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PETITION OF THE RATEPAYERS OF THE RIVER PLACE WATER AND WASTEWATER SYSTEMS APPEALING THE RETAIL WATER AND WASTEWATER RATES OF THE CITY OF AUSTIN	§	**BEFORE THE STATE OFFFICE OF ADMINISTRATIVE HEARINGS**

PETITIONERS' REPLY TO THE CITY OF AUSTIN'S RESPONSE TO PETITIONERS' MOTION FOR PARTIAL SUMMARY DECISION

TO THE HONORABLE ADMINISTRATIVE LAW JUDGES:

COME NOW, the Ratepayers of the River Place Water and Wastewater Systems ("Ratepayers" or "Petitioners") and file this their Reply to the City of Austin's ("City") Response to Petitioners' Motion for Partial Summary Decision ("City's Response"), and in support thereof, would respectfully show the following:

I. INTRODUCTION AND BACKGROUND

1. The City filed its Response to Petitioners' Motion for Partial Summary Decision on June 5, 2015. Petitioners' reply is due June 12, 2015, within five (5) working days of the City's response.[1] Petitioners have filed this reply timely.

II. RELEVANT FACTS AND LAW

2. On September 7, 2009, the City became co-owner of the River Place Water and Wastewater Systems in accordance with the terms of the Strategic Partnership Agreement between the City of Austin and River Place MUD (the "MUD").[2]

3. On October 1, 2014, the City took over operations and maintenance of the River Place Water and Wastewater Systems ("River Place Systems") from Severn Trent, a third party, private

[1] P.U.C PROC. R. 22.123(a)(4).

[2] *See* Strategic Partnership Agreement Between the City of Austin and River Place MUD.

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operating company. With the River Place Systems, the City serves 1,047 water utility customers and 1,035 sewer utility customers.[3]

4. The same day that the City assumed responsibility for serving the Ratepayers via the River Place Systems, the City increase the retail water and wastewater rates charged to Petitioners to a rate unrelated to the cost of service for operating the River Place Systems.

5. The City again raised Petitioners' retail rates a month later on November 1, 2014.

6. The City provides water and wastewater services to the Petitioners through the River Place Systems, which the City owns, operates, and controls.[4]

7. On December 22, 2014, Petitioners filed their Petition[5] challenging both the City's October 1, 2014 and November 1, 2014 rate increases of its water and wastewater services pursuant to TEX. WATER CODE § 13.043(b).[6]

8. On January 27, 2015, PUC Staff referred the above-docketed case to the State Office of Administrative Hearings ("SOAH") to hear the appeal.

9. On April 14, 2015, Petitioners filed their Motion for Partial Summary Decision and Brief in Response to Order No. 4 ("Petitioners' Motion") regarding the City's October 2014 rates.

10. On May 4, 2015, during a prehearing conference, the Administrative Law Judges' ("ALJs") adopted an agreed procedural schedule that fixed a deadline for parties to respond to the Petitioners' Motion.

11. Order No. 7, issued May 26, 2015, formally adopted the agreed procedural schedule.

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[3] *See* Original Petition Appealing Retail Water and Wastewater Rates of the City of Austin and Motion for Interim Rates, December 22, 2014, at 2.

[4] *Id.*; TEX. WATER CODE ANN. § 13.002(13).

[5] The Petition's 360 signers is more than the required 10% of 1,047 water customers and 1,035 wastewater customers of the River Place Water and Wastewater Systems.

[6] TEX. WATER CODE ANN. § 13.043(b)(3).

12. On June 5, 2015, despite arguing in a separate pleading that the procedural schedule was legally flawed,[7] the City filed its Response to Petitioners' Motion for Partial Summary Decision according to the time frame established by Order No. 7.

13. Petitioners filed timely this Reply to the City's Response to Petitioners' Motion for Partial Summary Decision on June 12, 2015.

