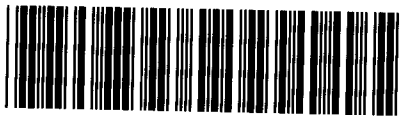

Control Number: 42866

Item Number: 169

Addendum StartPage: 0

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 PUBLIC UTILITY COMMISION OF TEXAS

TCMUD 12'S EXCEPTIONS TO THE PROPOSAL FOR DECISION

TABLE OF CONTENTS

169

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TO THE HONORABLE COMMISSIONERS:

TCMUD 12'S EXCEPTIONS TO THE PROPOSAL FOR DECISION

I. INTRODUCTION

TCMUD 12 urges the Commission to reject the Proposal for Decision ("PFD") upon consideration of the *entire* evidentiary record, which supports TCMUD 12's allegations that in setting wholesale rates for 2014, WTCPUA and its Participating Entities adversely affected the public interest by abusing their monopoly power by exercising their disparate bargaining power and by changing the methodology for computing the wholesale water revenue requirement and rates.

WTCPUA took over operations of the West Travis County Water System from LCRA in March 2012 under an Installment Purchase Agreement.[1] TCMUD 12, who was a wholesale water service customer of LCRA, became a wholesale customer of WTCPUA as a result of the transfer[2] from LCRA to WTCPUA of its Wholesale Water Services Agreement. Under that contract, WTCPUA is obligated to divert, treat and transport up to a maximum daily flow rate of 3.98 Million Gallons per Day (MGD) of treated water to TCMUD 12 in order for it to provide

[1] Under the Installment Purchase Agreement, WTCPUA operates the West Travis County System but will not own it until it has made all of the installment payments to LCRA, sometime in 2019. *See,* TCMUD 12 Ex. 1 (DiQuinzio Direct) at JAD Exhibit 8.

[2] TCMUD 12 Ex. 1 (DiQuinzio Direct) at JAD Exhibit 5 (Transfer Agreement, July 2012).

potable water to the retail customers in The Highlands. [3] Shortly after WTCPUA took over the System, its first rate decision was to adopt the same rates LCRA had been charging on the date WTCPUA took over operation of the System. Soon thereafter, in November 2012, WTCPUA Board increased the water rates[4] for only its wholesale customers, by 15.5% effective on January 1, 2013. That increase represented one-half of the 31% rate increase recommended by Ms. Heddin, WTCPUA's rate analyst, and was characterized as a phased or stepped increase.[5] The 2013 rate change, which had been undertaken without a complete cost of service analysis, was not protested by TCMUD 12 or any other wholesale customer. The 2013 wholesale rates are the starting point from which the Commission must evaluate the 2014 rates, including determining if the methodology used to set the 2014 rates represented a change from the methodology used to set the 2013 rates.

After adopting the 15.5% increase to wholesale rates to be charged in 2013, the WTCPUA Board directed its staff to continue reviewing wholesale rates in order to "identify a methodology acceptable to wholesale customers that would address the remaining needed increase in wholesale rates" for 2014.[6] This time, Ms. Heddin undertook a cost of service analysis in order to identify the wholesale rates to be charged in 2014, and by May 2013 had identified a new rate methodology to set 2014 Monthly Charges and Volumetric rates for all wholesale customers. She also identified significant changes to the terms of each customer's wholesale water service contracts that would need to be made to conform the contracts to the new methodology, and drafted a standard Contract Amendment offer that reflected her methodology.

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[3] Travis County MUD 12 brought the Petition on behalf of itself and TCMUDs 11 and 13 (sometimes collectively referred to as "the Districts.") Under the Wholesale Water Services Agreement, the potable water from the West Travis Water System is used by The Districts to serve an area known as The Highlands. See, Attached, TCMUD 12 Ex. 1, JAD Exhibit 6 - the map showing the geographic areas of the Districts and The Highlands, as well as Rough Hollow, which is in another section of TCMUD 11's service area and is served by TCMUD 11 through a wholesale water service agreement with Lakeway MUD.

[4] Monthly Charge and Volume Rate.

[5] TCMUD Ex. 12 (J. Joyce Rebuttal) at JJJ Exhibit R30 p. 2.

[6] TCMUD 12 Ex. 5 (Joyce Rebuttal) at JJJ Exhibit R8 (WTCPUA's General Counsel's June 6, 2013 Memo to WTCPUA Member Entities – Subject: Approval of WTCPUA Water and Wastewater Rates.)

Ms. Heddin sent the contract amendments which described the new methodology for calculating wholesale rates to the wholesale customers on May 14, 2013,[7] and the WTCPUA Board endorsed the "form wholesale amendment" by Resolution six months later,[8] at the November 21, 2013 board meeting at which it also entered an order changing the wholesale rates for 2014.[9] The 2014 wholesale rates were based on the new methodology described in the contract amendments offered by WTCPUA, but for those wholesale customers that did not accept the contract amendments, which included TCMUD 12, their rates were still set utilizing the new methodology as if they had accepted the contract amendment. *WTCPUA's ability to impose the new methodology for computing the wholesale revenue requirement and rates even on those wholesale customers who did not accept the proposed contract amendments evidences a clear abuse of monopoly power.*

The new rate methodology was needed to ensure WTCPUA could issue the bonds necessary for WTCPUA to purchase the System from LCRA. Those bonds series were scheduled to be issued in 2013, 2015, and 2019 and the methodology adopted for 2014 was *intended* to significantly raise the Monthly Charge for each wholesale customer each year through 2045 to ensure WTCPUA's coverage for each bond series. WTCPUA's rate analyst advised the WTCPUA Board regarding the 2014 Wholesale Rates, that she was "proposing a methodology," under which "the Agency assesses a monthly minimum bill schedule that **escalates annually**."[10] This change in methodology greatly concerned TCMUD 12 because, as Ms. Heddin also told the WTCPUA Board, "this escalating fee . . . would **not be subject to amendment** except for instances where the Agency refunds its bonds."[11]

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[7] WTCPUA Ex. 1 (Rauschuber) at Attachment P (N. Heddin May 14, 2013 email with Amended Agreement for Wholesale Customers Attached).

[8] WTCPUA Ex. 1 (Rauschuber) at Attachment Q (WTCPUA Resolution Authorizing the Negotiation and Execution of Form Amendments to Wholesale Customer Agreements).

[9] WTCPUA Ex. 1 (Rauschuber) at Attachment S (Order Regarding Amendments to Wholesale Water and Wastewater Rates, Nov. 21, 2013).

[10] TCMUD 12 Exhibit No. 5 (Joyce Rebuttal) at JJJ Exhibit R9 at WTCPUA00012018 (WTCPUA Response to TCMUD 12 RFI RFP 1-5 & 1-7, Letter from Water Resources Management, LLC to WTCPUA Board President Larry Fox dated March 12, 2013), Recommendation No. 2 (emphasis added).

[11] TCMUD 12 Exhibit No. 5 (Joyce Rebuttal) at JJJ Exhibit R9 at WTCPUA00012018 (underlined emphasis in original; bold emphasis added).

The ALJ[12] has been persuaded by WTCPUA's and Commission Staff's theory of this case, which is as follows: Even if WTCPUA has violated one of the public interest factors, the 2014 rate change is not adverse to the public interest because the rate change resulted in rates *lower* than those previously charged.[13] However, the theory that a rate change that does not immediately result in a rate increase cannot be adverse to the public interest is not supported by citation to any rule, statute, or precedent, and cannot be reconciled with the plain reading of the Public Interest rule nor is it supported by any discussion in the Preamble. Rather, TEX. WATER CODE § 13.043(f) requires the Commission to review "a decision of the provider of water service affecting the amount paid for water service" and it is undisputed that WTCPUA's action in November 21, 2013 affected the amount TCMUD 12 pays for water service. Similarly, P.U.C. SUBST. R. 24.133, the Public Interest rule, uses the term Protested "rate," and there is no mention of "increased or higher or larger" rate, and it is error to imply a word or phrase that is not included in the rule.[14] The word "rate" must be interpreted consistent with TEX. WATER CODE § 13.002(17) and P.U.C. SUBST. R. 24.3(38), which define "rate" as including: "any rules, regulations, practices, or contracts affecting that compensation, tariff, charge, fare, toll, rental, or classification." This admittedly broad definition encompasses the "methodology" about which TCMUD 12 complains. When the definition of "rate" is properly applied to the analysis of the evidence, it is clear that the Commission is charged with determining if WTCPUA's 2014 Wholesale Water Rates, including the methodology utilized to set the Protested Rate, adversely affects the public interest.[15]

The methodology approved by the Board meant that TCMUD 12's *monthly charge* was designed to increase from $ 8,140.89 in 2014, to more than double that ($16,775.17) in 2015, and to continue escalating annually, reaching $85,849.38 by 2023. *TCMUD 12 appealed WTCPUA's 2014 rate decision because it could only obtain review of the new methodology following its initial implementation – i.e., it is an integral part of the WTCPUA's November 21, 2013 rate*

[12] PFD at 30: "The Protested Rates TCMUD 12 pays are even lower than the Initial Rates [which] suggests that TCMUD 12 has greater bargaining power than WTCPUA."

[13] WTCPUA Brief at 13; PUC Staff Brief at 4.

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

[15] P.U.C. SUBST. R. 24.132(a)

decision for which TCMUD 12 initiated an appeal within 90 days, as required by TEX. WATER CODE § 13.043(f).

In these exceptions, TCMUD 12 explains why the Commission should not adopt the PFD, and describes the significant parts of the evidentiary record that the ALJ does not address, which, when properly considered, demonstrate the errors in the ALJ's analysis and conclusions. The omissions from the PFD of greatest concern that TCMUD 12 urges the Commission to analyze include:

- Dr. Jay Zarnikau's economic analysis which explains why *WTCPUA is a monopoly*, that it possesses market power, and all of the reasons supporting Dr. Zarnikau's conclusion that *WTCPUA abused its monopoly power* in setting the 2014 Rates;
- The WTCPUA rate schedules that illustrate the new methodology backloads the debt for the bonds WTCPUA has and will issue to pay for the West Travis County Water System it purchased from LCRA, and that the methodology, which WTCPUA does not intend to change, is designed so that rates will increase each year;
- The Contract Amendments, offered by WTCPUA to all wholesale customers, that included each discrete change to the wholesale contract provisions to conform the contracts to the new methodology for setting the Monthly Charges and Volumetric rates;
- The fact that the WTCPUA developed each of the wholesale customers' water rates using a new methodology found in the WTCPUA's proposed wholesale contract amendment regardless of whether each wholesale customer agreed to the methodology change; and
- The legal and practical limitations that preclude TCMUD 12 from financing the construction of an alternative water treatment system (diversion, treatment, and delivery) that rendered self-provisioning, which the ALJ identifies as a viable alternative to continuing service under the contract with WTCPUA, impossible.

II. PARTIES

The PFD describes WTCPUA as a political subdivision of the state of Texas under chapter 572 of the Texas Local Government Cod, but errs in failing to define WTCPUA as a

"retail public utility" as that term is defined under TEX. WATER CODE § 13.002(19).[16] As a result of this error, the ALJ also errs in concluding that WTCPUA is *not* a monopoly under Tex. Water Code § 13.001(b)(1), as addressed below in Section VII. C.

III. PROCEDURAL HISTORY

IV. BACKGROUND

TCMUD 12 does not except to Sections III or IV of the PFD.

V. JURISDICTION (PFD at 7-8)

Jurisdiction of TCMUD 12's Appeal of WTCPUA's Rate setting decision was accepted pursuant to TEX. WATER CODE § 13.043(f). It was not necessary for the purposes of the hearing to decide if jurisdiction also arose under TEX. WATER CODE § 12.013 and because it was unnecessary to reach that jurisdictional question, it was not fully briefed. Nonetheless, the ALJ addresses this jurisdictional question at page 8 of the PFD. In addition, the ALJ's analysis of jurisdiction contains an error of law because it does not accept that WTCPUA is a "retail public utility" under TEX. WATER CODE 13.002(19). Accordingly, TCMUD 12 urges the Commission to decline to adopt the PFD analysis at page 8 and to amend Finding of Fact 13 and Conclusion of Law 1, to clarify that WTCPUA is a Retail Public Utility under TEX. WATER CODE § 13.002(19).

VI. BURDEN OF PROOF (PFD at 9)

TCMUD 12 does not except to this Section of the PFD.

