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House Bill (HB) 1600 and Senate Bill (SB) 567 83rd
Legislature, Regular Session, transferred the functions
relating to the economic regulation of water and sewer
utilities from the TCEQ to the PUC effective
September 1, 2014

SOAH DOCKET NO. 582-12-6658
TCEQ DOCKET NO. 2012-1058-UCR

APPLICATION OF AQUA TEXAS, § BEFORE THE STATE OFFICE
INC., AQUA UTILITIES, INC., AQUA §
DEVELOPMENT, INC., HARPER §
WATER COMPANY, INC., AND §
KERRVILLE SOUTH WATER § OF
COMPANY, INC., DBA AQUA TEXAS §
FOR NORTH AND SOUTHWEST §
REGION WATER RATE/TARIFF §
CHANGES § ADMINISTRATIVE HEARINGS

**AQUA TEXAS' RESPONSE TO THE RECENTLY ACQUIRED WATER
SYSTEMS GROUP'S MOTION TO ADOPT INTERIM RATES**

TO THE HONORABLE ADMINISTRATIVE LAW JUDGE:

COMES NOW, Aqua Texas, Inc., Aqua Utilities, Inc., Aqua Development, Inc., Harper Water Company, Inc. and Kerrville South Water Company, Inc. d/b/a Aqua Texas ("Aqua Texas") and files this Response to the Recently Acquired Water Systems Group's ("RAWS") Motion to Adopt Interim Rates ("Motion"). RAWS has not articulated a single reason justifying the interim rates it requests. Aqua Texas respectfully requests that the Court deny RAWS' Motion. In support, Aqua Texas would show as follows.

I. INTRODUCTION

The RAWS Motion does not include a single piece of evidence or legal argument supporting its request for interim rates and should be denied outright. But, as the ED pointed out in his response, mediation in this case is ongoing. While Aqua Texas generally shares the ED's understanding that a SOAH ruling on an item filed by one of the parties involved in the mediation process, such as the RAWS Motion, would not typically be issued in the midst of that process that understanding has no application in this instance because neither Mr. Quest, the RAWS

representative, nor any member of RAWS attended the scheduled mediation on October 22, 2012.¹ If the ALJs consider taking any action on the RAWS Motion other than denial, Aqua Texas requests that a ruling be delayed until an evidentiary hearing and full briefing on requested interim rates has occurred. Aqua Texas submits such efforts would be duplicative of efforts already in the works regarding pre-filed direct testimony and the scheduled hearing on the merits concerning Aqua Texas' applied for rates,² but these procedures would protect Aqua Texas' due process and due course of law rights to which it is entitled. Aqua Texas presents the following brief response to the RAWS Motion, subject to later supplementation according to procedures to be determined by the Court if necessary, showing both why an evidentiary hearing is needed to address interim rates and why the RAWS Motion should be denied on its face.

II. APPLICABLE LAW

Any interim or permanent rate proceeding before the Texas Commission on Environmental Quality ("TCEQ") or the State Office of Administrative Hearings ("SOAH") is governed by the ratemaking criteria of TEX. WATER CODE Chapter 13, Subchapter F. More specifically, rates must meet the criteria of TEX. WATER CODE §§ 13.182, 13.189 and 13.190 regarding rate allocation and design, TEX. WATER CODE §§ 13.183 and 13.184 regarding return on invested capital, and TEX. WATER CODE § 13.185 regarding invested capital, allowable expenses and depreciation. Any rates set by the TCEQ, which do not properly address these statutory criteria based on an evidentiary record properly created under the Administrative Procedure Act ("APA") are defective and result in a voidable order.

¹ Aqua Texas would also support a court order for RAWS to participate in the next scheduled SW Region mediation session on November 20, 2012.

² Aqua Texas' pre-filed direct testimony and exhibits are currently due in December.

The Texas Legislature established the applicable test to determine whether a rate proposed or demanded is unjust or unreasonable in Chapter 13, Subchapter F of the Water Code. The TCEQ followed that test when adopting 30 TEX. ADMIN. CODE §§ 291.31- 291.32, the TCEQ's regulations governing cost of service and rate design. Those provisions apply to interim rate rulings just as they apply to the final rate ruling that will ultimately result from the pending contested case hearing.

Section 13.187(l) permits discretionary setting of interim rates, but 30 TEX. ADMIN. CODE §291.29(d) makes it clear that interim rates are an extraordinary form of rate relief that requires the additional evidentiary showing that "proposed rates could result in an unreasonable economic hardship on the utility's customers, unjust or unreasonable rates, or failure to set interim rates could result in an unreasonable economic hardship on the utility." 30 TEX. ADMIN. CODE §291.29(d).³ Effectively, there are two layers of evidentiary proof necessary to establish interim rates: (1) the standard rate-setting criteria which determines reasonable rates in all TCEQ utility rate cases; and (2) the §291.29(d) criteria. Interim rates are not "proposed rates" requested by a utility applicant and should be considered as "other matters or proceedings" under the TCEQ rules. 30 TEX. ADMIN. CODE §291.12. Consequently, the movant for interim rates, not the utility applicant, has the burden of proof on both evidentiary levels. *Id.*

