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Addendum StartPage: 0

**SOAH DOCKET NO. 473-17-4964.WS  
DOCKET NO. 46662**

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<b>PETITION OF THE CITIES OF GARLAND, MESQUITE, PLANO AND RICHARDSON APPEALING THE DECISION BY NORTH TEXAS MUNICIPAL WATER DISTRICT AFFECTING WHOLESALE WATER RATES</b>	<b>§ § § § § § §</b>	<b>BEFORE THE STATE OFFICE  OF  ADMINISTRATIVE HEARINGS</b>
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**COMMISSION STAFF'S RESPONSE TO NORTH TEXAS MUNICIPAL WATER  
DISTRICT'S OBJECTION TO AND MOTION TO STRIKE  
DIRECT TESTIMONY OF HEIDI GRAHAM**

**COMES NOW** the Staff of the Public Utility Commission of Texas (Staff), representing the public interest, and timely<sup>1</sup> files this response to the Objection to and Motion to Strike the Direct Testimony of Heidi Graham by the North Texas Municipal Water District (District):

On June 8, 2018, the District filed objections to the pre-filed direct testimony of Staff witness Heidi Graham. The District's objections include positions contrary to the Preliminary Order,<sup>2</sup> mischaracterizations of Ms. Graham's testimony, and misrepresentations of Texas case law. Therefore, the District's motion should be denied.

**I. The Direct Testimony of Heidi Graham is relevant to the proceeding.**

The District's argument that Ms. Graham's testimony should be stricken because it is "cost-of-service" evidence, and therefore irrelevant to the proceeding,<sup>3</sup> mischaracterizes the nature of her testimony. For the purposes of this case, cost of service means:

A calculation of the revenue requirement to which a seller is entitled to cover all cash needs, including debt obligations as they come due. Basic revenue requirement components considered under the cash basis generally include operation and maintenance expense, debt service requirements, and capital expenditures which are not debt financed. Other cash revenue requirements should

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<sup>1</sup> The District filed its Motion to Strike on June 8, 2018, and Staff received the District's motion that same day. Pursuant to 16 Tex. Admin Code (TAC) § 22.77(b), the response deadline is five working days from June 8, 2018. Therefore, Staff's response is due June 15, 2018.

<sup>2</sup> Preliminary Order at 27 (Jun. 29, 2017) (PO).

<sup>3</sup> North Texas Municipal Water District's Objection to and Motion to Strike the Direct Testimony of Heidi Graham at 3-7 (Jun. 8, 2018) (District's Motion to Strike).



be considered where applicable. Basic revenue requirement components under the cash basis do not include depreciation.<sup>4</sup>

Ms. Graham did not provide any testimony concerning the District's cost of service (also called the revenue requirement). She did not calculate the district's revenue requirement, nor did she critique the District's calculation of its cost of service. Ms. Graham's testimony addresses whether the District's rates are adverse to the public interest<sup>5</sup> and explains how the District's rate-setting methodology results in rates that are unreasonably preferential, prejudicial and discriminatory.<sup>6</sup> She specifically takes issue with how the District allocates its revenue requirement among the member cities.<sup>7</sup> This is not the same as calculating the amount to which the District is entitled to cover all of its cash needs. A closer look at *Texas Water Commission v. City of Fort Worth*,<sup>8</sup> makes this distinction more clear.

In that case, the City of Arlington (Arlington) appealed the City of Fort Worth's (Fort Worth) wholesale wastewater rate increase.<sup>9</sup> The rates were set pursuant to a formula based on Fort Worth's cost of service.<sup>10</sup> The formula was contained in a contract between the cities.<sup>11</sup> Arlington contended that Fort Worth had improperly included expenses related to a water treatment plant in its cost of service, which resulted in an improper rate increase.<sup>12</sup> In other words, the dispute was over whether or not a certain expense should be included in cost of service. The Texas Water Commission agreed with Arlington and "found that Fort Worth could not include such a component in its cost of service."<sup>13</sup> Fort Worth appealed, and the decision was overturned

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<sup>4</sup> 16 TAC § 24.129(3) (setting forth the definition of "Cash Basis method of calculating of cost of service").

<sup>5</sup> Direct Testimony of Heidi Graham at 5-6 (May 18, 2018) (Graham Direct).

