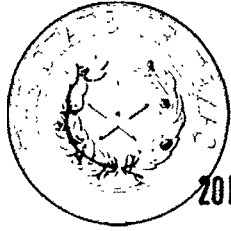


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State Office of Administrative Hearings

Kristofer Monson
Chief Administrative Law Judge

April 30, 2019

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

Via Facsimile 512/936-7268

RE: SOAH Docket No. 473-17-4964
PUC Docket No. 46662

Petition of the Cities of Garland, Mesquite, Plano, and Richardson Appealing the Decision by North Texas Municipal Water District Affecting Wholesale Water Rates

Dear Mr. Journeay,

On March 15, 2019, the undersigned Administrative Law Judges (ALJs) issued a Proposal for Decision (PFD) in the above-referenced case. On April 4, 2019, exceptions to the PFD were filed by the Cities of Garland, Mesquite, Plano, and Richardson (Petitioning Cities); the City of Royse City (Royse); the City of McKinney (McKinney); the North Texas Municipal Water District (District); and the Cities of Frisco and Forney (Frisco & Forney). The same parties and the staff (Staff) of the Public Utility Commission of Texas (Commission) timely filed replies to exceptions on April 22, 2019.¹

This letter describes our recommendations based on our review of all documents described above. The exceptions, which generally repeat arguments that we rejected for reasons discussed in the PFD, have not persuaded us to change our recommendations on any of the issues, other than in the limited instances discussed below. The matters addressed in this letter are presented below in the same order in which they appear in the PFD.

¹ The Cities of Farmersville, Princeton, and Wylie timely filed a reply adopting the exceptions filed by the District, McKinney, and Frisco & Forney.

I. Factual Background

The District correctly notes that the chart on page 9 of the PFD contains an error. The chart on page 9 of the PFD should be corrected as shown below.² However, no change is required to any findings of fact or conclusions of law.

Member City	Annual Minimum (Gallons) FY 2017	Year Established (Water Year)	Obligation (at \$2.53 per 1,000 gallons) FY 2017	Percentage FY 2017
Richardson	11,019,311,000	2001	\$34,716,546.15	14.4%
Mesquite	8,297,666,000	2001/2008 ³	\$20,993,094.98	8.7%
Plano	26,719,809,000	2001	\$67,601,116.77	28.1%
Garland	13,721,955,000	2006	\$27,878,856.83	11.6%
Allen	6,011,208,000	2011	\$15,208,356.24	6.3%
Farmersville	280,467,000	2006	\$709,581.51	0.3%
Forney	1,849,256,000	2016	\$4,678,617.68	1.9%
Frisco	10,225,090,000	2016	\$25,869,477.70	10.8%
McKinney Princeton	485,886,000	2016 2011	\$1,229,291.58	0.5%
Princeton McKinney	10,762,780,000	2011 2016	\$27,229,833.40	11.3%
Rockwall	3,330,881,000	2011	\$8,427,128.93	3.5%
Royse City	448,255,000	2016	\$1,134,085.15	0.5%
Wylie	1,877,558,000	2016	\$4,750,221.74	2.0%
TOTALS	95,030,122,000		\$240,426,208.66	100%

The District also argues that the Factual Background section should include two “undisputed” statements: (1) that the District has complied with all requirements in the Facilities Contract, including all rate-setting terms; and (2) that the District has following the Enabling Act, including requirements related to governance and Board Member service.³ The ALJs conclude that these statements are unnecessary to the ALJs’ findings and conclusions regarding the issues referred by the Commission. Moreover, because these statements were not issues referred by the Commission and were not litigated in the proceeding, the ALJs also cannot be certain that they are undisputed. Having reviewed the exceptions and replies, the ALJs do not recommend a change to the PFD regarding these statements.

² Stipulations at 7-8 (Oct. 25, 2018).

³ District Exceptions at 7-8.

II. Legal Framework

The District disagrees with the following statement in the PFD:

As noted below, the ALJs have found several violations of the public interest factors; therefore, *weighing* the particular degree to which the District's rates cause the impairment discussed in this section as opposed to other factors is not necessary. The Commission is ultimately tasked with weighing all relevant factors and giving due weight to each.⁴

The District takes issue with the ALJs' use of the word "weighing" in this sentence and argues that the ALJs conflate *weighing* in this instance with the "weigh all relevant factors" language in 16 Texas Administrative Code § 24.311(a)(3). This is a misreading of the PFD. Although the ALJs use the word "weighing" in the quoted sentence, the ALJs are clearly referring to *analyzing the extent* of the impairment the ALJs found *with respect to subsection (a)(2)* regarding impairment of the purchaser's ability to provide service based on the purchaser's financial integrity and operational capability. Because the ALJs also found violations of other factors listed in subsections (a)(3)(A)-(H), an analysis of the relative extent of the impairment found in subsection (a)(2) was not necessary. The ALJs individually analyzed each of the factors set forth in 16 Texas Administrative Code § 24.311 (the Public Interest Rule); therefore, the ALJs do not recommend a change to the PFD with respect to this exception.