Neither the TCEQ nor the Administrative Law Judges ("ALJs") may set interim rates just because a protestant, or protestant group, unilaterally declares that a utility applicant's proposed rates are unjust or unreasonable. Any decision affecting a utility's right to timely collect its operating

³ This standard is not in the Water Code, but was considered with respect to interim rate requests in Aqua Texas' last statewide rate case where protestants requesting interim rates were denied that relief for failure to demonstrate any unreasonable economic hardship beyond the adverse economic consequences naturally occurring from increased rates, as is present in any case, or that the proposed rates were unjust or unreasonable. *In re Application of Aqua Utilities, Inc. and Aqua Development Company d/b/a Aqua Texas, Inc. To Change Water and Sewer Rates*, SOAH Docket Nos. 582-05-2770, 582-05-2771, 582-05-3745, 582-05-4181, 582-05-4182, 582-05-4184, TCEQ Docket Nos. 2004-1120-UCR, 2004-1671-UCR, 2004-2122-UCR, 2005-0113-UCR, 2005-0114-UCR, 2005-0112-UCR, SOAH Order No. 6, Denying Requests for Interim Rate Relief (April 19, 2005).

costs, taxes, and earn a return on its used and useful invested capital dedicated to public service that is not based upon sworn evidence is arbitrary and capricious. As a result, a utility applicant is entitled to an evidentiary hearing concerning its operating costs and invested capital in connection with an interim rate request before this Court could order such a rate.

In addition, the TCEQ's rules do not explicitly authorize a utility to earn a return on a surcharge for under-collection of necessary revenues during a period of interim rates, and the TCEQ has never entered such an order since assuming IOU ratemaking jurisdiction on March 6, 1985. If an interim rate request is granted, and interim rates are set too low without evidence of a utility's actual operating costs and invested capital, that utility's capital will have been confiscated without due process or compensation. This violates both the federal and state constitutions. U.S. CONST. amend. XIV, § 1; TEX. CONST. art. I, § 19.

The TCEQ is not authorized to circumvent a utility's right to a hearing under the Texas Rules of Evidence in a "contested case" under the Administrative Procedures Act by rule.⁴ Yet, the TCEQ purports to do so in 30 TEX. ADMIN. CODE § 291.29(e)(1), which allows the TCEQ or an ALJ to set interim rates based solely on oral argument.⁵ A "contested case," under the APA, means a proceeding, including a ratemaking proceeding, where the legal rights, duties or privileges of a party are determined by an agency after an opportunity for an adjudicative hearing.⁶ Action on interim rates is a proceeding in which a utility's legal rights, duties and privileges will be adjudicated. If the utility opposes a motion for interim rates, it is contested. Any order — even an interlocutory interim rate order — may be entered only after an evidentiary APA contested case hearing. Indeed, 30 TEX.

⁴ TEX. GOV'T CODE §§ 2001.001(1), 2001.002, 2001.003(1) and 2001.081.

⁵ This provision is not in the Water Code.

⁶ TEX. GOV'T CODE § 2001.003(1).

ADMIN. CODE § 291.29(f) contemplates an evidentiary hearing on interim rates and is the proper way to consider such matters.

If this Court (or the TCEQ) were to grant an interim rate request without a record of operating costs and invested capital — relying instead solely on customer complaints that they do not want to pay more for their service — relevant evidence would be ignored in favor of hearsay and supposition. The Texas Rules of Evidence were designed to exclude such non-evidence from judicial consideration. The Legislature has mandated that the APA applies to TEX. WATER CODE Chapter 13 cases.⁷ Notwithstanding, the TCEQ disregarded this mandate when it adopted 30 TEX. ADMIN. CODE § 291.29(e)(1) with respect to interim utility rates.⁸ Aqua Texas respectfully submits that the agency lacks the power to supercede the requirement of an evidentiary hearing imposed by the Legislature on contested administrative matters under TEX. WATER CODE Chapter 13. An interim rate order issued based on unsworn pleadings and arguments without hearing would be constitutionally suspect, arbitrary and capricious, and subject to reversal.

An arbitrary and capricious order is one that fails to properly consider the relevant facts, fails to articulate a rational connection between the facts found and the choice made, violates due process or is based on “unfair or unreasonable conduct that shocks the conscience.”⁹ An agency decision may be arbitrary and capricious if the agency abused its discretion by considering irrelevant factors

⁷ TEX. WATER CODE §13.003.

⁸ See, TEX. WATER CODE §13.003 (providing that the APA applies to “all proceedings under [Chapter 13] except to the extent inconsistent with [Chapter 13].”).