VII. THE PUBLIC INTEREST DETERMINATION (PFD at 9- 11)

A. Requirement for an Initial Public Interest Determination (PFD at 9-10)

In a wholesale water rate dispute that arises "pursuant to a contract," the Commission's Public Interest rule requires the petitioner to carry the burden of proving that the protested rate adversely affects the public interest. Use of the phrase "*pursuant* to a contract" in the Public Interest rules was intentional because, as TNRCC explained in adopting the rule, "rates set forth *in* a contract do not generally give rise to appeals before the commission. It is those rates

[16] (19) "Retail public utility" means any person, corporation, public utility, water supply or sewer service corporation, municipality, political subdivision or agency operating, maintaining, or controlling in this state facilities for providing potable water service or sewer service, or both, for compensation.

demanded *pursuant* to a Contract that are usually appealed."[17] Although the Protested Rates in this matter were not set forth in the Wholesale Water Services Agreement, but were established by WTCPUA's Board through issuance of an Order,[18] the WTCPUA's authority to charge wholesale rates to TCMUD 12 arises under, or "pursuant to," that contract and the Transfer Agreement.[19]

B. Determining Whether Public Interest Is Adversely Affected (PFD at 10-11)

TCMUD 12 filed its Petition at TCEQ seeking review of WTCPUA's 2014 rates pursuant to the Public Interest rule.[20] The Public Interest rule and the bifurcated process that governed this case was implemented by TNRCC, predecessor to TCEQ, in 1994. Twenty years later, in 2014, upon transfer of jurisdiction of economic regulation over water and sewer utilities back to the PUC, this Commission adopted, without substantive change, the TCEQ's wholesale water rules.[21]

There is no process at the Commission comparable to the bifurcated Public Interest process utilized in this case, and TCMUD 12's Appeal presents the first opportunity for the Commission to consider and decide on its own interpretation of P.U.C. Subst. R. 24.133.[22] The PUC is the Texas agency with the greatest depth of experience in economic regulation of

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[17] WTCPUA Ex. 76: Preamble to 30 TAC §§ 291.128-291.138, 19 TexReg 6227 (middle column) (Aug. 9, 1994).

[18] TCMUD 12 Ex. 1 (DiQuinzio Direct) JAD Exhibit 13 (WTCPUA's Dec. 17, 2013 Notice of Rate Change to TCMUD 12); WTCPUA Ex. 1 (Rauschuber), Attachment R (Minutes of WTCPUA Board Nov. 21, 2013) and Attachment S (Order Regarding Amendments to Wholesale Water and Wastewater Rates).

[19] TCMUD Ex. 1 (DiQuinzio Direct) JAD Exhibit 4 (Wholesale Water Services Agreement, Article IV, 4.01.f. (authorizing the modification of the wholesale rates consistent with the terms of the Agreement); and JAD Exhibit 5 (Transfer Agreement at p. 3, Para. 3 – authorizing WTCPUA to set and collect the Monthly Charge and Volume Rates in strict accordance with the terms and conditions of the Water Services Contract.)

[20] P.U.C. Subst. R. § 24.133.

[21] P.U.C. Subst. R. Chapter 24, Subchapter I, §§ 24.128 – 24.138.

[22] The Commission recently issued an order in Docket No. 42857, *Petition of North Austin MUD No. 1 et al Appealing the Ratemaking Actions of the City of Austin* which arose under Tex. Water Code § 13.044. Based upon arguments presented by the respondent, City of Austin, the Commission discussed and adopted Findings of Fact and Conclusions of Law that discuss the public interest standard. In the Docket 42857 Order at page 4, theh Commission discusses why the public interest inquiry was not required under TWC § 13.044, and states "more importantly," because the rates complained of were set by municipal ordinance and not by the parties' contracts, it need not reach the issue of whether there is an impairment of contract or a constitutional prohibition on impairing contracts. Similarly, WTCPUA has not set the Protested Rates by contract, but instead set them by Order, but since jurisdiction attaches under TWC 13.043(f), the case was processed under the Public Interest Rule which TNRCC adopted in response to *Texas Water Commission v. City of Fort Worth*, 875 S.W. 2d 332 (Tex. App. – Austin 1994, writ denied) (construing TWC § 13.043 and finding public interest inquiry was required.)

utilities, which undoubtedly influenced the decision to transfer jurisdiction of water and sewer utility matters back to this agency.

TCMUD 12 urges the Commission to apply its expertise in arriving at its own interpretation of the Public Interest Rules and in analyzing the evidence in this Wholesale Rate Appeal.

The ALJ has interpreted the Public Interest at two extremes. First, he applied a very *expansive* interpretation of P.U.C. Subst. R. 24.133(b), which prohibits a determination whether the protested rate adversely affects the public interest based on an analysis of the seller's "cost of service," and seems to invite the Commission to explain if it views the prohibition more narrowly.[23] TCMUD 12 encourages the Commission to interpret the prohibition of "an analysis of cost of service"[24] in the public interest phase in a narrower manner so as to not preclude consideration of "changes to the computation of the revenue requirement or rate from methodology to another"[25] as one factor to be weighed in determining if the seller abused its monopoly power.

On the other hand, the ALJ applied a *narrow* interpretation of the terms from the public interest rule that address how WTCPUA violated the public interest, including the following terms: "monopoly", "disparate bargaining power", "alternative means and costs," "methodology," and "abuse of monopoly power." The interpretation of those terms in the PFD sets the burden so high that it is difficult to fathom how any Petitioner could ever prove abuse of monopoly power,[26] and therefore, how the Commission could discharge its duty under TEX.

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[23] PFD at 39, fn. 209 ("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.")

[24] P.U.C. Subst. R. 24.133(b).

[25] P.U.C. Subst. R. 24.133(a)(3)(C).

[26] While each case must be decided on its own set of unique facts, since the TNRCC adopted the bifurcated public interest process there has not been a single Appeal in which TNRCC or TCEQ found the Seller's rate adversely affected the public interest, which means there is no precedent to follow in determining that a protested rate evidences the seller's disparate bargaining power, or that the protested rate resulted from the Seller's change in the computation of the revenue requirement or rate methodology. *See, e.g., City of McAllen Appeal the Wholesale Water Rate Increase of Hidalgo County WID No. 3 and Request for Interim Rates in Hidalgo County (Application No. 33671-M),* SOAH Docket No. 582-02-2470, TCEQ Docket No. 2001-01583-UCR.*; Petition of BHP Water Supply Corporation Appealing the Wholesale Water Rate Increase of Royce City, Texas and Request for Interim Rates,* SOAH Docket No. 582-07-2049, TCEQ Docket No. 2007-0238-UCR*; Multi-County WSC's Appeal of the Wholesale Water Rate Increase Imposed by the City of Hamilton; Application No. 36280-M;*

WATER CODE § 13.043(j) to ensure rates are not unreasonably preferential, prejudicial, or discriminatory but are sufficient, equitable, and consistent in application to each class of customers.

TCMUD 12 urges the Commission to reject the ALJ's expansive interpretation of the "cost of service prohibition" provision in the Public Interest Rule, and also reject the narrow interpretation of the terms related to abuse of monopoly power. TCMUD 12 successfully discharged its burden of proof by presenting evidence that the 2014 wholesale water service rates adversely affect the public interest[27] because those rates evidence WTCPUA's abuse of monopoly power in its provision of water service to TCMUD 12.[28] TCMUD 12 addressed through Dr. Zarnikau's expert testimony why WTCPUA is a monopoly. The evidence that demonstrates WTCPUA abused its monopoly power addressed two factors under the Commission's Rule: (1) WTCPUA's disparate bargaining power,[29] and (2) WTCPUA's changes to the computation of revenue requirement and rate methodologies in setting the 2014 wholesale water service rates.[30] Upon finding that WTCPUA's actions evidence abuse of monopoly power, the rule requires the Commission to determine that the rate adversely affects the public interest[31] and then to remand this matter to SOAH for further evidentiary proceedings on the rate.[32]

VIII. ABUSE OF MONOPOLY POWER (PFD at 11-51)

WTCPUA is a Monopoly: The PFD gives scant analysis of the thorough economic analysis of the characteristics of a monopoly that support a finding that WTCPUA is a monopolist, and instead addresses primarily the factors that evidence abuse of monopoly power

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SOAH Docket No. 582-09-2557, TCEQ Docket No. 2009-0048-UCR; *Petitions of Navarro County Wholesale Ratepayers, et. al. 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.

[27] P.U.C. Subst. R. § 24.136.

[28] P.U.C. Subst. R. § 24.133(a)(3) (Abuse of Monopoly Power is one of four public interest criteria in 24.133(a).)

[29] P.U.C. Subst. R. § 24.133(a)(3)(A).

[30] P.U.C. Subst. R. § 24.133(a)(3)(C).

[31] P.U.C. Subst. R. § 24.133(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: * * * (3) the protested rate evidences the seller's abuse of monopoly power."

[32] P.U.C. Subst. R. 24.133-24.134(b).

before concluding that WTCPUA is *not* a monopoly.[33] The ALJ conflates the expert analysis presented by Dr. Zarnikau by suggesting he reached his opinion that WTCPUA is a monopoly in only "two ways."[34] In the first instance the ALJ declines to apply the statutory determination that WTCPUA is a monopoly[35] because he does not accept that WTCPUA is a "retail public utility." TCMUD 12's exception to that erroneous interpretation of the statute, is discussed in Section VIII. C of these Exceptions, below. What the ALJ characterizes as the "second" basis for Dr. Zarnikau's opinion that WTCPUA is a monopoly, is actually the ALJ's list of four considerations.[36] Unfortunately, after listing those four considerations, they are all but ignored in the Judge's analysis that follows.[37] To the extent the PFD addresses one of the considerations, which concerns the cost for TCMUD 12 to build a new substitute water service system, that is addressed in Section VIII. A. 1. d., below. TCMUD 12 submits that the following evidence that is not presented for the Commission's consideration in the PFD supports a finding that WTCPUA is a monopoly.

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

In addition to TEX. WATER CODE § 13.001(b) that defines WTCPUA as a monopoly, the two definitions that support a finding that WTCPUA operates as a monopolist include: First, under antitrust law, they hold a dominant position in this market and have the ability to control prices and quantities associated with the provision of wholesale water services to TCMUD 12; and second, under modern economic theory, the Suppliers exercise exclusive control over the

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[33] PFD at 11-12 and 47 – 51.

[34] PFD at 47.

[35] TEX. WATER CODE § 13.001(b): The legislature finds that: (1) retail public utilities are by definition monopolies in the areas they serve.

[36] PFD at 48: "Second, in Dr. Zarnikau's opinion, WTCPUA, Bee Cave, Hays County, and District 5 operate as a monopoly because (1) they are operating in concert, (2) they are the only providers of wholesale water services within TCMUD 12's retail service area, (3) there are formidable barriers to other suppliers entering the field to serve TCMUD 12, and (4) building a new system to serve TCMUD 12 would be prohibitively expensive. (citing to TCMUD 12 Ex. 3 (Zarnikau Direct) at 7-8."

[37] *See*, PFD at 48 – 49.

provision of wholesale water services to the TCMUD 12 service area.[38] Dr. Zarnikau's findings and opinions are unaffected by which definition is employed and his analysis therefore included both definitions.[39]

In the economics literature, a monopoly is a market structure within which one producer, or group of producers acting in concert, exercises exclusive control over all, or nearly all, of a supply of a good or service in a certain area or market, and where there are formidable barriers to entry.[40] The antitrust cases and law[41] have developed a much lower standard to classify a market structure as a monopoly. Antitrust cases often result in a court considering a 70% market share sufficient to establish a prima facie case of monopoly power, even if there are some smaller "fringe" suppliers with a significant market share in the same market. While economists would be reluctant to accept that level of concentration as proof of a true monopoly, but instead would characterize that as a market structure with a dominant firm, WTCPUA is the only provider of services for diversion, treatment, and delivery of wholesale water within the water service area of TCMUD 12.[42] Therefore, WTCPUA's control of wholesale water services fits the definition of monopoly under either definition discussed herein.

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

WTCPUA is the Only Provider of Services: In addition to the statutory provision that defines WTCPUA, a retail public utility, as a monopoly,[43] evidence that the WTCPUA operates as a monopolist includes: WTCPUA is **presently** the only provider of services related to the diversion, treatment, and delivery of water, i.e., wholesale water services, within the retail water service area of The Highlands. The PFD properly rejects the arguments advanced by WTCPUA

[38] TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 4:26–5:2. "TCMUD 12 service area" refers to The Highlands, consisting of all of TCMUD 12 and 13, and the portion of TCMUD 11 that is not the Rough Hollow Development. *See,* Attached, JAD Ex. 6.

[39] *Id.,* at 7:11–21.

[40] *Id.,* at 6:3–6.

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

[42] TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 6–7.