III. ARGUMENT

The City attempts to bootstrap its prior jurisdictional arguments and use them as grounds for the ALJs to deny Petitioners' Motion,[8] arguing that the jurisdiction issue somehow creates a material issue of fact and ostensibly defeats Petitioners' Motion.[9] The parties have thoroughly briefed the jurisdiction issue, and the Petitioners will not repeat their responses here. However, for purposes of *this* Reply, Petitioners must underscore that the City's position is flawed. The ALJs ruled that the petition was valid and jurisdiction was proper,[10] and the PUC has not overturned that decision.[11] The validity of the petition cannot raise a genuine question of material *fact,* and the ALJs have already answered the validity question. Moreover, the jurisdictional question is not a matter of fact; the ALJs settled the question as a matter of law.

The City further claims that Petitioners did not support their Motion with summary decision evidence.[12] On the contrary, Petitioners provided the very type of evidence that P.U.C PROC. R. 22.182(a) specifies, and the evidence comports with TEX. R. CIV. P. 166a(c) – the City's own answers to discovery requests. In its answers to discovery questions propounded by PUC staff, the City admitted that it did not complete a cost of service study or develop water or

[7] *See* City of Austin's Appeal of SOAH Order No. 7, June 5, 2015.

[8] Petitioners' Motion only applies to the City's October 1, 2014 rates. The City has already conceded that jurisdiction is proper for Petitioners' appeal of these rates.

[9] City's Response at 3.

[10] SOAH Order No. 6.

[11] *See* May 28, 2015 Commission Notification Memorandum advising that the City's appeal would not be considered.

[12] City's Response at 4.

wastewater rates for the River Place Systems.[13] As set out in the Petitioners' Motion,[14] for utility rates to comply with state law, the rates must be just and reasonable and based on the actual cost of service using costs incurred during an historic test year. The ratemaking process is well established, and the City cannot claim questions about its ratemaking are "premature."

Under federal regulation of utility rates, for over 100 years the U.S. Supreme Court has defined "just and reasonable" as the cost incurred in providing utility service plus a reasonable return on investment.[15] Many of those cases were rate cases that involved interpretation of Section 5(a) of the Natural Gas Act,[16] to determine maximum just and reasonable rates for sales in interstate commerce of natural gas produced in the Permian Basin of Texas.[17] Other cases involved the Federal Energy Regulatory Commission ("FERC") and its definition of "just and reasonable" as a utility's legitimate costs plus a reasonable return on investment. As a governmental, non-profit entity, the City cannot recover through its rates a reasonable return on its investment. Rather, the City is allowed under the U.S. Supreme Court's definition to simply recover enough revenue to cover its reasonable and necessary costs for providing the utility service, including debt service for prudent expenditures on infrastructure used for service.

The Legislature previously unified Texas utility law under the Texas Public Utility Regulatory Act. Before the Legislature transferred the regulatory jurisdiction for water utilities to the Texas Water Commission in 1986, the Commission regulated water and wastewater utility rates in Texas, as the "water company" and "sewer company" acted as monopolies similar to "the electric company" or "the telephone company." Consequently, a review of case law involving utilities under the Commission's jurisdiction and before deregulation of the electric and telephone industries sheds considerable insight and basis for determining what is a just and reasonable rate for a water or wastewater utility like the City.

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[13] *See* City's Comments, Concerns, and Response to Commission Staff's 1st RFI, Response 1-1 and 1-4.

[14] Petitioners' Motion for Partial Summary Decision and Brief in Response to Order No. 4, April 14, 2015, is incorporated herein as if set out in full.

[15] See e.g., *Smyth v. Ames*, 169 U.S. 466 (1898); *Bluefield Water Work & Improvement. Co. v. Public Serv. Comm'n of W. Va.*, 262 U.S. 679 (1923); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

[16] 15 U.S.C. § 717d(a).

[17] *Permian Basin Area Rate Cases*, 390 U.S. 747, 754-55 (1968).

In *PUC v. Houston Lighting & Power Company, et al.*, the Texas Supreme Court said that the establishment of a just and reasonable rate requires the utility to demonstrate 1) its operating expenses for utility service are reasonable and prudent; 2) its rate base includes only that infrastructure that is used and useful to provide utility service; and 3) its rate of return on invested capital is reasonable. "To ensure that its rate is just and reasonable, a utility must prove that all operating expenses have been actually incurred."[18] So, for a utility to prove that its rates are just and reasonable, the utility must show from historical records that its actual operating expenses are reasonable and necessary expenses for the utility service provided.

