.[223] The Prior Rates included a uniform volume charge of $2.77 per 1,000 gallons for wholesale water services customers that had their own raw water supply, including TCMUD 12.[224] However, the volumetric rate per 1,000 gallons that WTCPUA charges TCMUD 12 under the Protested Rates differs from the volumetric rate adopted at the same time for other wholesale customers with their own raw water.[225] Mr. Joyce contends that these changes were due to changes in the underlying methodology used to calculate the Protested Rates.[226]

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[220] 39 Tex. Reg. 2667, 2720–22 (Apr. 11, 2014).

[221] 39 Tex. Reg. 5903, 5939–40 (Aug. 1, 2014).

[222] TCMUD 12 Ex. 2 at 5, 7–10, 18–22.

[223] TCMUD 12 Ex. 2 at 20.

[224] TCMUD 12 Ex. 2 at 20; *see also* WTCPUA Ex. 3, attach. F at 202.

[225] TCMUD 12 Ex. 2 at 20 & JJJ-14 at 9501; *see also* WTCPUA Ex. 3, attach. G at 204–06.

[226] TCMUD 12 Ex. 2 at 20.

As to the monthly rate, Mr. Joyce testified that WTCPUA used a simple methodology to set the Prior Rates, which included: (1) a calculation of the total wholesale costs; (2) a calculation of total wholesale revenues at then-current rates; (3) a calculation of the resulting "required" rate increase; and (4) adoption of one-half of the "required" rate increase.[227] For the Protested Rates, however, Mr. Joyce claims WTCPUA applied an entirely different and much more complex methodology to set monthly rates for TCMUD 12 and other customers:[228]

> (1) Separating the total capital cost allocation to TCMUD 12 into Series 2013, Series 2015, and Series 2019, related to the existing or anticipated WTCPUA bond issues;
>
> (2) Adding approximately 6.5% to this total capital cost allocation for reserve requirements;
>
> (3) Adding another 2% to the total capital cost allocation for issuance costs;
>
> (4) Considering the growth projection in TCMUD 12 each year from 2014 through 2048;
>
> (5) Subtotaling the results from 1, 2, and 3 above (capital cost + 6.5% + 2%) and to that subtotal adding another 25% for bond coverage;
>
> (6) Subtotaling the results from 1, 2, and 3 above (capital cost + 6.5% + 2%) and from that subtotal subtracting 17% for system-wide impact fee credit;
>
> (7) Taking the subtotal and adding the 25% from 5 above and subtracting the 17% from 6 above to calculate the total amounts owed by Bond Series (one amount for Series 2013, another for Series 2015, and another for Series 2019); and
>
> (8) Calculating the levelized principal and spreading the amount over the 30-year period for each bond issue to pro-rate the amount to the growth in number of connections.

The other pertinent experts do not agree that WTCPUA changed its rate computation methodology. Mr. Stowe testified that WTCPUA used the same methodology to set the Prior and Protested Rates: a monthly fee and a flat volumetric rate.[229] Ms. Graham's analysis was different, but she concluded that the evidence did not show a change without examining cost of

[227] TCMUD 12 Ex. 2 at 18–20 & JJJ-12.

[228] TCMUD 12 Ex. 2 at 21 & JJJ-15.

[229] WTCPUA Ex. 3 at 17–19.

service, which is prohibited. She testified that it appeared that the methodology to compute the "fixed charge," apparently meaning the monthly charge, had not changed and was computed for each customer by using the fixed amount of revenue WTCPUA was trying to recover and a forecasted number of connections.[230] It also appeared to her that the "variable rate" methodology—apparently meaning the methodology for the volumetric rate—had not changed; the variable rate was computed using the forecasted amount of consumption and the amount of variable revenue WTCPUA wanted to recover.[231]

5. Evidence Does Not Show WTCPUA Changed it Rate Computation Methodology

The ALJ does not find that WTCPUA changed its rate computation methodology when it adopted the Protested Rates.

The Public Interest Rule does not explain what it means by a change in rate computation methodology. However, no party in this case disputes that a change in the rate structure would reflect a change in rate computation methodology. According to the M1 Manual, a "rate structure" is developed during the rate design analysis and classifies customers, establishes the frequency of billing, and identifies the charges or schedule of charges that each classification of customers will be assessed.[232] No Commission rule defines "rate structure," although some rules use the phrase similarly to the M1 Manual.[233]

The Commission's rules refer to several possible rate structures, including declining-block and inclining-block,[234] and phased or multi-step volumetric rates.[235] In a prior case, the ALJ concluded that a change in the rate design, which he might have better called a change in

[230] Staff Ex. 1 at 11.

[231] Staff Ex. 1 at 11.