[43] TEX. WATER CODE § 13.001(b)(1)

that other water providers could provide wholesale water services to The Highlands,[44] and assuming *arguendo* that TCMUD 12 could abandon the WTCPUA system and build its own diversion, treatment and transmission system, it is undisputed that there is not an *existing* TCMUD 12 water service system that provides those services. WTCPUA exercises sole control over the existing supply of wholesale water services that TCMUD 12 must obtain in order to provide potable water to the retail customers of The Highlands.[45]

Significant Barriers to Entry: Another factor mentioned only in passing in the PFD[46] but which was thoroughly analyzed by Dr. Zarnikau in determining that WTCPUA is a monopoly, is the existence of *barriers to entry*. If a new supplier could easily enter the market, then the current Suppliers[47] would have less control over the supply of the good or service, and less control over prices because of the threat of competition. When there is ease of entry and exit such that the market is contestable, any attempt to change a price or the quantity of the good or service supplied could invite competition, which would diminish control by the incumbent supplier. A more competitive market, *i.e.*, a market where there is ease of entry, is a key consideration in determining if the Suppliers are a monopoly.[48]

One formidable barrier to entry is the fact[49] that there are no other existing suppliers of wholesale water services with the capacity and infrastructure necessary to provide an alternative to the wholesale water services and system controlled by WTCPUA. The extensive resources that would be necessary to allow a new entity to enter this market and operate an entire water system to serve The Highlands, include: facilities to divert raw water out of the lake, which in turn would require a new intake structure (barge), a new transmission line from the intake structure to the location of a new Water Treatment Plant ("WTP"), a site for a new WTP, additional new transmission lines from the new WTP to a new point of delivery ("POD"), and

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[44] PFD at 16 – 20 (at 16: "the ALJ does not conclude that TCMUD 12 has or had other available alternatives"; at 17: "the ALJ concludes that service from the City of Austin is not a realistic alternative available to [the Highlands]"; at 19-20 "the ALJ concludes that LMUD and HCMUD are not alternatives available to [The Highlands] for water treatment services.")

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

[46] PFD at 48 (first full paragraph)

[47] WTCPUA and its three participating entities.

[48] TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 8:3–13.

[49] The PFD accepts this fact at 16-20.

the construction of the new POD.[50] A new water services supplier would also have to arrange for storage. TCMUD 12 currently obtains under the Wholesale Water Services Agreement a static pressure at the POD,[51] which means TCMUD 12 does not have to provide water storage facilities to ensure appropriate pressurization in The Highlands.[52] A new supplier could *not easily* enter the market and therefore WTCPUA's control over the supply of the good or service is not threatened by competition. The absence of a competitive market supports a finding that WTCPUA is a monopoly.

The absence of a competitive threat to WTCPUA's control is also ensured, or at least substantially enhanced, by WTCPUA's contract with its three Participants, the City of Bee Cave, Hays County and TCMUD No. 5. The Participants are contractually obligated, under the Acquisition, Water Supply, Wastewater Treatment and Conditional Purchase Agreement[53] to prohibit competition:

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

Under the same Participants' Acquisition Agreement, the three Participants are also prohibited from reselling water that they purchase from WTCPUA to third party wholesalers without obtaining consent of WTCPUA and the other Water Participants; and the Water Participants are prohibited from entering into contracts with any entity other than WTCPUA for supply of water during the term of the Acquisition Agreement.[54] These contractual provisions ensure there are formidable barriers to entry by any third party alternative wholesale water service provider.

WTCPUA, City of Bee Cave, Hays County and TCMUD No. 5 have agreed to do whatever they can to ensure the continued monopolistic operation of the West Travis County

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[50] TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at 14:27 – 15:7.

[51] *Id.*, at JAD Exhibit 4, Section 3.03.e.

[52] *Id.*, at 15:3-7.

[53] *Id.*, at JZ Exhibit 2, "Acquisition Agreement" (WTCPUA00006075–6125) Section 7.07(h).

[54] *Id.*, at 9 and at JZ Exhibit 2, "Acquisition Agreement," Section 5.08.

Water System by WTCPUA, thereby creating even greater barriers to entry for water services by another entity. All of these barriers to entry precluding any alternative supplier from entering the market to serve The Highlands meet the stricter definition of a monopolist used in modern economic theory which supports rejecting the ALJ's conclusion and finding that WTCPUA does not operate as a monopoly.[55]

Wholesale Water Services Contract Obligates TCMUD 12 to Obtain Wholesale Water Service from WTCPUA: TCMUD 12's Wholesale Water Services Agreement requires it to use the potable water obtained from WTCPUA before it can use potable water from any other source:

> Section 3.01.b. The Raw Water Contract currently provides for the reservation and/or purchase of 1,680 acre-feet per year of raw water. It shall be District No. 12's sole responsibility to secure any amendments to the Raw Water Contract necessary in order for District No. 12 to purchase any additional raw water required for full development of the District Service Area. *Water made available under the Raw Water Contract and provided through the Wholesale Water Services provided by LCRA pursuant to this Agreement will be used by the Districts in order to provide potable water service within the District Service Area prior to the use of potable water obtained from any other source.*[56]

This contractual provision secures WTCPUA's control over the supply of wholesale water services that TCMUD 12 must have to serve The Highlands and that control supports a finding that WTCPUA is a monopoly.

The PFD focuses on Section 3.03.c of the Wholesale Water Services Agreement to reach the erroneous conclusion that "TCMUD 12 is free to use an alternative [wholesale water service provider] even if its demand for treatment does not exceed the amount specified in the agreement."[57] Section 3.03.a. of the contract obligates WTCPUA, to divert, transport, and treat for TCMUD 12 all the water needed and requested up to the peak hourly flow rate of 414,000 gallons per hour and a maximum daily flow rate of 3,980,000 GPD.[58] Under section 3.03.c., if TCMUD 12's demand for wholesale water services ever exceeds that amount, which it has not to date and is not forecasted to do for several years, then TCMUD 12 must notify WTCPUA of the

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[55] TCMUD 12 Exhibit No. 3 (Zarnikau Direct) at 5:20–22.

[56] TCMUD 12 Exhibit No. 1 (DiQuinzio Direct) at JAD Exhibit 4, Section 3.01.b.(emphasis added).

[57] PFD at 12-13 and 49. ("the ALJ does not conclude that WTCPUA is a monopoly.")

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

shortage and the amount of additional water needed. *If WTCPUA is unable to provide additional water under that scenario, it will be in default and TCMUD 12 may then seek water from another source.* [59]

WTCPUA cited to § 3.03.c. of TCMUD 12's Wholesale Water Services Agreement in its Initial Brief[60] and argued that "it does not require TCMUD 12 to obtain all of its raw water treatment services from the LCRA." The ALJ accepts this contractual interpretation argument by stating: "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."[61] This conclusion overlooks the limitation on TCMUD 12 seeking an alternative supplier found in Section 3.01.b, and the fact that WTCPUA did not present affirmative evidence that it would not object to TCMUD 12 obtaining wholesale water services elsewhere. WTCPUA's alleged "stipulation" that TCMUD 12 is free to find water services elsewhere is sound and fury signifying nothing. Assuming WTCPUA's contract interpretation is correct, it does not support a finding that there are other existing providers of wholesale water service available to TCMUD 12 instead of WTCPUA.[62]

The ALJ's conclusion that WTCPUA is not a monopoly rests in part on WTCPUA's flawed interpretation of the Wholesale Water Service Agreement. The contractual provisions found in Article III of the Agreement discussed herein legally and contractually prohibit TCMUD 12 from obtaining wholesale water services from any source other than WTCPUA.

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[59] *Id.,* at JAD Exhibit 4, Section 3.03.c.:

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

Under section 3.03.d, if TCMUD 12 is not in default, it may purchase *additional* Wholesale Water Services from WTCPUA on the same terms and conditions as other similarly situated customers if TCMUD 12 acquires additional raw water from LCRA and if WTCPUA has additional wholesale water service available in the PUA's System.

[60] WTCPUA Brief at 15.

[61] PFD at 13 (emphasis added).

[62] *See,* TCMUD 12's Exceptions at Section VIII.A.1 below.

The plain reading and hence the correct interpretation of these contract provisions is that TCMUD 12 is prohibited from obtaining an alternative supplier of wholesale water service unless and until TCMUD 12's demand for wholesale water service exceeds the quantity that WTCPUA is obligated to provide under the Agreement. TCMUD 12 was at the time WTCPUA implemented the new rates in 2014 and continues to be contractually and legally required to obtain all of its wholesale water services from WTCPUA.

Herfindahl-Hirschman Index Evidences WTCPUA is a Monopoly: Another analysis provided by Dr. Zarnikau to demonstrate why WTCPUA is a monopoly, that is overlooked in the PFD, concerns the Herfindahl-Hirschman Index (HHI). HHI is a screen that provides useful information, albeit not conclusive evidence, of market power, which is often used by the U.S. Department of Justice (USDOJ) to measure market concentration.[63] Under the HHI formula, WTCPUA's HHI is 10,000, which indicates a *highly concentrated market*, and in Dr. Zarnikau's opinion, indicates that a monopoly exists.[64] Although market concentration is not exactly synonymous with market power, higher market concentration such as is evident in WTCPUA's service area, is associated with a greater ability to control prices and quantities, which are factors that support a finding of monopoly power.[65]

Price-Inelasticity Gives WTCPUA Greater Control Over Pricing: It is common for there to be a single utility providing goods and services because it tends to be uneconomical to construct and operate competing systems to transport and distribute a commodity such as potable water or electricity. This imbues these types of utility services with natural monopoly characteristics.[66] Due to the importance of and human necessity for water, the demand for these utility services tends to be price-inelastic which means a change in price tends to have a less-than-proportionate effect on the demand for the product.[67] The significance of price-inelasticity in this case is that it gives the monopolist, WTCPUA, greater control over prices. Because water

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

[64] *Id.*

[65] *Id.* at 11:25–12:1. WTCPUA holds CCN No. 13207 (the West Travis County System, transferred to the PUA from the Lower Colorado River Authority ("LCRA")) pursuant to Section 3.2 of the Utilities Installment Purchase Agreement. WTCPUA's water service area is shown on Attachment E to Mr. Rauschuber's Testimony (WTCPUA Ex.1).

[66] *Id.* at 12:4–9.

[67] *Id.* at 12:19–22.

is a necessity for human life it is imbued with the public interest and because it is supplied by a utility that has monopoly characteristics, the Water Code establishes the process to enable the Commission to exercise regulatory oversight.[68] In this proceeding, the Commission has jurisdiction to examine WTCPUA's change to wholesale water service rates to determine if that action is adverse to the public interest, and upon finding that it is, to determine WTCPUA's cost of service.

A. Bargaining Power of the Parties as Evidence of Abuse of Monopoly Power (PFD 12 – 30)

The first factor that demonstrates abuse of monopoly power is WTCPUA's disparately greater bargaining power relative to TCMUD 12's.[69] "Bargaining power refers to the relative ability of parties to exert influence over each other [and i]n a competitive market where there are many viable suppliers and many buyers, there is equal bargaining power. [However,] where there is a monopoly or a dominant firm, there is disparate bargaining power, with the supplier holding more power."[70] TNRCC's Preamble to the Public Interest rules, which have now been adopted by the Commission, explained that the public interest is invoked when the facts demonstrate that the seller "exercises near monopoly power over the purchaser because many agreements allow the seller the unilateral right to adjust the rate [and] the purchaser substantially has no alternatives to obtain water service because it has entered into a long term agreement with the seller."[71] The Wholesale Water Services Agreement, a 40 year contract,[72] provides WTCPUA with the unilateral right to change the Monthly Charge and Volume Rate, as confirmed by the Transfer Agreement.

TCMUD 12 presented evidence of WTCPUA's abuse of monopoly power based upon the "disparate bargaining power" factor in the Public Interest rule. The rule contains a non-exclusive list of facts that may evidence disparate bargaining power, "including the purchaser's alternative means, alternative costs, . . . and problems of obtaining alternative water . . . service." The focus of the disparate bargaining power analysis under this part of the rule should have been whether

[68] *Id.* at 12:10-22.

[69] P.U.C. Subst. R. 24.133(a)(3)(A).

[70] TCMUD 12 Exhibit 6 (Zarnikau Rebuttal) at 24:18-25.

[71] WTCPUA Ex. 76, 19 TexReg 6227,

[72] TCMUD 12 Ex. 1 (DiQuinzio Direct) at JAD 5 p. 20, § 7.13 and at JAD 2 (Raw Water Contract) at p. 9, Art. II.A.

WTCPUA's order adopting the Protested Rates evidence abuse of monopoly power because there was not a reasonable alternative *existing in 2013* that would have permitted TCMUD 12 to obtain wholesale water service elsewhere. Instead, the PFD focuses on what the ALJ supposes TCMUD 12 could have or should have done – build its own system – either in 2009 or in 2013, but fails to acknowledge that TCMUD 12 did not and does not have a water system that could provide an alternative to continued use of the WTCPUA system. The ALJ also adopts an interpretation of the Wholesale Water Services Agreement that is inconsistent with the terms of that contract. If TCMUD 12 had left the WTCPUA system and built its own, that would have constituted a breach of the Wholesale Water Services Agreement.

The conclusions in the PFD concerning Disparate Bargaining Power that constitute error, and to which TCMUD 12 excepts, are summarized as follows:

(1) TCMUD 12 was and is free to reduce the quantity of water services it receives from WTCPUA;[73]

(2) TCMUD 12 was and is free to obtain water service elsewhere;[74]

(3) replacing all or part of its "reserved water treatment capacity in the WTCPUA system" was a viable alternative available to TCMUD 12;[75]

(4) building its own facilities to transport, treat and deliver the raw water TCMUD 12 purchases from LCRA is a viable alternative available to TCMUD 12 to serve The Highlands;[76] and

(5) "the ALJ does not find the self-service option was or is prohibitively costly";[77]and

(6) with respect to "other factors" related to disparate bargaining power, the errors in the PFD include: (a) WTCPUA's 2012 change to the Connection Fee does not evidence the seller's greater bargaining power;[78] (b) WTCPUA's contract amendment

[73] PFD at 12.

