



Control Number: 48650



Item Number: 50

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PETITION FOR AN ORDER  
APPOINTING A TEMPORARY  
MANAGER TO BLUE CEREUS, LLC  
WITHOUT A HEARING

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PUBLIC UTILITY COMMISSION  
PUBLIC UTILITY COMMISSION  
OF TEXAS  
FILING CLERK

**COMMISSION STAFF'S MEMORANDUM TO THE COMMISSION REGARDING  
THE LETTER TO BLUE CEREUS FILED SEPTEMBER 5, 2019**

NOW COMES the Staff of the Public Utility Commission of Texas (Commission) and files this memorandum to the Commission regarding the letter to Blue Cereus, LLC (Blue Cereus) filed in this docket on September 5, 2019.

**I. INTRODUCTION**

Blue Cereus is a retail water utility currently under the temporary management of Lynn Sherman in accordance with an emergency order filed by the Commission’s Executive Director on August 14, 2019.<sup>1</sup> He has served as Blue Cereus’s temporary manager since February 26, 2019.<sup>2</sup> A hearing to affirm, modify, or set aside the emergency order is currently scheduled for the Commission Open Meeting on September 12, 2019.<sup>3</sup> Seguro Water Co., LLC and San Pedro Canyon Water Resources (together, wholesalers) are the wholesale water suppliers for Blue Cereus.<sup>4</sup> The wholesalers are not a party to this action.<sup>5</sup>

On September 5, 2019, counsel for the wholesalers filed a letter (Letter) addressed to Mr. Sherman in this docket.<sup>6</sup> Commission Staff has identified several misstated issues in the

<sup>1</sup> Docket 48650, Emergency Order Appointing a Temporary Manager to Blue Cereus, LLC Without a Hearing (Aug. 14, 2019).

<sup>2</sup> Docket 48650, Emergency Order Extending the Term of the Commission Order Appointing a Temporary Manager to Blue Cereus, LLC Without a Hearing (Feb. 26, 2019).

<sup>3</sup> Docket 48650, Order No. 1 Scheduling Hearing and Setting Procedural Schedule (Aug. 19, 2019).

<sup>4</sup> *Request of Seguro Water Company, LLC and San Pedro Canyon Water Resources to Place Blue Cereus, LLC Under Temporary Management or Supervision*, Docket No. 48455, Petition (Jun. 11, 2018).

<sup>5</sup> See Docket No. 48455, Commission Staff’s Motion to Dismiss at 2 (Jun. 29, 2018) (citing TWC §§ 13.412, 13.4131 and 13.4132 which are the provisions within the Texas Water Code addressing the ability to place a utility into receivership, temporary management, or supervision. Commission Staff identified these provisions as falling under Subchapter K of the TWC, which exclusively provide the Commission and, in some instances, the Texas Commission on Environmental Quality (TCEQ) with the ability to place a utility under receivership, temporary management, or supervision.

<sup>6</sup> Docket 48650, Letter to Blue Cereus, LLC Temporary Manager Regarding Wholesale Contracts (Letter) (Sep. 5, 2019).

wholesalers' letter and seeks to clarify the record. Commission Staff therefore files this memorandum, and respectfully asserts the following:

## II. ISSUES REQUIRING CLARIFICATION

### A. Payments to the Wholesalers

Commission Staff acknowledges that Lynn Sherman and the wholesalers have not yet executed a contract for the wholesale supply of water to Blue Cereus; Commission Staff indicated as much in its recent request for an emergency order appointing a temporary manager to Blue Cereus.<sup>7</sup> Commission Staff takes issue with any implication in the Letter, however, that the lack of current written agreement for wholesale water supply has resulted in total nonpayment to the wholesalers during Mr. Sherman's temporary management of the utility.