⁹ *Texas State Bd. of Dental Exam'rs v. Silagi*, 766 S.W.2d 280, 285 (Tex. Civ. App—El Paso 1989, writ denied); *Consumers Water v. Public Utility Commission*, 774 S.W.2d 719 (Tex. Civ. App.—Austin 1989, no writ); *Starr County v. Starr Industry Servs., Inc.*, 584 S.W.2d 352 (Tex. Civ. App—Austin 1979, writ ref'd n.r.e.); *Gerst v. Nixon*, 411 S.W.2d 350 (Tex. 1966); *Bowman Transp., Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 95 S.Ct. 438 (1971).

or excluding factors which the Legislature intended it to consider.¹⁰ When the agency bases its decision on a factor not included in the enabling legislation, such a decision is arbitrary and capricious by violating the due process rights of the parties.¹¹

In summary, the ALJs cannot set interim rates based merely on a protestant's request for interim rates. Before interim rates may be granted, an evidentiary hearing is required and certain evidentiary standards must be met by the movant as discussed herein.

III. RESPONSE TO RAWS MOTION TO ADOPT INTERIM RATES

Aqua Texas opposes the RAWS Motion. Denying the RAWS Motion on its face is warranted because it is devoid of any legal or factual support in the slightest. The request merely indicates that RAWS would like ratepayers to be charged unspecified interim rates that represent a 27% increase over rates in effect prior to Aqua Texas' pending application. There is no rationale supporting RAWS' conclusory assertion, nor any evidence supporting a finding under either the standard rate-setting criteria or the 30 TEX. ADMIN. CODE §291.29(d) criteria.

If the ALJs do not deny the RAWS Motion and proceed to consider its request for interim rates, Aqua Texas is entitled to, and hereby requests, a full evidentiary hearing on the RAWS interim rate request. Aqua Texas' request for an evidentiary hearing is especially justified in this case given that, while unclear, it appears the sole grounds for RAWS' request may be Aqua Texas' regionalized

¹⁰ *Gerst*, 411 S.W.2d at 360 & n.8; *Consumers*, 774 S.W.2d at 721-722; see also *AEP Tex. Cent. Co. v. PUC of Tex.*, 286 S.W.3d 450, 475 (Tex. App.—Corpus Christi 2008, pet. denied) (holding that an agency acts in an arbitrary and capricious manner when it (1) fails to consider a factor the legislature required it to consider; (2) considers an irrelevant factor; or (3) considers only relevant factors, yet reaches an unreasonable result).

¹¹ *Texas Health Facilities Comm'n v. Charter Medical-Dallas, Inc.*, 665 S.W.2d 446, 453-454 (Tex. 1984); *Public Utility Comm'n v. South Plains Elec. Coop., Inc.*, 635 S.W.2d 954, 957-58 (Tex. App.—Austin 1982, writ ref'd n.r.e.); *Starr County*, 584 S.W. 352.

approach to rate-setting which was specifically approved by the Commission in Aqua Texas' 2004 statewide rate case.¹²

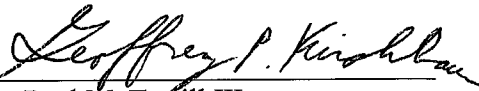
In sum, the ALJs should deny the RAWs Motion outright. Alternatively, the ALJs should schedule an interim rates evidentiary hearing and briefing schedule to occur once the ongoing mediation process is completed.

IV. PRAYER

Aqua Texas respectfully requests that the Motion to Adopt Interim Rates filed by the Recently Acquired Water Systems protestant group be denied in all respects. Alternatively, if the ALJs decide to consider the merits of the RAWs Motion, Aqua Texas requests that it be afforded a full evidentiary hearing on the Motion as required by the Water Code, APA, and as guaranteed to Aqua Texas by the due process and due course of law protections of the U.S. and Texas Constitutions.

Respectfully submitted,

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¹² *In re Application of Aqua Utilities, Inc. and Aqua Development Company d/b/a Aqua Texas, Inc. To Change Water and Sewer Rates*; SOAH Docket Nos. 582-05-2770 and 582-05-2771, TCEQ Docket Nos. 2004-1120-UCR, and 2004-1671-UCR, Proposal for Decision (July 5, 2007) and Final Order (September 23, 2008). There is a partial statement at the bottom of the pleading that indicates RAWs has a complaint about Aqua Texas' regionalization: "Aqua Texas is in direct violation of the TWC whereby they are attempting to treat all their ratepayers as the same, or one class only,". This statement is inaccurate in multiple respects, but is presumed to be an attempted complaint about Aqua Texas' regionalized rate structure proposed in the application. Aqua Texas is not completely certain what the statement means because it is unclear and appears to be incomplete. Only RAWs knows what is truly intended by this partial statement.

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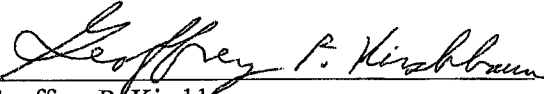
**ATTORNEYS FOR AQUA TEXAS, INC., AQUA
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CERTIFICATE OF SERVICE

I hereby certify that on October 26, 2012, a true and complete copy of the foregoing was sent to the following by e-mail, facsimile, overnight delivery, or by first class mail:

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