[74] PFD at 12.

[75] PFD at 15.

[76] PFD at 16. TCMUD 12 does not except to the ALJ's conclusion that TCMUD 12 did not have other viable alternatives from City of Austin, Lakeway MUD (LMUD) or Hurst Creek MUD (HCMUD).

[77] PFD at 23.

[78] PFD at 24.

offer did not evidence disparate bargaining power;[79] (c) WTCPUA gave TCMUD 12 and its other wholesale customers a meaningful opportunity for input before adopting the Protested Rates;[80] and (d) LCRA and then WTCPUA needed TCMUD 12 as a wholesale customer to purchase the capacity and that gave TCMUD 12 significant bargaining power.[81]

1. Alternative Means and Costs and Problems in Obtaining Alternative Wholesale Water Service (PFD at 12-23)

a. There are No Reasonable Alternatives for TCMUD 12 to Obtain Wholesale Water Services (PFD at 12 – 14)

The provisions of Article III of the Wholesale Water Services Agreement that govern the relationship between TCMUD 12 and WTCPUA, as discussed above,[82] contractually prohibit TCMUD 12 from obtaining wholesale water services from any entity other than WTCPUA, unless and until TCMUD 12 reaches the maximum quantity of water as provided for in its Raw Water contract and the Wholesale Water Services Agreement. It is undisputed that TCMUD 12's demand for potable water to serve The Highlands is nowhere near the maximum quantity of either raw water or potable water it is entitled to receive under those contracts from LCRA and WTCPUA, respectively. Accordingly, without breaching its contract with WTCPUA, there is no alternative provider of wholesale water services available to TCMUD 12. TCMUD 12 could not legally self-provision the water services WTCPUA is obligated to and currently provides and therefore the ALJ errs in recommending self-service as a reasonable alternative.

WTCPUA touted its offer of a contract amendment as a means by which TCMUD 12 could reduce its Monthly Charge.[83] That characterization of the Contract Amendment, which unfortunately the ALJ appears to accept, fails to fully capture the negative effect the amendment would have had on TCMUD 12. It isn't that the offer was "illusory" as the ALJ suggests,[84] but rather the problem was that the intended effect of the Contract Amendment was to reduce

[79] PFD at 25-26.

[80] PFD at 26-27.

[81] PFD at 27-28.

[82] *See,* TCMUD 12 Exceptions at p. 14–15, Section VIII. *Wholesale Water Services Contract Obligates TCMUD 12 to Obtain Wholesale Water Service from WTCPUA:*

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

[84] PFD at 13, citing to TCMUD 12's Initial Brief at 38.

WTCPUA's obligations under the Wholesale Water Services Agreement, and deprive TCMUD 12 of the wholesale water services capacity it contracted for in 2009. The mere fact of TCMUD 12's refusal to accept the contract amendment left the parties' relative bargaining power unchanged – WTCPUA still has a monopoly in provisioning of wholesale water services which allows it to control the supply and price of wholesale water service to TCMUD 12 until 2048. WTCPUA's Contract Amendment offer[85] does not negate the existence of WTCPUA's significantly greater bargaining power and TCMUD 12's refusal to accept it does not indicate it had bargaining power – especially since the new methodology contained in the contract amendment was used to set TCMUD 12's rates.

TCMUD 12 was most concerned that the Contract Amendment would have replaced the provisions in the Wholesale Water Services Agreement that established the methodology for setting the Monthly Charge[86] and the Volume Rate[87] and replaced them with the new contract provisions that established the methodologies that were used in setting the 2014 Protested Rates. The WTCPUA Resolution authorizing the General Manager and Board President to negotiate and execute the contract amendments with all wholesale customers, explicitly states that in addition to changing the capacity reservation, the purpose of the Amendment is to "***establish wholesale rate methodology***."[88] The ALJ dismisses the Board's statement as a "casual" reference[89] and concludes that the contract amendments did not reflect a change of methodology. That conclusion must be rejected because it fails to reflect any analysis of the explicit amendment terms. TCMUD 12 provides that analysis in Section VIII. B. of these exceptions, below.[90]

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

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

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

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

[89] PFD at 38.

[90] TCMUD Exceptions, p. 44–45.

TCMUD 12's second concern was that the standard Contract Amendment offered by WTCPUA would have lowered TCMUD 12's Monthly Charge *only* by reducing the Districts' Maximum Day Reservation under the Wholesale Water Services Agreement, which would have unreasonably required a young and growing district, to relinquish water rights during the worst drought in the history of Texas. The Highlands is growing and expects to need the full capacity commitment under the Wholesale Water Services Agreement in 7 – 10 years, or by 2022 – 2025.[91] Since TCMUD 12 needs the capacity it contracted for to be able to provide potable water to The Highlands, *the offer by WTCPUA to reduce the quantity of water does not represent an opportunity of value to TCMUD 12 and does not indicate a change to WTCPUA's market power.*[92] If TCMUD 12 had accepted the offer to reduce its maximum capacity, WTCPUA would not have been obligated to agree in the future to provide additional capacity up to the current levels if TCMUD 12 needed it to satisfy the growing development at The Highlands.

Finally, voluntarily reducing the Max Day reservation would have stranded TCMUD 12's $1.5 million investment in capacity in the West Travis County Water System. Although the ALJ agrees on this point,[93] he then appears to give no weight to stranding that investment when he evaluates the reasonableness of the cost of alternatives. The offer of the Contract Amendment, when understood in light of these effects on TCMUD 12, evidences WTCPUA's disparately greater bargaining power continued to exist.

b. Treatment Capacity Needed (PFD at 14 – 15)

TCMUD 12 acquired a raw water supply from LCRA in 2008 as the first step necessary to provide potable water to allow The Highlands to be developed.[94] In 2008 The Highlands was nothing but raw land. LCRA then took another year to explore the possibility of constructing a new regional water system at The Highlands to serve customers all the way to Marble Falls to the west. When LCRA finally gave up on that as economically unfeasible, it offered TCMUD 12 the Wholesale Water Services Agreement, which was executed in 2009.[95] The Highlands was

[91] WTCPUA Exhibit No. 53.

[92] TCMUD 12 Exhibit No. 6 (Zarnikau Rebuttal) at 21: 16- 22:8; See, also TCMUD Reply Brief at 24 for the analogy described by Dr. Zarnikau)

[93] PFD at 20-21 and Proposed FOF 49.

[94] TCMUD 12 Ex. 4 (DiQuinzio Rebuttal) at 4:22-27.

[95] *Id.*, at 4:28 – 5:14.

still nothing but raw land. The Highlands is one of the fastest growing developments in Travis County,[96] and the number of customers served by TCMUD 12 in The Highlands listed on page 15 of the PFD supports that. Inexplicably, the ALJ looks at that evidence of growth and concludes that TCMUD 12 could have replaced the "reserved water treatment capacity in the WTCPUA" because that capacity is not currently needed. That is a myopic analysis that ignores the realities of how MUDs plan for the potable water necessary to enable residential development. TCMUD 12 urges the Commission to reject the "Treatment Capacity Needed" analysis in the PFD[97] and the ultimate conclusion that rests on this analysis, to the effect that TCMUD 12 had a viable reasonable alternative to the capacity WTCPUA was obligated to provide.

c. Available Alternatives (PFD 15 – 20)

Based upon the erroneous conclusion that there is no legal impediment to TCMUD 12 serving itself[98] and because a municipal utility district has statutory authority to construct and operate water treatment facilities, the ALJ concludes that WTCPUA does not have disparate bargaining power. The ALJ's analysis of an "alternative" is not only divorced from his analysis of the "cost" of that alternative,[99] but it also ignores other factors, including restrictions on TCMUD 12's ability to finance a complete water system, that demonstrate why TCMUD 12 cannot serve itself. This section of the PFD also improperly fails to consider the uncontestable fact that TCMUD 12 did not have at any time since 2009 and still does not have an existing water system that would allow it to abandon the WTCPUA system and obtain the potable water that is necessary to serve its retail customers from another serve – including itself. The Commission should not accept this analysis of disparate bargaining power which turns on what "might have been" (in 2008-09) or "could be" (after the 2014 rate decision was made) but rather should examine the reality of what "is." At the time the Protested Rate was adopted and charged, and continuing through today, TCMUD 12 did not own or operate a water system that would allow it to deliver potable water to The Highlands.

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[96] *Id.*, at 8:20 – 23.

[97] As well as Proposed FOF 42 – 46.

[98] TCMUD 12 Exceptions at 16–18 re Wholesale Contract Art. III.

[99] See subsection d., immediately below.

If the Commission nonetheless accepts that it is appropriate to analyze what alternatives TCMUD 12 should have or could have developed in 2008-09 or in 2013-14, then the evidence about TCMUD 12's inability to *finance* its own water service and treatment facilities must be considered. TCMUD 12 was not in 2013–14 (at the time that WTCPUA changed and implemented the rates protested here) and is still not in any position to finance or shoulder the cost for alternative water service facilities, even with 132 customers. The Highlands' tax base is so small that it could not support a bond issuance of the size that would be needed to construct a water service system to replace the services provided by WTCPUA under the contract. TCMUD 12 and 13 were only able earlier this year (2015) to sell their *first* bonds ($2.7 million and $3.0 million, respectively). This illustrates two important points: First, TCMUD 12 would not have been able to issue bonds in 2008–09 to fund the construction of its own WTP because it had no tax base to support issuance of bonds. Second, it is undeniable that the recently issued bonds are not available to fund a new water services system, and if they were, their combined total would not be sufficient to enable TCMUD 12 to fund the construction of a new water services system.[100]

TCMUD 12 has an authorized maximum allowable bond issuance amount of approximately $84 million.[101] But that "authorized maximum allowable bond issuance" does not mean TCMUD 12 could have built its own WTP and associated facilities in 2009 or in 2013/14. First, the Districts' current ability to issue bonds is best represented by the $5.7 million of combined bonds that Districts 12 and 13 recently issued[102], which is well below the cost of a new water services system for The Highlands. Second, under the Water Code, the combined tax rate in Travis County may not exceed $1.20, and the Districts have adopted a combined tax rate limit of $0.7725 for both O&M and debt service.[103] Therefore, as TCMUD 12's General Manager, Mr. DiQuinzio, explained, based on the hypothetical scenario constructed by WTCPUA's counsel, TCMUD 12 could not have issued bonds to pay for a $25.52 million water system because the resulting tax rate would have been $8/$100 assessed value; and if the new water system cost *only* $13.5 million, TCMUD 12 could not have issued that amount of debt either because the resulting

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

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

[102] Tr. 83.

[103] Tr. 625.

tax rate would have been $4.78/$100. Both of those tax rates which would have greatly exceeded the Travis County allowable rate by a considerable amount.[104] So even though the ALJ concludes in the next section of the PFD that he cannot determine what a new water system would cost and therefore he assumes the cost would not foreclose TCMUD 12 from self-serving, that does not resolve the restrictions that would have made financing a new system impossible. The PFD fails to mention any of this evidence concerning the limitations on TCMUD 12's authorized tax rate and ability to finance a new water system.

The ALJ acknowledges there are problems, risks and costs[105] when considering if Lakeway MUD or Hays County MUD could provide wholesale water service to The Highlands, and those problems lead the ALJ to conclude they "are not alternatives available to TCMUDs 11, 12, and 13 for water treatment services."[106] That portion of the PFD relies on Mr. DiQuinzio's live testimony during the hearing. Mr. DiQuinzio also described in his prefiled Direct testimony the extensive resources that would be necessary to allow any new entity to enter this market and operate an entire water system to serve The Highlands, including all of the facilities discussed earlier on pages 14-15 of these Exceptions. In addition, if there was an alternative supplier who could construct all of those facilities, then TCMUD 12 would have to re-design the internal water system to get the water from the POD to The Highlands. These problems should have considered when the ALJ analyzed TCMUD 12 being a self-provider. If they had been, the only reasonable conclusion would have been that TCMUD 12 is not and should not be found to have the capability to become an alternative water service provider to WTCPUA.

Alternatives that obviate the monopolist's greater bargaining power should not only actually exist, they should be reasonably achievable, not just whatever the monopolist dreams up as something that could have been. Instead of speculating about what might or could have been, the analysis of alternatives to the monopoly seller should be whether or not there are *existing* viable, reasonable, alternatives taking into consideration the problems that would have to be resolved, and the ability (or lack of ability) to finance an alternative. TCMUD 12 could and can not finance a new water service system to provide potable water to The Highlands, and all of the

[104] Tr. 625–626.

[105] PFD at 16–19.