In *PUC v. City of Austin*, the City argued, like the City has argued in this matter, that because the City's electric utility was a retail public utility, and not a utility as defined under PURA, then the ratemaking standards, including the historic test year requirement, did not apply to the City. The Texas Third Court of Appeals disagreed, declaring that the Legislature made the Commission the safety valve to ensure rates were just and reasonable for retail public utilities in the same manner as for privately-owned utilities.[19] In reviewing PURA and the differences between a utility and a public utility, the Court concluded the following:

> The legislative history indicates a belief by several drafters that municipally-owned utilities and privately-owned utilities could be treated the same for ratemaking review purposes. This is evident from the fact that in the initial Senate bill drafts, alluded to earlier, both types of utilities were included within the Commission's jurisdiction. We also decline to accept the City's argument that the standards in PURA §§ 37-47 cannot be fashioned to provide a ratemaking review framework for rates set by municipally-owned utilities, since the standards are not the type applicable to a non-investor-owned utility. . . the standards are the type that can properly and reasonably be used to set rates of electric companies which are municipally-owned.[20]

The Court thereby rejected the City's argument that different ratemaking standards applied to public utilities versus retail public utilities.

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[18] *PUC v. Houston Lighting & Power Company, et.al.*, 748 S.W.2d 439, 441 (Tex. 1987).

[19] *PUC v. City of Austin*, 728 S.W.2d 907, 916 (Tex. App.- Austin 1987, pet denied).

[20] *Id.*

Under Subchapter B of Chapter 24, the Commission has provided its standards for determining a just and reasonable rate in cases involving water and sewer utilities. While the City is not a public utility or a water and sewer utility as defined in Chapter 24, the City is a retail public utility. Section 24.1 states that Chapter 24 shall govern the determination of ***ALL*** water and sewer causes and proceedings,[21] and Chapter 24 establishes a comprehensive regulatory system under Texas Water Code Chapter 13 to assure all rates are just and reasonable.[22] The Commission's rules, like the Texas Water Code, define test year as a historical test year, declaring a test year to be "[t]he most recent 12-month period for which representative operating data for a **retail public utility** are available."[23] Neither the Commission's rules nor the Water Code provide a separate "test year" definition for a public utility versus a retail public utility, such as the City. As discussed below, P.U.C. SUBS. R. 24.31 states that just and reasonable rates are based upon the utility's historic cost of service,[24] and only those incurred expenses that are reasonable and necessary to provide utility service to the ratepayers may be included in allowable expenses.[25] Again, a separate rate review procedure does not exist for retail public utilities in either the Water Code or the Commission's rules. As P.U.C. SUBS. R. 24.1 states, the Commission's rules govern the determination of ***ALL*** water and sewer rate cases. Logically, the Commission cannot have a methodology for ensuring that an investor-owned utility's rates are just and reasonable that is different from the methodology applied to a City.

Furthermore, the Commission has declared that a public utility must demonstrate its proposed rates are just and reasonable.[26] Moreover, like the U.S. Supreme Court and other states around the nation, the Commission has defined "just and reasonable rates" as the reasonable and necessary cost of providing the utility service. P.U.C. SUBS. R. 24.25 states that the utility must submit data for review to prove that its rates are just and reasonable. P.U.C. SUBS. R. 24.31 further clarifies that just and reasonable rates must be based upon the utility's cost of rendering

[21] *See* P.U.C. SUBS. R. §24.1 (emphasis added).

[22] *Id.*

[23] P.U.C. SUBS. R. §24.3 (52)(emphasis added).

[24] P.U.C. SUBS. R. §24.31(a).

[25] P.U.C. SUBS. R. §24.31(b).