[232] WTCPUA Ex. 73, ch. I.1 at 5 & ch. IV.1 at 91.

[233] 16 Tex. Admin. Code § 24.14, .32, .34, .122, .124.

[234] 16 Tex. Admin. Code § 24.32(b).

[235] 16 Tex. Admin. Code § 24.34(c).

the rate structure, from uniform to inclining-block volumetric rates reflected a change in the rate computation methodology.[236] The TCEQ agreed, finding that the seller changed its methodology for designing its rates when it switched to inclining-block rates.[237]

WTCPUA used the same rate structure for both the Prior Rates and the Protested Rates it has charged TCMUD 12. Both include a flat monthly charge, sometimes referred to as a "Minimum Bill," and a flat volumetric rate per 1,000 gallons of water used.[238] The monthly charge was $10,891.65 and now is $8,140.89. The volumetric rate was $2.77 and now is $2.11 per 1,000 gallons.[239]

Despite the continuity in rate structure for TCMUD 12, Mr. Joyce claims WTCPUA changed the method of computing TCMUD 12's rates. WTCPUA formerly charged all of its wholesale water service customers, including TCMUD 12 under the Prior Rates, a flat volumetric rate of $2.77 per 1,000 gallons.[240] Now it charges each wholesale customer a unique, single volumetric rate, ranging from $1.86 to $2.35 per 1,000 gallons, including a rate of $2.11 per 1,000 gallons to TCMUD 12 under the Protested Rates.[241] According to Mr. Joyce, the fact that WTCPUA changed from a flat volumetric rate for all customers to a different one for each customer evidences that the methodology for calculating the rates fundamentally changed.[242] Additionally, as described above, Mr. Joyce claims that WTCPUA changed the computation

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[236] *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 50 (Aug. 17, 2011).

[237] *An Order Denying the Petitions of Navarro County Wholesale Ratepayers, et al. to Review the Wholesale Rate Increase Imposed by the City of Corsicana*, TCEQ Docket No. 2009-1925-UCR, SOAH Docket No. 582-10-1944, Finding of Fact 69 at 12 (Nov. 9, 2011).

[238] *Compare* WTCPUA Ex. 3, attach. F at 202 *to* WTCPUA Ex. 3, attach. G at 205–06 & TCMUD 12 Ex. 1 at JAD 13 at 399.

[239] *Compare* WTCPUA Ex. 3, attach. F at 202 *to* WTCPUA Ex. 3, attach. G at 205–06 & TCMUD 12 Ex. 1 at JAD 13 at 399.

[240] WTCPUA Ex. 3, attach. F at 202.

[241] WTCPUA Ex. 3, attach. G at Bates 205–06.

[242] TCMUD 12 Ex. 2 at 20.

methodology for the monthly rates by switching from a three-step method to a method with more steps.[243]

The ALJ does not find that WTCPUA changed it rate-computation methodology. First, the rate structure for TCMUD 12 was not changed; it still includes a single monthly charge and a single volumetric rate. Second, charging wholesale-contract customers different volumetric rates and monthly charges does not prove that WTCPUA has changed its rate computation methodology. WTCPUA has a separate contract with each wholesale customer, meaning a wide range of factors other than a change in rate computation methodology could have led their rates to be different from the rates charged TCMUD 12.

Third, in attempting to prove WTCPUA changed the method for computing TCMUD 12's rates, TCMUD 12 once again offered, through Mr. Joyce, an analysis of WTCPUA's costs and their allocation among its wholesale customers, which led Mr. Joyce to conclude that WTCPUA changed its rate computation methodologies.[244] The details are different, but Mr. Joyce and TCMUD 12 are once again claiming that analyzing WTCPUA's cost of service and its allocation is not a cost-of-service analysis. The ALJ will not repeat the details concerning the meanings of "analysis of the seller's cost of service" that he discussed above when considering the alleged change in revenue-requirement computation methodology. Applying those same meanings, the ALJ concludes that the evidence TCMUD 12 offered in attempting to show a change in rate computation methodology was a cost-of-service analysis, under both (1) the common definition of "analysis" and the meaning of cost of service that the ALJ derived from the Cost Of Service Rule and (2) the M1 Manual's description of a cost-of-service analysis.[245]

Fourth, as discussed previously, TCMUD 12's narrow interpretation of the ban on considering cost-of-service analysis appears contrary to the expressed intent and practice of the

[243] TCMUD 12 Ex. 2 at 18–21, JJJ-12, JJJ-15.

[244] TCMUD 12 Ex. 2 at 19–21, JJJ-12, JJJ-15.

[245] WTCPUA Ex. 73, ch. I.1 at 4–5.