[106] PFD at 19–20.

components and facilities that would have to be constructed constitute a barrier to TCMUD 12's ability to self-provide.

d. Costs of Alternatives (PFD at 20 – 23)

If TCMUD 12 had accepted the contract amendment offer to reduce its reserved capacity and to build its own water services system, the ALJ agrees the $1.5 million TCMUD 12 had prepaid as connection fees when it entered into the Wholesale Water Services Agreement would have been stranded.

Evidence of the cost for TCMUD 12 to construct its own Water Treatment Plant and associated facilities was presented by Mr. Rauschuber ($13,500,000 for a 5 MGD WTP only)[107] and Mr. DiQuinzio ($25,520,000 for a 4 MGD WTP, raw water pipe, barge, and engineering & permitting cost)[108], both of whom relied on engineers for their respective systems to arrive at these estimated costs.[109] The PFD rejects these cost estimates for two different reasons.

First, as to Mr. DiQuinzio's estimate, the ALJ "assigns no evidentiary weight" because he concludes the estimate is "unsupported."[110] TCMUD 12's estimate of $25,520,000 was introduced into evidence in Mr. DiQuinzio's prefiled direct testimony.[111] No party objected or moved to strike that testimony.[112] Then WTCPUA introduced the prefiled direct testimony of Mr. Rauschuber, which criticized Mr. DiQuinzio's estimate and included his estimate of the cost of a WTP and some of the associated facilities, to which Mr. DiQuinzio filed rebuttal.[113] In Mr. DiQuinzio's rebuttal, he included the discovery response which was the basis for his $25.52 million estimate.[114] WTCPUA objected to both the rebuttal and the discovery response on grounds of hearsay and the ALJ struck some of the rebuttal testimony, and JAD Exhibit R1 in its entirety, leaving the following part of Mr. DiQuinzio's rebuttal testimony in evidence: "To

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[107] WTCPUA Ex. 1 (Rauschuber) at 30:4 – 31:10.

[108] WTCPUA Ex. 19

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

[110] PFD 21-22.

[111] TCMUD 12 Ex. 1 (DiQuinzio Direct) at 5:27-30.

[112] *See,* WTCPUA's Objections and Motion to Strike (Mar. 17, 2015) at pp. 15-17.

[113] *Id.*

[114] TCMUD 12 Ex. 4 (DiQuinzio Rebuttal), at JAD Exhibit R1.

arrive at the approximate cost, I asked TCMUD 12's engineer, Douglas Rummel with Carlson, Brigance & Doering, to give me some high level numbers to construct a 4 MGD WTP in western Travis County. Those high-level estimates total $25.52 million."[115]

Then, at the hearing, WTCPUA offered into evidence WTCPUA Exhibit No. 19, which is the exact same document as JAD Exhibit R1. It was admitted without objection. Mr. DiQuinzio's testimony throughout the hearing was based on his experience as the manager of the Districts, in consultation with other professionals, including engineers who assist him with managing districts; and based on his experience as a developer in Central Texas in which capacity he has evaluated over the course of many years various sources and the economic viability of alternative water treatment options.[116]

Based upon the evidence, as explained above, the Commission should reject the ALJ's refusal to assign any evidentiary weight to Mr. DiQuinzio's $25.52 million estimate, because it was based upon the high-level calculation supplied by TCMUD 12's engineer, and the engineer's analysis was admitted without objection and accordingly, under TRE 802 "shall not be denied probative value" because it is hearsay.

Next, the ALJ corrects the argument in TCMUD 12's brief which assumed Mr. Rauschuber's estimate of $13.5 million was for a 4.0 MGD plant, when it was actually for a 5.0 MGD plant. Accordingly, the ALJ "extrapolates" the cost of a 4.0 MGD plant and determines that would have been $10.8 million, not $13.5 million.[117] As indicated in the calculation in the footnote, the correct cost based on the cost per component presented by WTCPUA would have been $14.146 million, not $10.8 million as the ALJ assumed. The critical error is the ALJ's conclusion that Mr. Rauschuber's cost estimate proves that TCMUD's $25.52 million is "unreliably high," while also concluding that he will <u>not rely</u> on Mr. Rauschuber's testimony to support a finding of the cost of a 4.0 MGD plant. It is simply inexplicable how the $10.8 million

[115] TCMUD 12 Ex. 4 at 7:18-23.

[116] Tr. at 80.

[117] PFD at 22. Upon closer review, the $10.8 million calculated by the ALJ represents only the cost of a 4.0 MGD WTP, and should not be compared to Mr. DiQuinzio's estimate of $25.52 million, which includes $20 million for a 4 MGD plant, $1,200,000 for 15,000 feet of raw water pipe, $2,000,000 for a barge, and 10% for engineering and permitting fees of $2,320,000. WTCPUA Ex. 19. To make an apt comparison based on Mr. Rauschuber testimony, a 4 MGD WTP would cost $10.8 million, as the ALJ calculated; plus $860,000 for a raw water intake ($215,000 per MGD x 4); plus $1,200,000 for a 16" waterline (@ $80/linear foot); plus a barge – which Mr. Rauschuber doesn't address, so assuming $2,000,000 per WTCPUA Ex. 19 – which would total $12,860,000 + 10% for engineering and permitting ($1,286,000) for a total estimated cost of $14,146,000.)

estimated cost of a 4.0 MGD plant is persuasive proof that $25.5 Million is "unreliably high", if $10.8 million is not also persuasive evidence of the cost of a 4.0 MGD WTP.

The remainder of this section of the PFD returns to the arguments related to TCMUD 12's capacity need, which is addressed above in subsection b, "Treatment Capacity Needed."

In determining if TCMUD 12 could have reasonably constructed its own complete water service system, the Commission is urged to give some weight to either or both cost estimates for a 4.0 MGD plant; to consider the evidence concerning the significant practical and legal restrictions on TCMUD 12's ability to *finance* a new alternative system; and to conclude that the analysis should focus on whether there is an *existing alternative*, rather than speculating as to what might have been or could be in the future.

2. Other Bargaining Power Factors (PFD at 23- 30)

a. Connection Fee in Prior Rates (PFD at 23 – 24)

TCMUD 12 presented evidence that WTCPUA exercised disparate bargaining power in its dealings with TCMUD 12, by increasing the Connection Fee, or Water Impact Fee charged to TCMUD 12 in 2012. TCMUD 12's purpose in bringing forward this evidence was expressly limited to demonstrating WTCPUA's ability to control prices, even when setting a price that exceeded its contractual authority. TCMUD 12 did not protest the Connection Fee rate change in 2012 and was not seeking a ruling that the rate was unreasonable. The PFD misses this point and after stating Connection Fees "are not at issue in this case", makes a contradictory finding that the Connection Fees "were not unreasonable because they were not appealed."

The un-rebutted evidence demonstrated that under the terms of the Transfer Agreement, WTCPUA's authority related to the Connection Fee (aka Water Impact Fee) was limited to the *collection*, but not the *setting* of that rate.[118] Notwithstanding that provision of the Transfer Agreement entered into by LCRA, WTCPUA and TCMUD 12, on November 1, 2012, less than 6 months after TCMUD 12 entered into the Transfer Agreement, and shortly after WTCPUA took over operations of the West Travis County Water System, WTCPUA changed TCMUD 12's Connection Fee by increasing it from $4,120 per LUE to $5,992 per LUE.[119] The restriction on WTCPUA's authority to set a new Connection Fee was a major provision of the Transfer

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

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

Agreement, and it is restated *three* times in paragraph 3 of the Transfer Agreement.[120] And yet, WTCPUA ignored this contractual provision because, as a monopolist and due to its disparate bargaining power, it could. TCMUD 12 did not protest that change of rate (Connection Fee) but WTCPUA's 2012 increase to the Connection Fee in light of the restriction in the Transfer Agreement is additional probative evidence of WTCPUA's disparate bargaining power in its dealings with TCMUD 12.

b. Option to Amend Contract (PFD at 24 – 26)

The offer to amend the wholesale water services agreement is addressed in several parts of the PFD. Rather than repeatedly re-stating its exceptions on this issue, TCMUD 12 incorporates here by reference the exceptions found in Section VIII.A.1.a. above and in Section VIII.B.3, below.

As explained above, WTCPUA's Contract Amendment offer[121] does not negate the existence of WTCPUA's significantly greater bargaining power. The ALJ's conclusion that he "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 TCMUD 12" misses the mark because the ALJ fails to accept that the stated purpose of the contract amendment offer was twofold – to reduce WTCPUA's obligation to continue providing 3.98 MGD daily flow of potable water to TCMUD 12, *and* to insert the new methodology into the Wholesale Water Services Agreement by changing the provisions concerning the Monthly Charge and Volumetric Rate in order to contractually bind those wholesale customers who accepted the Contract Amendment to the new methodology used to set the Protested Rates. Those changes are discussed in detail in Section VIII.B.3 below.

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[120] *Id.* at JAD Exhibit 5, page 3 of 8, para. 3: "LCRA desires . . . to delegate to the PUA the authority to **collect the Connection Fees** . . . and the authority to *set and collect the Monthly Charges and Volume Rates* . .. (collectively the '*Water Services Contract Fees*")" * * * "Subject to the foregoing, and provided that all **Connection Fees are collected** and credited and all *Water Services Contract Fees are set, collected,* and credited in strict accordance with the terms of the Water Services Contract, the District agrees that the LCRA may delegate to the PUA authority **to collect the Connection Fees** and *to set and collect the Water Services Contract Fees* under the Water Services Contract."

[121] TCMUD 12 Exhibit No. 23 at HC 0775 – 0778, and 0782; and WTCPUA Exhibit No. 1 (Rauschuber Direct) at 209 – 214, Attachment Q (WTCPUA Nov. 21, 2013 Resolution Authorizing Negotiation and Execution of Form Amendments "the Agency is utilizing a form wholesale amendment . . . *to establish wholesale rate methodology*").

c. WTCPUA Provided No Meaningful Opportunity for Input before Protested Rates Implemented (PFD at 26-27)

TCMUD 12 incorporates by reference its Initial Brief at page 42 to explain its exceptions to the ALJ's conclusion that TCMUD 12 and the other wholesale customers had a meaningful opportunity to provide input before WTCPUA implemented the Protested Rates.[122]

d. WTCPUA's Risk of Losing TCMUD 12 as a Customer (PFD at 27 – 28)

The ALJ finds that the existence of wholesale water service capacity on LCRA's system in 2009 evidences LCRA needed TCMUD 12 as a customer because without them, LCRA would have lost revenue from the sales of wholesale water services. There is no evidence to support the assumption that LCRA was in such financial straits that it "needed" the additional revenue provided by TCMUD 12, nor is there any evidence that there were no other customers – either retail or wholesale – that could have used the capacity on LCRA's West Travis County System that was reserved by TCMUD 12 in 2009. The ALJ has also not provided any analysis that would explain why – assuming LCRA *needed* the revenue from TCMUD 12 – it waited over a year after entering into the Raw Water Contract with TCMUD 12 to execute the Wholesale Water Services Agreement, which was a necessary prerequisite to start the revenue stream flowing.

Applying the same assumption to WTCPUA – i.e., that TCMUD 12 had bargaining power because it provided a needed revenue stream -- the analysis in the PFD overlooks WTCPUA's goal in 2013 to persuade TCMUD 12 to *reduce* its max reserve capacity – which would have reduced the revenue WTCPUA would receive from TCMUD 12. WTCPUA cannot have it both ways – if it *needed* the revenues from TCMUD 12 then why did it encourage TCMUD 12 to reduce the maximum capacity of water service it was obligated to pay for. The ALJ speculates about LCRA's and WTCPUA's need for revenue from TCMUD 12 to arrive at a conclusion that cannot be reconciled with the evidence and the Commission should decline to accept this part of the PFD and reject Proposed Findings of Fact 56-57.

[122] See, also Proposed FOF 51 – 55.

e. Conclusion: WTCPUA Exercised Disparate Bargaining Power in Setting the Protested Rates (PFD at 37 – 42)

The ALJ's conclusion that the protested rates do not evidence abuse of monopoly power because the Protested Rates resulted in lower rates for 2014 is not unsupported by citation to statute, rule or precedent, and neither PUC SUBST. R. 24.133 nor the Preamble to the predecessor rule, contain any language that supports the argument that a decreased or lower rate prevents a finding that the seller abused its monopoly power. The Protested Rates resulted from a change to the methodology for calculating revenue requirement and rates and the offered Contract Amendment explicitly modified the methodology by deleting provisions of the original Agreement and replacing or adding provisions that set out the new methodology. TCMUD 12 did not accept the contract amendment, and yet the new methodology was imposed upon TCMUD 12 through the 2014 Protested Rates. TCMUD 12's ability to say "No" to the contract amendment did not detract from WTCPUA's disparate bargaining power as evidenced by the fact that the new methodology reflected in the form contract amendment was nonetheless imposed on TCMUD 12. WTCPUA's offer to provide a lower quantity of service to reduce the monthly charge similarly was not an offer that would have benefited TCMUD 12 and did not change WTCPUA's status as a monopoly. Finally, the fact that WTCPUA convened wholesale customer meetings does not persuasively demonstrate that they did not exercise disparate bargaining power in setting the 2014 rates. Holding a meeting does not equate with making any concessions or modifications based upon the feedback given by the wholesale customers and the persuasive evidence in this record demonstrates that WTCPUA decided on the new rate methodology early in the process and that methodology did not change – regardless of the number of meetings it held.[123]

WTCPUA's monopoly power is evident from its control of the prices charged and the supply of water services sold to TCMUD 12, and is reflected in the disparately greater bargaining power that flows from the long-term Wholesale Water Services contract and the absence of any viable, reasonable alternative means of obtaining wholesale water services sufficient to provide potable water to the retail customers of The Highlands. WTCPUA's exercise of its disparate bargaining power was an abuse of monopoly power.