III. Preliminary Order Issues

A. Issues 1-3 regarding the Commission's authority to hear the appeal and the sufficiency of the petition.

With respect to Preliminary Order Issues 1-3, the District, McKinney, and Frisco & Forney make various arguments challenging the Commission's jurisdiction over this case. These issues were argued by the parties, analyzed by the ALJs, and addressed at length in the PFD. Additionally, the Commission's Preliminary Order also addressed and rejected many of the parties' arguments on these issues. Having considered the exceptions and replies, the ALJs do not recommend changes to the PFD regarding Preliminary Order Issues 1-3 for the reasons discussed in the PFD.

Petitioners correctly pointed out an error in Finding of Fact No. 39 regarding the dates the hearing on the merits was held. The ALJs recommend the following change:

39. A hearing on the merits was held October ~~4~~15-18, 2018.

⁴ District Exceptions at 8, quoting PFD at 43 (emphasis added in District Exceptions).

B. Issue 4 regarding whether the rates adversely affect the public interest under Texas Water Code § 13.043(j) and *Texas Water Commission v. City of Fort Worth*, 875 S.W.2d 332, 336 (Tex. App.—Austin 1994, writ denied).

The District, McKinney, and Frisco & Forney argue that the ALJs erred by not giving the underlying Facilities Contract in this case the adequate deference before concluding that the rates charged pursuant to the Facilities Contract adversely affect the public interest. The District argues that deference to the contract may only be overcome in “extraordinary circumstances” when the Commission concludes that the rate “seriously harms the public interest.”⁵ The District further argues that the public interest review is a “threshold test” that must be answered in the affirmative before the Commission’s rate-fixing jurisdiction attaches to wholesale rates. In support of these arguments, the District cites the *City of Fort Worth* case and states that the case adopted the federal public interest review requirement adopted in two U.S. Supreme Court opinions.⁶

The ALJs do not read the *City of Fort Worth* opinion as adopting the federal standard, however. The court mentioned the federal public interest review standard in relation to a different case in which the court decided the scope of the Texas Railroad Commission’s appellate jurisdiction over gas service contracts between a city and a gas pipeline company. The court then drew a distinction between the two cases, noting that unlike the statute applicable in the gas pipeline case, Texas Water Code § 13.043(f) explicitly requires a finding that the rates are not just and reasonable and are unreasonably preferential, prejudicial, or discriminatory prior to modifying the rates.⁷ Therefore, because Texas Water Code § 13.043(f) explicitly included such a finding, there was no need to apply the federal standard by implication and the federal “extraordinary circumstances” standard did not apply in the *City of Fort Worth* case and does not apply here.

The District further argues that the Facilities Contract would be invalidated in the face of an adverse public interest finding, and that the impacts of an invalid Facilities Contract—including the validity of the District’s bonds and the responsibility of the Member Cities to pay such bonds—should be considered by the Commission. The ALJs see no evidence suggesting that the Facilities Contract would be invalidated by an adverse public interest finding. Although the costs among the parties for water purchased may shift, the Member Cities will remain jointly and severally liable for the District’s debts. The Commission signaled its agreement in the Preliminary Order by stating that if the Commission were to “ultimately revise the rates the

⁵ District Exceptions at 14-15.

⁶ District Exceptions at 15.

⁷ *Tex. Water Comm’n v. City of Ft. Worth*, 875 S.W.2d 332, 335-36 (Tex. App.—Austin 1994, writ denied).

[D]istrict charges for water service, the bonds and contracts would nevertheless be valid, enforceable, and binding.”⁸

The District also reurges its “incontestability” arguments. Those arguments were addressed and rejected in the Preliminary Order and are not repeated here. Therefore, the ALJs reject the parties’ exceptions to Preliminary Order Issue No. 4 and recommend no changes to the PFD on that basis.

C. Issue 5 regarding whether the rates the District charges Petitioners for water service adversely affect the public interest.

The District, McKinney, and Frisco & Forney devote extensive portions of their exceptions to the many factors considered in determining whether the protested rates adversely affect the public interest. The ALJs dedicate over 50 pages of the PFD to these issues and will not repeat the analysis here, but will briefly respond to the excepting parties’ novel arguments.