[26] P.U.C. SUBS R. §24.25(b).

service.[27] According to the Commission's rules, only those expenses that are reasonable and necessary to provide utility service to the ratepayers may be included in allowable expenses.[28] Under the Commission's rules, allowable expenses are made up of ***historical test year expenses*** adjusted for future years based upon known and measurable changes in allowable costs.[29] Thus, under the Commission's rules, to prove that its rates are just and reasonable, the City must show that the revenue requirement used to establish its rates is made up of allowable expenses from a historical test year adjusted for known and measurable changes in allowable costs.

Whether an entity is a retail public utility or a public utility evolves solely around the question of which governmental body has original jurisdiction in the matter. For a public utility, the Commission, or other regulatory authority, has original jurisdiction over rate setting, which is the reason that these public utilities must submit an application for review. For a retail public utility, its governing body is charged with reviewing all of the information presented before that governing body makes the initial decision to set the rates, and the Commission has appellate jurisdiction, reviewing *de novo* that information supporting the rate change. Other than original jurisdiction versus appellate jurisdiction, a difference does not and cannot exist for the review of rates between a retail public utility and a public utility.

The City's assertion that it was not required to "perform a separate cost of service study for this petitioner group"[30] simply is not true. Prior to setting a rate different than the cost-of-service based rates of the MUD, the City must show that its new rates are just and reasonable for *each* rate that it charges Petitioners. The prescribed method to do that is through a credible demonstration that the City based its rates upon the River Place Systems' historic cost of service adjusted for known and measurable changes. Without a cost of service study or evidence that it developed Petitioners' rates using actual operating costs for the River Place System, the City is unable to prove that its rates are just and reasonable. Furthermore, the revenue requirement for the City's rates charged to other customers did not include the costs associated with the operation

[27] P.U.C. SUBS. R. §24.31(a).

[28] P.U.C. SUBS. R. §24.31(b).

[29] *Id.*

[30] City's Response at 6.

and maintenance of the River Place Systems. No evidence can exist to support rates different than the cost-of-service based rates of the MUD. No genuine material issue of fact exists as to whether the October 2014 rates are unjust and unreasonable, as the City admitted it did not perform a rate study to determine its cost of providing service to Petitioners.

Finally, without any evidence substantiating its claim, the City also argues that it did not perform a cost of service study for the rates imposed on River Place Ratepayers because the rates were "agreed to" by the MUD.[31] This proposition is misguided. First, the MUD was not and is not the legal representative of the individual River Place Ratepayers – they are separate entities – and the MUD cannot contractually bind the Petitioners in contradiction to Petitioners' right to appeal under Chapter 13 of the Water Code. Petitioners were not parties to or privy to the annexation agreement between the MUD and the City, which detailed the continuation of the MUD as a limited purpose district. Second, the City contradicts itself just three (3) pages later by claiming that observations about the MUD are "irrelevant to any issue in this case."[32] Third, the MUD did not agree that the City could charge Petitioners unjust or unreasonable rates. To clarify, Petitioners' discussion in Petitioners' Motion about the joint utility agreement, the CCN, and the involvement of the MUD was *not* part of Petitioners' Motion for Partial Summary Decision, but rather a part of Petitioners' brief in response to the ALJs' Order No. 4.

IV. SUMMARY

Despite making its Response to Petitioners' Motion for Partial Summary Decision a rehash of its serial pleadings on jurisdiction, the City has failed to point to a single issue of fact regarding the rates that it is charging Petitioners or how the City simply applied the rates charged other customers to Petitioners without reviewing the actual cost of providing service through the River Place Systems. Granting the Motion for Partial Summary Decision would not only be well founded on the facts, but it would bring judicial efficiency to a proceeding that has sorely lacked any efficiency.

[31] *Id.*

[32] City's Response at 9.

V. PRAYER

WHEREFORE, PREMISES CONSIDERED, Petitioners pray that the ALJs grant their Motion for Partial Summary Decision and grant other such relief to which they may be entitled.

Respectfully submitted,

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ATTORNEYS FOR PETITIONERS

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing document has been served via hand delivery, facsimile, electronic mail, overnight mail, U.S. mail and/or Certified Mail Return Receipt Requested on all parties on the 12th of May 2015.

_____
Randall B. Wilburn