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[123] Compare, WTCPUA Exhibit No. 1 (Rauschuber Direct), Attachments P (May 2013) and P (Nov. 2013).

B. Methodologies for Computation of Revenue Requirement and Rates (PFD at 30 – 47)

The Changes to Computation Methodologies analysis in the PFD contains two fundamental errors. First, the ALJ's conclusion that the computation methodology did not change cannot be reconciled with the evidence of the methodology changes as reflected in the standard contract amendments. Second, the ALJ errs in concluding that TCMUD 12 witness, Jay Joyce's analysis is a cost of service analysis that he is prohibited by rule from considering.

In the PFD's Disparate Bargaining Power section PFD, the ALJ states that he considers later in the PFD TCMUD 12's claim that the proposed contract amendments offered to TCMUD 12 by WTCPUA would have amended the provisions in the Wholesale Water Services Agreement that established the methodology for setting the monthly charge and the volumetric rate and replaced them with the methodologies underlying the Protested Rates.[124] However, the Changed Methodologies section of the PFD, does not address the fact that the computation methodology used to set TCMUD 12's 2014 Monthly Charge and Volumetric Rate is the same computation methodology reflected in the contract amendments offered to TCMUD 12 by WTCPUA. Instead, the Judge's analysis rests on findings that the WTCPUA did not change from a cash basis to utility basis method for computing revenue and rates, and that Mr. Joyce's testimony explaining the changes to methodology is a prohibited cost of service analysis.

Assuming *arguendo* that Mr. Joyce's testimony is a prohibited cost of service analysis,[125] that does not negate the following uncontroverted evidence:

- The Wholesale Water Services Agreement establishes the computation methodology for the rates to be charged under the Agreement, including the Monthly Charge and the Volumetric Rate;
- WTCPUA's rate analyst recommended a standard amendment to all wholesale customers' Contracts that explains the new computation methodologies for the Monthly Charge and Volumetric Rate, and expressly deletes and replaces provisions in the Wholesale Water Services, all of which reflects the significant scope of the computational methodology changes;

[124] PFD at 24–25.

[125] TCMUD 12 does not concede this argument and will address the argument elsewhere in these exceptions. See, Section VIII.B.3, specifically pages 37–42.

- TCMUD 12 did not accept WTCPUA's proposed contract amendment but the methodology stated in that amendment is the same new methodology that WTCPUA utilized to calculate the Protested Rates; and
- WTCPUA calculated TCMUD 12's Monthly Charge and Volumetric rate using the new computation methodology rather than the computation methodology established by the Wholesale Customer Service Agreement.

The PFD adopts an expansive view of the Public Interest rule's cost of service prohibition,[126] while at the same time adopting a very narrow view of what a "methodology" is under the public interest rule. The effect of this interpretation is that the Public Interest rule is cabined to only those situations in which the seller changes between the cash basis and the utility basis. This result ignores the fact that switching between cash and utility basis would be *highly* unusual as discussed in the original Preamble for the Public Interest Rule.[127]

1. Alleged Change in Revenue-Requirement Computation Methodology (PFD at 30-31)

2. Computation Methodology and Cost-of-Service Analysis (PFD at 31 – 37)

3. Evidence Does Show WTCPUA Changed its Revenue Requirement Computation Methodology (PFD at 37 – 42)

The ALJ briefly summarizes seven types of methodology changes Mr. Joyce identified from WTCPUA's O&M calculation that illustrate the significantly differently allocation of those costs in determining the Protested Rates compared to the Prior Rates[128] After providing the brief summary of these changes, the PFD turns to determining the meaning of "computation methodology" and "cost of service" in order to determine what, if any weight to give to the evidence from Mr. Joyce about the changes to methodology utilized by WTCPUA in adopting the Protested Rates.

Four Computational Methodologies: Based upon his review of other Commission rules that use the term "methodology", the Judge concludes there are only four computational methodologies that he should consider: (1) cash-needs; (2) utility-basis; (3) phased, and (4)

[126] At the same time the ALJ points out that this Commission may adopt a differing interpretation. PFD at 39, fn 209.

[127] WTCPUA Ex. 76 at 6230, first column. Traditionally, non-profit utilities use the cash basis and investor-owned utilities use the utility basis so a switch between the two methodologies would be very unlikely.

[128] PFD at 30, citing to TCMUD 12 Ex. 2 (Joyce Direct) at 11-18, & Exhibit JJJ-10. Note, the analyses are also explained in Exhibits JJJ -4, 5, 6, 7, 8, 9, selected pages of 11, and 16.

contractual.[129] He then decides that there is no evidence that WTCPUA used a phased methodology or one set out in a contract in establishing either the Prior Rates or the Protested Rates, which causes him to narrow his examination of Mr. Joyce's testimony and analyze only whether WTCPUA changed computation methodologies from cash-needs to utility-basis.

Cash v. Utility Bases Methodologies: The cornerstone of the ALJ's analysis is that the WTCPUA used the cash-needs basis methodology consistently – in setting the Prior Rates (i.e., the 2013 Monthly and Volumetric rates which were the LCRA's rates + 15.5%) and in setting the Protested Rates.

The use of "cash or utility bases" in P.U.C. SUBST. R. 24.135(b) but not in P.U.C. SUBST. R. 24.133(a)(3)(C) demonstrates that the Commission knows when to specify it is limiting the word "methodology" to only the Cash v. Utility bases and it is inappropriate to imply that the Commission intended to refer only to Cash v. Utility basis when it included the word "methodology" in 24.133(a)(3)(C). In interpreting a statute or rule, effect should be given not only to the terms used, but also to the terms that the drafting body chose *not* to use.[130] P.U.C. SUBST. R. 24.133(a)(3)(C) does not have the same limiting language found in P.U.C. SUBST. R. 24.135(b) and it is improper to "read into" 24.133 words that are not in that rule.

Contractual Method: After identifying "contractual method" as one of four methods he identifies in the Commission's rules, the ALJ concludes there is "no evidence" that WTCPUA used a "contractual method" to set rates rests. [131] The "no evidence" finding, however, cannot be reconciled with the record. The PFD contains the ALJ's explanation of the contractual method for setting the Monthly Charge and Volume rate reflected in TCMUD 12's Wholesale Water Service Agreements.[132] And the PFD also acknowledges TCMUD 12's argument and the evidence upon which that argument was based, that the standard "contract amendment would have replaced the provisions in the Water Services Agreement that established the methodology for setting the monthly charge and the volumetric rate and replaced them with the methodologies

[129] PFD at 33-34.

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

[131] PFD at 34 and 38.

[132] PFD at 5, fns. 18–20; PFD at 24–25, fns. 133 and 134.

underlying the Protested Rates."[133] And yet inexplicably, the PFD concludes that there is no evidence of the WTPUA ever using the contractual method of establishing computation methodologies.[134] The evidence described elsewhere in the PFD demonstrates that the Wholesale Water Service Agreement, which is a contract, contains a method for establishing revenue requirement and rates, and therefore the "no evidence" conclusion must be rejected.

Another explanation for the ALJ's conclusion that there is no contractual method may be that the ALJ's understanding of the four categories of methodologies he describes is that they are mutually exclusive. So, once he found that the WTCPUA consistently used the cash-needs basis methodology,[135] he could not also find it used a contractual methodology.

As further evidence that the formulas in the Wholesale Water Services Agreement are a "contractual method," it is useful to consider the definitions of the Cash Basis and Utility Basis methodologies – the only two computation methodologies defined by the Commission rules. Those definitions set out what costs are to be recovered by the seller.[136] In much the same way, the Wholesale Water Services Agreement specifies the types of costs and expenses the seller may recover through the Monthly Charge and the Volume Rate.

For example, the Wholesale Water Services Agreement provision setting the Volume Rate states:

> The Volume Rate shall be designed primarily to recover the operation and maintenance related Costs of the LCRA System, together with any other Costs of the LCRA System not recovered through the Connection Fee or the Monthly Charge. The Volume Rate does not include, however, any charges for raw water and District No. 12 shall remain liable for such costs under the Raw Water Contract. The Volume Rate will be just and reasonable and established in accordance with the provisions of this Agreement and applicable legal requirements.[137]

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[133] PFD at 24-25, citing to TCMUD 12 Ex. 1 (DiQuinzio Direct) at JAD Ex. 4 at 150-51, § 4.01.d; and WTCPUA Ex. 2, Att. Q at 212-213. The ALJ's analysis of the contract amendment offer quickly shifted away from consideration of the new methodology described therein, and focused instead on the fact that TCMUD 12 could have lowered its reserved capacity if it had accepted the contract amendment in order to conclude that evidenced TCMUD 12 had greater bargaining power. [See, Section VIII. A. 2. b., above] There is no analysis in the PFD of the new methodology set out in the contract amendment.

[134] PFD at 38, fn. 208.

[135] PFD at 38.

[136] PFD at 33 citing 16 Tex. Admin. Code § 24.129(3) and (4).

[137] TCMUD 12 EX. 1 at JAD Ex. 4 at 151, §4.01.e;

The Wholesale Water Services Agreement provision setting the Monthly Charge states which costs may be collected through the Monthly Charge and specifically excludes costs which are to be collected through the Connection Fee[138]:

> The Monthly Charge has been designed primarily to recover District No. 12's allocable share of the capital-related Costs of the LCRA System not recovered in the Connection Fee. The Monthly Charge shall be just and reasonable and established in accordance with the provisions of this Agreement and applicable legal requirements.[139]

Furthermore, the provisions of the Wholesale Water Service Agreement contain defined terms which in turn impact revenue requirement allocation methodologies. For example, the definition of Costs of the LCRA System exclude costs attributable to the provision of retail service.[140]

Taken together, these terms and provisions of the Wholesale Water Service Agreement set out the categories of WTCPUA's costs which may or may not be recovered through the Monthly Charge and Volumetric Rate and as such are "reasonable methodologies set by contract" which may be used to identify costs of providing service and/or allocate such costs in calculating the cost of service.

The rates for wholesale water services charged to TCMUD 12 have always been set in accordance with the terms of the Wholesale Water Services Agreement, until WTCPUA set the 2014 Protested Rates. In 2009, TCMUD 12 and LCRA entered into the Wholesale Water Services Agreement in which the LCRA 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 potable water to TCMUD 12 at a specified delivery point.[141] As the PFD acknowledges, the

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[138] The Wholesale Water Services Agreement provides: The Connection Fee has been designed to fund or recover all or a part of the Costs of the LCRA System for capital improvements or facility expansions intended to serve "new development" (as that term is defined in the Texas Impact Fee Law, Chapter 395 of the Texas Local Government Code) in the LCRA Service Area and, upon payment, District No. 12 will have a guaranteed reservation of capacity in the LCRA System for the number of LUEs for which a Connection Fee has been paid. The Connection Fee will be reasonable and just and established as required by law and in accordance with the provisions of this Agreement. TCMUD 12 EX. 1 at JAD Ex. 4 at 151–152, §4.01.c.

[139] TCMUD 12 EX. 1 at JAD Ex. 4 at 151–152, §4.01.d.

[140] *Id.*, , § 1.01.

[141] PFD at 4TCMUD 12 Ex. 1 at JAD Ex. 4 at 146.

Wholesale Water Services Agreement set out a Monthly Charge[142] and a Volume rate.[143] There is no evidence to support an assumption that LCRA used anything but the computation methodologies set out in the Agreement to establish the rates it charged TCMUD 12. When the WTCPUA took over the LCRA System in 2012, it adopted the Monthly Charge and Volumetric Rate that LCRA was charging to TCMUD 12 and all other wholesale water customers.[144] In November 2012, the WTCPUA simply increased the rates LCRA was charging at the time of transfer of operations to WTCPUA by adding 15.5% across the board to the Monthly Charge and Volume Rate.[145] Up through the 2013 rates, the computation methodologies used to determine which of the seller's costs would be covered by the rates charged to TCMUD 12 were those found in the Wholesale Water Services Agreement.

The terms and provisions of the Wholesale Water Services Agreement constitute a contractual methodology. The overarching methodology may be the cash basis methodology, but for specific categories of costs and allocations, the Wholesale Water Services Agreement establishes a contractual methodology that governs how the WTCPUA is required to calculate revenue requirements and set rates. Any changes from the contractual methodologies are therefore, a change in the computation of the revenue requirement or rate from one methodology to another which evidences abuse of monopoly power under the Public Interest Rule.