<sup>6</sup> *Id.* at 10-11.

<sup>7</sup> *Id.* at 6, 8-11.

<sup>8</sup> *Texas Water Comm'n v. City of Fort Worth*, 875 S.W.2d 332 (Tex. App.—Austin 1994, writ denied).

<sup>9</sup> *Id.* at 333.

<sup>10</sup> *Id.* at 333-34.

<sup>11</sup> *Id.*

<sup>12</sup> *Id.* at 334.

<sup>13</sup> *Id.*

because the Texas Water Commission did not “first make a finding that the rates . . . adversely affect the public interest by being unreasonably preferential, prejudicial, or discriminatory.”<sup>14</sup>

After *City of Fort Worth*, the Texas Water Commission amended its rules to ensure compliance with this decision.<sup>15</sup> The resulting rule requires a public interest hearing and prohibits the Commission from making a public interest determination solely on an analysis of the seller’s cost of service.<sup>16</sup> The Commission has made clear that the rule does not mean that cost of service issues cannot be considered.<sup>17</sup> It only prohibits “analysis of the cost of service for the purpose of setting rates,”<sup>18</sup> which is exactly what occurred in *City of Fort Worth*.<sup>19</sup> Ms. Graham has not proposed the setting of any rates.

The issues raised by Ms. Graham are completely dissimilar from those in *City of Fort Worth*. She has not testified that the District improperly included expenses in its cost of service. She has taken no issue with the cost of service (its Annual Requirement) alleged by the District. She has never performed a cost of service study in her capacity as a testifying witness, and the area is largely outside of her expertise. Had Staff wished to offer testimony on cost of service, it would have selected a member of the Commission’s Water Utility Regulation Division that specializes in that area. Ms. Graham’s expertise lies in rate design.<sup>20</sup>

The District has misapplied the term cost of service to what is clearly a rate design issue. However, Ms. Graham’s testimony should stand even if it does constitute cost of service evidence because the issues identified in the Commission’s Preliminary Order has made it clear that cost of service is not irrelevant to the proceeding.<sup>21</sup> Furthermore, Ms. Graham testified about the arbitrary and unreasonably prejudicial way in which the District allocated its cost of service.<sup>22</sup> This

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<sup>14</sup> *Id.* at 336.

<sup>15</sup> See District’s Motion to Strike at 3 (discussing the history of 16 TAC § 24.133(b)).

<sup>16</sup> 16 TAC § 24.133(b); *see also* PO at 27.

<sup>17</sup> PO at 27 (“[T]he public interest determination cannot depend solely on whether the challenged rates match the cost of service. This rule does not preclude the admission of evidence on and consideration of the various costs of the district, including its bond servicing costs, and its various sources of revenues.”).

<sup>18</sup> *Id.*

<sup>19</sup> *City of Fort Worth*, 875 S.W.2d at 333-34.

<sup>20</sup> Graham Direct at 4.

<sup>21</sup> PO at 27.

<sup>22</sup> Graham Direct at 6-10, Attachment HG-3.

testimony is directly relevant to Issue 4b: “Are the rates unreasonably preferential, prejudicial, or discriminatory.”<sup>23</sup> Consequently, the District’s objections and motion to strike, which are based on a misunderstanding of the nature of Ms. Graham’s testimony and its relevance to the issues set forth in the Preliminary Order, should be denied.

**II. The District’s arguments regarding unreliability are confusing and inaccurate and should be denied.**

The District begins its argument with a misstatement of Texas case law. The Texas Supreme Court in *Merrell Dow Pharmaceuticals, Inc. v. Hanver*, did not hold that when an “expert brings to court little more than his credential and a subjective opinion, this is not evidence that would support a judgment.”<sup>24</sup> This is actually a quote from a federal opinion.<sup>25</sup> While the Texas Supreme Court did include the quotation in the opinion, it did so as part of a larger summary of rulings on the same topic by other jurisdictions.<sup>26</sup> It neither commented favorably or unfavorably as to the Fifth Circuit’s holding.<sup>27</sup> Consequently, treating the *Viterbo v. Dow Chem. Co.* as Texas case law is inaccurate.<sup>28</sup>

The District further confuses the issue by stating, “In this case, the rate the District ‘demands’ from the Member Cities is \$2.53/1,000 gallons for usage *up to* the city’s highest annual usage and \$0.41/1,000 gallons for usage above the annual maximum.”<sup>29</sup> This is an erroneous description of the District’s rates. The District’s contract is in fact a take-or-pay contract. The District demands \$2.53/1,000 gallons for every gallon of each City’s annual minimum regardless of whether or not it is used.