Similar to the District’s arguments that the Factual Background section should include consideration and findings that the District has complied with the contract and applicable law on governance issues (discussed above), the District argues that a conclusion that the District has disparate bargaining power is improper so long as the District complies with the contract and applicable law. The ALJs reject this contention. The Public Interest Rule contains no such requirement and the District has pointed to no law supporting its contention.

The District contends that the ALJs’ discussion on changed conditions that would form the basis for a rate change “amounts to a prohibited finding that the [FY] 2017 rates are not equal to the District’s cost of service.”⁹ As noted by the Preliminary Order, however, the Public Interest Rule does not “preclude the admission of evidence on and consideration of the various costs of the District,” but only precludes “an analysis of the cost of service for the purpose of setting rates.”¹⁰ The ALJs are not setting rates in this PFD and have made no determination as to the District’s cost of service; therefore, the ALJs consideration of the District’s budgeting practices in analyzing this factor is appropriate.

The District argues that the ALJs do not give sufficient weight to the value the District provides as a regional project when considering the Public Interest Rule at subsection (a)(3) regarding monopoly power. Further, the District argues that the regionalization factor is the “*most* important factor under the Public Interest Rule.” In support of this contention, the District cites to the direct testimony of its experts.¹¹ Although District expert Carlos Rubinstein opines

⁸ Preliminary Order at 15.

⁹ District Exceptions at 55-58.

¹⁰ Preliminary Order at 27.

¹¹ District Exceptions at 59 (emphasis in original).

that regionalization is the most important factor, neither the Public Interest Rule, its preamble, nor any other authority supports the contention that regionalization is the most important factor in the rule. Therefore, the ALJs suggest no changes to the PFD regarding this factor.

D. Issue 7 regarding the District's costs to operate and maintain its facilities and systems.

Petitioners request that Finding of Fact No. 96 be amended to clarify the nature of the operating expenses specified. The District did not reply to this issue. The ALJs believe the clarification is useful to avoid confusion and recommend the following change:

96. Based on the District's FY 2017 Comprehensive Annual Financial Report (FY 2017 CAFR), the District's total operating expenses for its entire enterprise (including its water, wastewater, and solid waste systems) for FY 2017 were \$253,691,088. Total operating expenses for the District's water system, based on the FY 2017 CAFR, were \$145,249,620.

E. Issue 14a regarding the total demand for water on an average basis.

The District excepts to the ALJs' calculation of the total demand for water on an average basis. The ALJs based the calculation on the average of the total demand from 2012 to 2017. The District argues that demand from any year other than FY 2017 is not relevant to this case and argues that its calculation of average demand for each customer and the resulting average consumption for member and non-Member City customers for water year 2016 (the water year used to calculate the protested rate) should be used. Petitioners did not reply to this exception. The ALJs recommend no change to the PFD in response to this exception. The Preliminary Order asked for the total demand for water on an average basis, not on a per customer basis.

F. Issue 21 regarding cost allocation between Member Cities and other entities that purchase water from the District.

Petitioners point to a correction necessary in Finding of Fact No. 123 wherein the ALJs included an error in the cost allocation for the Customer Cities, which then affected the total cost allocation. The District did not reply to this exception. After consulting District Exhibit 5 (Direct Testimony of Judd Sanderson), Attachment JRS-7 at page 6 of 7, the ALJs recommend the following change:

123. The Customer Cities' cost responsibilities are reflected in, and limited to, their individual contracts with the District. The few retail customers and raw water purchasers served by the District have the cost responsibilities specified in, and limited to, their original contracts. For the FY 2017 budget, the cost responsibility was allocated as follows:

Water Purchaser	FY 2017 Budget Cost Allocation
Member Cities	\$240,426,209.00
Customer Cities	\$49,026,772.00 \$49,028,772.00
Retail Customers	\$23,000.00
Raw Water Customers	\$3,400.00
TOTAL	\$289,479,381.00 \$289,481,381.00

IV. Conclusion

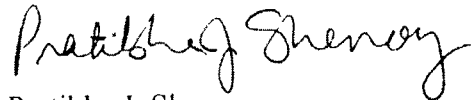
Although the ALJs recommend corrections to Findings of Fact Nos. 39, 96, and 123 as described above, our recommendations on the issues remain the same based on the evidence in the record and the analysis provided in the PFD.

Sincerely,



Holly Vandrovec
Administrative Law Judge

Sincerely,



Pratibha J. Shenoy
Administrative Law Judge

xc: All Parties of Record