Rejecting Evidence of Computational Methodology Changes as Impermissible Cost of Service Analysis: Citing to the *American Heritage Dictionary's* definition of "analysis," the ALJ concludes that Mr. Joyce's testimony is an impermissible "analysis of the seller's cost of service."[146] He explains that he "erred on the side of caution and admitted this evidence to ensure a more complete evidentiary record because the issues are complicated and intertwined."[147] The ALJ also acknowledges that the Commission overruled SOAH Order No. 6 in which the ALJ had upheld WTCPUA's objection that discovery documents sought by

[142] PFD at 5and fn. 19; see also JAD Exhibit 4 (LCRA TCMUD12 Wholesale Water Services Agreement) at Art. IV, Sec. 4.01.d

[143] PFD at 5and fn. 20.

[144] PFD at 6, fn. 24.

[145] PFD at 6, fn. 28.

[146] PFD at 40.

[147] PFD at 39, f.n. 209.

TCMUD 12 was impermissible cost of service, and agrees the Commission's disagreement with Order No. 6 "suggests the possibility that the Commission might view the prohibition on consideration of cost-of-services analyses more narrowly than the ALJ."

However, the ALJ's conclusion that all evidence presented by TCMUD 12 concerning changes to computational methodology is impermissible cost of service analysis highlights that he gave no weight to the Commission's Order, other than to admit and then dismiss TCMUD 12's evidence. Instead of applying a less expansive view of the prohibition, the ALJ held fast to his view, as expressed in Order No. 6, that there is no evidence describing changes to revenue requirement or rate methodology that fall outside the cost of service analysis prohibition in P.U.C. SUBST. R. 24.133(b).

The PFD fails to give any weight to the fact that the changes to allocations described by Mr. Joyce are changes to the methodologies established by contract and have nothing to do with establishing WTCPUA's cost of service. For example, the Wholesale Water Services contract that governs WTCPUA's rate-setting authority for TCMUD 12 provides in part that costs attributable to the provision of *retail* water service shall *not* be included in TCMUD 12's rates.[148] And yet, as Mr. Joyce explains, WTCPUA changed the methodology of allocating repair and maintenance costs from "retail-only" in FY 2013 to an allocation method referred to as "Common-to-All" in addition to "retail-only" in FY 2014. That means, some part of costs that had previously be attributable to the provision of retail water only, consistent with the Wholesale Water Services Contract, are now paid by the wholesale customers. This evidence addresses WTCPUA's change to the revenue requirement methodology that resulted in TCMUD 12 and other wholesale customers now bearing some part (quantity unknown) of repair and maintenance costs that were previously classified as retail only.[149] Mr. Joyce did not testify to the dollar amount that resulted from this change because he was not trying to determine WTCPUA's cost of service. This allocation change is one example of WTCPUA's change of the revenue requirement methodology as established in the contract, which evidences abuse of monopoly power.

[148] *Id.*, Wholesale Water Services Agreement at 3-4, Art. I Definitions: Costs of the LCRA System.

[149] J. Joyce Direct at 12, line 19 -13, line 18 and Exhibit JJJ-6.

Reconciling P.U.C. SUBST. R 24.133(a)(3)(C) and 24.133(b): The ALJ struggles to reconcile the fact that the Public Interest Rule provides, in one provision, that a seller's changing "the computation of the revenue requirement or rate from one methodology to another" is a factor to be considered in determining whether a protested rate evidences the seller's abuse of monopoly power[150] with another provision of the same Rule prohibiting the Commission from determining "whether the protested rate adversely affects the public interest based on an analysis of the seller's cost of service."[151]

The ALJ first examines the meanings of the phrases "revenue requirement" and "cost of service". He concludes that the Commission rules use the terms "revenue requirement" and "cost of service" synonymously, which creates a situation in which "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."[152]

The PFD's analysis of the apparent conflict in the Public Interest Rule does not include an interpretation that permits the seemingly inconsistent provisions in P.U.C. SUBST. R. 24.133(a)(3)(c) to be reconciled. These two provisions are readily reconcilable however by interpreting the prohibition to mean that the Commission may not declare a rate adverse to the public interest because it does not equal the seller's cost of service. This interpretation of §24.133(b) finds support in the Preamble from the original adoption of the Public Interest rule, in which TNRCC declared:

> the public interest does not demand that a wholesale rate shall equal the seller's cost of providing service to the purchaser. * * * [T]he Water Code provisions concerning the commission's appellate jurisdiction over disputes between utilities states that rates must be 'just and reasonable.' See, Water Code § 13.043(f), (j). But nowhere does it specify that the rates must equal the seller's cost of providing service to the purchaser"[153]

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[150] P.U.C. SUBST. R. § 24.133(a)(3)(C).

[151] P.U.C. SUBST. R § 24.133(b).

[152] PFD at 33.

[153] WTCPUA Ex. 76, 19 TexReg 6228 (left column): "Most of the comment received was directed at all or parts of §291.133. About half of these commenters argued that the determination of the public interest requires an analysis of the seller's cost of service. On the other hand, the other half of the commenters argued that the seller's cost of service cannot be part of the analysis of the public interest, and that the proposed rules should be revised to clarify that the cost of service will not be considered during the evidentiary hearing on public interest.

Interpreting § 24.133(b) as prohibiting evidence that the Protested Rate is not equal to WTCPUA's cost of service, would give effect to both provisions of the rule, and not only allow, but require, the ALJ and Commission to consider the evidence TCMUD 12 presented related to WTCPUA's changes to the methodologies for computing revenue requirement and rates. Courts construe administrative rules, which have the same force as statutes, in the same manner as statutes.[154] Statutory construction requires courts to avoid a construction that creates a redundancy or renders a provision meaningless.[155] In this case, it is possible to interpret the Public Interest Rule in way that does not render meaningless either of the provisions which the ALJ finds conflict.

The preamble explains (twice) that the "analysis of the seller's cost of service" refers to comparing the Protested Rate to the rate that should have been set based on the seller's cost of service to determine whether the public interest has been violated. TCMUD 12 has made no such argument in this case. Instead, evidence concerning WTCPUA's method of computing the revenue requirement and/or rates demonstrates that "the seller changed the computation of the revenue requirement or rate from one methodology to another."[156] Nowhere in the preamble, or the rule, is there a prohibition against examining formulas and allocation factors that may be part of a cost of service study to show that the seller has changed the computation methodology for the revenue requirement or the rate.

Thus, the two provisions of the Public Interest may and should be reconciled by allowing an analysis of the methodologies used to set the revenue requirement and rates to determine if the methodology changed, while prohibiting consideration of whether the protested rate adversely impacts the public interest because it *does not equal* the seller's cost of providing service to the

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The commission concludes that the public interest does not demand that a wholesale rate ***shall equal*** *the seller's cost of providing service to the purchaser." See, also,* 19 TexReg 6228 (middle column): The commission's conclusion is also consistent with the opinions of the courts. The court in *High Plains Natural Gas Company v. Railroad Commission of Texas,* 467 S.W.2d 532 (Tex. Civ. App.--Austin 1971, writ ref'd n.r e.) was confronted by a similar wholesale rate dispute, but concerning a contract for the sale of natural gas. The court specifically rejected the argument that the court should *compare the disputed rate with a rate based on cost of service in order to determine the public interest.*

[154] Rodriguez v Service Lloyds Ins. Co., 997 S.W.2d 248, 254 (Tex. 1999), See Lewis v. Jacksonville Bldg. & Loan Ass'n, 540 S.W.2d 307, 310 (Tex. 1976).

[155] Williams v. Tex. State Bd. of Orthotics & Prosthetics, 150 S.W.3d. 563, 573 (Tex. App.-Austin 2004, no pet.).

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

purchaser. This interpretation gives effect to P.U.C. SUBST. R. 24.133 (b) without eviscerating P.U.C. SUBST. R. 24.133 (a)(3)(C).

The PFD states that there is there is no evidence that TNRCC or TCEQ ever narrowly interpreted the prohibition on considering cost-of-service analysis.[157] TCMUD 12 would respectfully point out that the sections of the preamble cited above suggest otherwise. Those sections of the preamble support the interpretation that the TNRCC or TCEQ meant to prohibit an analysis that the public interest is violated because a wholesale rate does not equal the seller's cost of providing service. However, the Commission is not bound by whatever interpretations TNRCC or TCEQ may have applied to the cost of service analysis prohibition. This is a case of first impression in which the Public Utility Commission has the opportunity decide on and apply its own interpretation of these provisions of the Public Interest rules. TCMUD 12 respectfully urges the Commission to reconcile these two provisions in a manner that will allow an examination of changed methodologies without casting that aside as an impermissible cost of service analysis.

Finally, the PFD cites to other provisions of the Preamble which address TNRCC's intent to give deference to contracts. [158] This is odd, considering that in this case, it is TCMUD 12 that is seeking to retain the terms of the contract it bargained for, while WTCPUA has replaced the contractual methodologies set forth in that contract with the new methodologies it developed in May 2013, which were significant enough to WTCPUA that it asked the wholesale customers to amend their contracts. If this Commission decides to take a conservative approach in order to give deference to wholesale contracts, it should conclude that WTCPUA's *unilateral changes to the contractual methodologies is* a violation of the public interest, and remand this case to SOAH for a hearing on the rate at which time it may consider "any reasonable methodologies set by contract."[159]

The Standard Contract Amendment Reflects the Methodologies Used by WTCPUA in Setting the Protested Rates and Expressly Modifies the Wholesale Water Service Contracts: The Wholesale Water Services Agreement entered into by TCMUD 12 with the LCRA (and

[157] PFD at 41.

[158] PFD at 41.

[159] P.U.C. Subst. R. 24.135(a).

subsequently with the WTCPUA) contains a methodology to compute the monthly charge[160] and the volumetric rate.[161] The WTCPUA proposed to amend section 4.01 – the section addressing rates – through the new methodology contained in the proposed amended contract.[162] The changes can be seen in the **attached comparison** of the Monthly Charge and the Volume Rate in the existing Agreement and in the amended contract. Although TCMUD 12 did not accept the contract amendment, the WTCPUA set the Protested Rates using the computation methodology that is included in the contract amendment rather than the computation methodology in the Wholesale Water Services Agreement.[163] The following evidence illustrating this point is not discussed in the PFD:

WTCPUA's FYE2014 Wholesale Customer Annual Minimum Bill Analysis for TCMUD 12 (which becomes the Monthly Charge when divided by 12) contains the following computation methodology:

> Total Annual Minimum Bill = Total Annual Payment + (Total Annual Payment * 25% Times Coverage) - (Total Annual Payment * Impact Fee Credit).[164]

The standard contract amendment that modifies the Wholesale Water Services Agreement of six of WTCPUA's wholesale customers contains the following computation methodology for setting the Annual Minimum Bill:

> Total Annual Minimum Bill = Total Annual Payment + (Total Annual Payment * 25% Times Coverage) - (Total Annual Payment * Impact Fee Credit).[165]

The new computation method for calculating the protested Monthly Charge is based on the "Annual Allocated Debt Service Payment" which was also changed by the proposed

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[160] PFD at 5and fn. 19; see also JAD Exhibit 4 (LCRA TCMUD12 Wholesale Water Services Agreement) at Art. IV, Sec. 4.01.d

[161] PFD at 5and fn. 20.

[162] WTCPUA Exhibit No. 1 (Rauschuber Direct), Attachment Q, page 212.

[163] See, the formula used to set the Protested Rate in WTPCUA Exhibit No. (Stowe Direct), Exhibit E at WTCPUA00009767 and compare to TCMUD 12 Exhibit No.7 at WTCPUA00003873. See also, TCMUD 12 Initial Brief, Attachment C.

[164] WTPCUA Exhibit No. (Stowe Direct), Exhibit E at WTCPUA00009767. See also, TMCUD 12 Exhibit No.2 (Joyce Direct), Exhibit JJJ-15 at 14.