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<sup>23</sup> PO at 22.

<sup>24</sup> *Merrell Dow Pharmaceuticals, Inc. v. Hanver*, 953 S.W.2d 706, 712 (Tex. 1997).

<sup>25</sup> *Viterbo v. Dow Chem. Co.*, 826 F.2d 420, 421 (5th Cir. 1987).

<sup>26</sup> *Hanver*, 953 S.W.2d at 712.

<sup>27</sup> *Id.*

<sup>28</sup> District’s Motion to Strike at 8.

<sup>29</sup> *Id.* at 9 (*emphasis added*).

The District compounds the confusion by using the singular of “rate” in describing the primary issue in this case.<sup>30</sup> The District attacks the reliability of Ms. Graham’s testimony based on allegations that she fails to understand the “protested rate.”<sup>31</sup> This case is not about a “protested rate” but about “protested rates.”<sup>32</sup> Multiple parties attempted to make this case about a “protested rate,”<sup>33</sup> but the Commission described the issues in this phase as “protested rates” in the Preliminary Order.<sup>34</sup> Thus, this case is not about a single rate as the District contends but about the total charges imposed by the District. Consequently, Ms. Graham’s definition of protested rate is not grounds for striking her testimony, but rather makes it consistent with the Preliminary Order.

Striking Ms. Graham’s testimony is not the appropriate procedural mechanism to address the questions the District raises in its motion. The discovery period has not closed, and the District has already filed requests for information (RFI) to elicit the information it seeks.<sup>35</sup> Additionally, the District is scheduled to depose Ms. Graham at which time it will have the opportunity to explore topics relevant to Ms. Graham’s testimony in depth.<sup>36</sup> To the extent the District wishes to attempt to invalidate Ms. Graham’s methods, they are free to do so through cross-examination at the hearing on the merits.<sup>37</sup> The District’s objection under Texas Rule of Evidence 702 should be denied because it has not offered any explanation as to why striking the testimony in its entirety should supplant these procedural options.

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<sup>30</sup> *Id.* (“In this case, the rate the District ‘demands’ from the Member Cities is \$2.53/1,000 gallons for usage up to the city’s highest annual usage and \$0.41/1,000 gallons for usage above the annual maximum.”)

<sup>31</sup> *Id.*

<sup>32</sup> PO at 21-27.

<sup>33</sup> See Commission Staff’s List of Issues (Apr. 28, 2017); Petitioner’s List of Issues (Apr. 28, 2017).

<sup>34</sup> PO at 21, Issue Nos. 4-5.

<sup>35</sup> See e.g., North Texas Municipal Water District’s Second Request for Information to Commission Staff at 7 (May 25, 2018) (NTMWD RFI 2-13. Refer to Page 6, lines 12-17 of Ms. Graham’s Direct Testimony. Define and explain the term “projected rate year costs.”)

<sup>36</sup> Notice of Intention to Take the Oral Deposition of Heidi Graham (May 29, 2018).

<sup>37</sup> *Gammill v. Jack Williams Chevrolet, Inc.*, 972 S.W.2d 713, 728 (Tex. 1998) (citing *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579, 596 (1993)) (The trial court’s gatekeeping function under Rule 702 does not supplant cross-examination as ‘the traditional and appropriate means of attacking [allegedly] shaky but admissible evidence.’)

For the foregoing reasons, Staff respectfully requests the entry of an Order denying the District's objections to and motion to strike the Direct Testimony of Heidi Graham.

**Dated: June 15, 2018**

PUBLIC UTILITY COMMISSION  
LEGAL DIVISION

Respectfully Submitted,

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Division Director

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**SOAH DOCKET NO. 473-17-4964.WS**  
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**CERTIFICATE OF SERVICE**

I certify that a copy of this document will be served on all parties of record on June 15, 2018, in accordance with 16 TAC § 22.74.

A handwritten signature in black ink, appearing to read 'L. Lill', is written above a horizontal line.

Landon J. Lill