[165] TCMUD 12 Exhibit No.7 at WTCPUA00003873.

amended contract.[166] There were several changes related to the calculation of the allocated debt service to determine the Monthly Charge between the Prior Rate charged in 2013 and the 2014 Protested Rate. As an example, the Allocated Debt Service Payment computation methodology was based on the wholesale customer's pro-rata share of WTCPUA's capital costs. Historically, each customer's pro-rata share had been calculated on a historic average day and historic peak day.[167] But the Allocated Debt Service Payment in the 2014 Monthly Charge was based solely on a *projected or contractual peak day*.[168] The projected or contractual peak day, also referred to as the "Max Day Reservation" was "as determined based on input from the District..." Mr. Rauschuber explained that phrase meant the same thing as the wholesale customer's projected or requested absorption schedule for LUEs.[169] Switching from historic average or peak day to projected or contractual peak day is a change in methodology, and the significance of the change is highlighted by another new condition imposed by WTCPUA: the projected LUEs or requested absorption schedule included in that methodology will be used by WTCPUA "regardless of whether the District meets the buildout projections used to develop the annual debt payment schedule."[170] In other words, the Monthly Charge is now based on a projected peak day that is "set-in-stone." WTCPUA's new methodology for establishing wholesale revenue requirement and rates, incorporates schedules that show escalating monthly charges, which is consistent with the provision discussed herein that sets in stone the wholesale customer's buildout projection. It is also consistent with Ms. Heddin's admonition to the WTCPUA Board, that "this **escalating fee** . . . would **not be subject to amendment** except for instances where the Agency refunds its bonds."[171]

That WTCPUA used a new computation method in calculating the Protested Monthly Charge is also supported by the analysis found in Tables JJJ-T3 and JJJ-T4 on page 16 of Mr. Joyce's Direct testimony. Those tables illustrate the allocated debt service method used to set

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[166] TCMUD Exhibit No. 7, at WTCPUA00003863 and at WTCPUA00003873 (Schedule B).

[167] TCMUD 12 Ex. 2 (Joyce Direct) at 9.

[168] Id.

[169] Tr. 465:16–466:10.

[170] TCMUD Exhibit No. 8, section 4.01(b) at WTCPUA00003475.

[171] TCMUD 12 Exhibit No. 5 (Joyce Rebuttal) at JJJ Exhibit R9 at WTCPUA00012018 (underlined emphasis in original; bold emphasis added).

the Prior 2013 Monthly Charge compared to the allocated debt service methodology used to calculate the Protested Monthly Charge. The methodology used to compute the Protested Rate does not give the wholesale customers, including TCMUD 12, credit for "times coverage used to reduce Debt Service."[172]

Furthermore, if one compares the formula in the standard contract amendment, to Ms. Heddin's "proposed approach" for calculating the wholesale rates that she presented as a "Wholesale Minimum Bill Computation Flow Chart," it is readily apparent that the computation of the Annual Minimum Bill is identical in both.[173] The following table provides a side-by-side comparison of two components of the WTCPUA's Monthly Charge computation methodology as found in Ms. Heddin's Flow Chart and in the Contract Amendment:

FY 2014 Wholesale Minimum Bill ("Monthly Charge") Computation Flow Chart[174]	**Contract Amendment**[175]
Project Cost per Gallon Capacity Total Original Project Cost Divided by: 27 MGD System Wide Assets 15 MGD Hwy 71 Assets 12 MGD US 290 Assets	PUA's Cost per Gallon of Regional Facilities: shall be calculated by dividing the cost of System Wide Regional Facilities by 27,000,000 gallons; dividing the cost of Hwy 71 facilities by 14,829,230 gallons; and the cost of US 290 facilities divided by 12,170,770.
Gross Allocated Capital Cost- total cost per gallon x individual reserved capacity	The District's pro-rata share of the PUA's capital costs is calculated based on its Max Day Reservation, multiplied by the PUA's cost per gallon of the regional facilities.

The purpose of the proposed contract amendment was of course to *amend* the Wholesale Water Services Agreement, which it did by changing the computation methodology from that found the Wholesale Water Services Agreement. Without providing any analysis in the PFD

[172] *Id.*, at 16:3–13; TCMUD Exhibit No. 7, at WTCPUA00003863.

[173] *Id.*, Exhibit JJJ-11, at page 37 of 81 (The only difference is that the contract amendment describes the Monthly Charge, (by dividing the annual minimum bill by 12), whereas the computation flow chart shows the Annual Minimum bill and omits the final step (dividing by 12) to derive the Monthly Charge). *See, also* Exhibit JJJ-11, at page 26 of 81, steps 2 and 3.

[174] TCMUD 12 Ex. 2 (Joyce Direct) at Exhibit JJJ-11, p. 37 of 81.

[175] TCMUD 12 Ex. 7 at p. 2 (Hays County WCID #1's Contract Amendment); or WTCPUA Ex. 1 (Rauschuber) Attachment Q at bates p. 212 (Form Contract Amendment approved by WTCPUA Board)

indicating he conducted this comparison, the ALJ instead dismisses all proof of methodology change because he determined that the statements from WTCPUA about new, proposed or changed methodology made by the Board and its rate consultant were merely "casual" references. The evidence in the record, however, shows otherwise.

Mr. Rauschuber, the WTCPUA's General Manager, reported to the WTCPUA Board that he met with wholesale customers on March 25 and April 1, 2013 where he discussed "*refining methodology.*"[176] Later, he reported to the WTCPUA Board that he met with wholesale customers on May 6 and May 14 and that the "The purposes of these meetings were to allow Staff to *present updated wholesale rate methodology analyses* and to give Wholesale Customers an opportunity to provide input and vet questions."[177] Ms. Nelisa Heddin, the WTCPUA's Financial Manager and Rate Analyst, wrote in a memo to the President of the WTCPUA Board, that the methodology she was proposing to use to set the 2014 minimum bill rates (the Monthly Charge) was different from the methodology used prior:

> *This proposed methodology is a change from the utilized method of assessing minimum bills to wholesale customers.* ... It is expected that the Agency's volumetric rates should decrease as a result of the *change in methodology.*[178]

Counsel for the WTCPUA reminded the WTCPUA Board in a memo that the Board had instructed the PUA staff to identify a methodology for the wholesale customers' rates: "The PUA Board also directed staff to continue to review wholesale rates and attempt to identify a methodology acceptable to wholesale customers that would address the remaining needed increase in wholesale rates."[179] And finally, the WTCPUA Board Resolution approving the proposed contract amendment states that the amendment adopts a methodology for setting wholesale rates in its third recital: "WHEREAS, the Agency is utilizing a form wholesale

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[176] TCMUD 12 Exhibit No. 5 (Joyce Rebuttal) at JJJ Exhibit R6: Memorandum from Don Rauschuber to the WTCPUA Board of Directors on March 31, 2013.

[177] TCMUD 12 Exhibit No. 5 (Joyce Rebuttal) at JJJ Exhibit R7: Memorandum from Don Rauschuber to the WTCPUA Board of Directors on May 19, 2013, p. 3.

[178] TCMUD 12 Exhibit No. 5 (Joyce Rebuttal) at JJJ Exhibit R9 (WTCPUA Response to TCMUD 12 RFI RFP 1-5 & 1-7) at WTCPUA00012017 (emphasis added), Letter from Water Resources Management, LLC to WTCPUA Board President Larry Fox dated March 12, 2013.

[179] TCMUD 12 Exhibit No. 5 (Joyce Rebuttal) at JJJ Exhibit R8 (Hays County Response to TCMUD 12 First RFP), HC 0873–0874, Memorandum from Lauren Kalisek to the WTCPUA Board of Directors on June 6, 2013.

amendment attached as Exhibit A, to effect these capacity changes **and establish wholesale rate methodology**; "[180]

The WTCPUA's General Manager, Financial Manager and Rate Analyst, and General Counsel, are familiar with the meaning of their words indicating the methodology was changing. Furthermore, the expressions about changes to "methodology" were part of formal communications to the WTCPUA Board and in the Board's resolution adopting the proposed contract amendment. These were not offhanded, casual comments by someone unfamiliar with the Commission's regulations, and the Commission should not accept the ALJ's summary dismissal of this evidence that provides persuasive evidence that WTCPUA did change its methodology for computing wholesale revenue requirement.

4. Changes in Rate Computation Methodology

5. Evidence Shows WTCPUA Changed its Rate Computation Methodology

The PFD discusses briefly TCMUD 12's claim that WTCPUA changed the rate computation methodology but does not discuss the evidence that demonstrates the new Volume Rate included a new charge for raw water lost on the seller's side of the meter, which is prohibited by the Wholesale Water Service Agreement.

The Wholesale Water Services Agreement section 4.01(e) provides that TCMUD 12 shall pay a Volume Rate "for diversion, transportation, treatment and delivery of the ***actual amount of water delivered*** to TCMUD 12 as measured by the Master Meter at the Delivery Point, including all water used or lost due to leakage or for any other reason *within* the District Service Area."[181] Thus, under the Wholesale Water Services Agreement, the Volume Rate should include only water actually delivered to and measured by the Master Meter. The Wholesale Service Agreement also states "***The Volume Rate does not include, however, any charges for raw water*** and District No. 12 shall remain liable for such costs under the Raw Water Contract." These two provisions prohibit a raw water loss charge for water lost on the seller's side of the meter. Accordingly, there were no raw water loss charges included in the Prior Rates. [182]

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[180] WTCPUA Exhibit No. 1 (Rauschuber Direct), Attachment Q (Resolution and Form Amendment), third recital (emphasis added).

[181] Emphasis added.

[182] Nelissa Heddin, the WTCPUA's Rate Analyst, stated in a letter on December 11, 2012, that the WTCPUA's rate study for the 2013 rates (i.e. the previous rates) "did not calculate costs associated with [raw water] losses and did not pass this cost through to wholesale customers."

WTCPUA's Final Analysis used to set the 2014 Volume Rate (*i.e.* the Protested Volume Rate) for TCMUD 12,[183] includes in Schedule 25 the "Raw Water Surcharge Calculation":

> **Raw Water Surcharge Fee = [LCRA Raw Water cost per Thousand Gallons/ (1-.10 water loss)]/10**[184]

This "Raw Water Surcharge Fee" is included in the 2014 Volume Rate and is inconsistent with the terms of the Wholesale Water Services Agreement which explicitly states that TCMUD 12's Volume Rate shall not include any charges for raw water, or for lost water on WTCPUA's side of the meter.

The "Raw Water Surcharge Fee" formula used by WTCPUA to set the Protested Volume Rate, is identical to the provision of the proposed amended contract offered to wholesale customers in May 2013, which included the following provision: "The Volume Charge shall recover the PUA's expenses associated with operating and maintaining the Regional Facilities, including a systems raw water loss fee per thousand gallons to be calculated as follow"

> **[LCRA Raw Water cost per Thousand Gallons/(l-.10 water loss)]/l0"**[185]

The same language is found in the proposed contract amendment approved by the WTCPUA Board in November 2013.[186] As an example, the contract amendment accepted by Hays County WCID #1 includes this language in Paragraph 4, expressly ***replacing*** the language that had been in the Wholesale Water Services Agreement:

> 4. Section 4.01 (c) is hereby deleted in its entirety and replaced with the following:
>
> (c) The Volume Rate shall recover the PUA's expenses associated with operating with maintaining the Regional Facilities, including a systems raw water loss fee per thousand gallons to be calculated as follows:
>
> **[LCRA Raw Water cost per Thousand Gallons/(1-.10 water loss)]/10**[187]

This is persuasive, credible evidence that WTCPUA changed the method for calculating the Volume Rate for 2014, from the method established in the Wholesale Water Services Agreement for the Prior 2013 Volume Rate. The PFD does not address this evidence related to

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[183] TCMUD 12 Exhibit No. 2 (Joyce Direct), Exhibit JJJ-14, pg. 233.

[184] *Id.*, at WTCPUA00009502.

[185] WTCPUA Exhibit No. 1 (Rauschuber Direct), Attachment P at 208.

[186] *Id.*, Attachment Q at 213.

[187] WTCPUA Exhibit No. 7, at WTCPUA00003864.

the inclusion of the raw water surcharge in the 2014 Volume Rate, or that raw water and lost water were expressly excluded under the terms of the Wholesale Water Services contract between the parties. Instead, the ALJ concludes that the WTCPUA did not change its rate computation methodology because the rate still includes a Monthly Charge and a Volume Rate. The PFD's conclusion rests on an extremely narrow interpretation of what a rate computation methodology is, and TCMUD 12 urges the Commission to reject the PFD and adopt instead a more reasonable interpretation.

And finally, as Mr. Joyce pointed out, in 2013 each wholesale water services customer was charged the exact same Volume Rate per thousand gallons[188] despite difference in size, connections, or other distinguishing factor. In 2014, the same wholesale water services customers are charged widely differing Volume Rates. According to the PFD, charging wholesale contract customers different Volume Rates and Monthly Charges does not prove that WTCPUA has changed its rate computation methodology because WTCPUA has a separate contract with each wholesale customer, so a wide range of factors other than a change in rate computation methodology could explain why other wholesale customers rates are different from the rates charged TCMUD 12. But if the fact that each wholesale customer has a separate contract explains charging different Volume Rates in 2014, why were all wholesale customers' 2013 Volume Rates identical? Even without exploring the formulas or computational methodologies involved, principles of mathematics and probability strongly suggest the different outcome is possible only if a change to the calculation of the Volume Rate methodology occurred.

C. WTCPUA Is a Monopoly and Has Abused Monopoly Power

This case arises under TEX. WATER CODE § 13.043(f), which allows retail public utilities to appeal wholesale rates charged to them by another retail public utility. WTCPUA is a retail public utility as that term is defined in TEX. WATER CODE § 13.002(19) and P.U.C. SUBST. R. 24.2(41)[189], and that definition applies to the entirety of chapter 13,[190] including § 13.001(b)

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

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