The Letter states that "[a] signed contract will ensure that my clients are paid for the water they are currently voluntarily providing to Blue Cereus."<sup>8</sup> The unavoidable inference drawn from this statement is that Mr. Sherman has failed to pay the wholesalers for water provided to Blue Cereus since his appointment as temporary manager on February 26, 2019. In reality, Mr. Sherman has made monthly payments to San Pedro Canyon Water Resources and Seguro Water Co. beginning in April 2019 with an initial payment of \$1,878.15 as indicated in the Statement of Cash Flow section of Mr. Sherman's April Temporary Manager Monthly Report.<sup>9</sup>

Mr. Sherman provided additional information about the nature of his payments to the wholesalers in his Temporary Manager's Summary Report filed August 9, 2019.<sup>10</sup> In a section of the report titled "Payments to Wholesalers," Mr. Sherman states that "[s]ince assuming the responsibilities of temporary manager, **we have paid both the base fee and volumetric charges for each invoice submitted by the wholesaler, save and except the most recent month's invoices.**" (emphasis added).<sup>11</sup> Since that time, Mr. Sherman has made monthly base fee payments for each retail system to-date, with the exception of the September 2019 base fee to Seguro Water

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<sup>7</sup> Docket 48650, Commission Staff's Request for an Emergency Order Appointing a Temporary Manager to Blue Cereus, LLC Without a Hearing at 6 (Aug. 14, 2019) ("Blue Cereus and the wholesalers have been unable to resolve the alleged debt owed to the wholesalers, and have been unable to negotiate new agreements for the wholesale supply of water to Blue Cereus.").

<sup>8</sup> Docket 48650, Letter at 2 (Sep. 5, 2019).

<sup>9</sup> Docket 48650, Temporary Manager's Second Monthly Report at 4 (May 2, 2019) (Erroneously titled "second" monthly report); *see also* Response to Submission by Legal Counsel for Seguro Water Co. and San Pedro Canyon Water Resources (Lynn Sherman Response) at 1-2 (Sep. 9, 2019) and Exhibit A to Lynn Sherman Response.

<sup>10</sup> Docket 48650, Temporary Manager's Summary Report (Aug. 9, 2019).

<sup>11</sup> *Id.* at 4.

Co.<sup>12</sup> Due to issues with a discrepancy between wholesale and retail meter readings as described in Mr. Sherman’s monthly reports, temporary manager summary report, and Mr. Sherman’s September 9, 2019 response to the Letter, Mr. Sherman began paying only the monthly base fees for each system as of June 2019 for the La Caleta system and July for the San Pedro system. These base fees are outlined in the written wholesale agreements executed in 2009 which, according to the Letter, are as follows: base monthly flat fee of \$3,400 for wholesale water from Seguro Water Co. and a base monthly flat fee of \$1,100 for wholesale water from San Pedro Canyon Water Resources.<sup>13</sup> Mr. Sherman additionally began making payments toward the debt accrued during Jane Whaley’s<sup>14</sup> time as temporary manager during which no payments were made to the wholesalers at all. According to Blue Cereus’s records as maintained by Mr. Sherman, at a minimum, Blue Cereus has paid **\$36,290.52**<sup>15</sup> to the wholesalers since Mr. Sherman was appointed temporary manager. As Mr. Sherman indicates in his September 9, 2019 response to the Letter, these payments have exceeded the monthly payments by Blue Cereus to the wholesalers for every year dating back to 2008.

<b>Monthly Payments for Lynn Sherman TM Period</b>		
	<b>San Pedro</b>	<b>Seguro</b>
April 2019	<b>\$1,878.15</b> (\$1,100 base + \$778.15 volumetric)	<b>\$4,205.47</b> (\$3,400 base + \$805.47 volumetric)
May 2019	<b>\$2,592.39</b> (\$1,100 base + \$1,492.39 volumetric) <sup>16</sup>	<b>\$4,730.08</b> (\$3,400 base + \$1,330.08 volumetric)

<sup>12</sup> Response to Submission by Legal Counsel for Seguro Water Co. and San Pedro Canyon Water Resources (Lynn Sherman Response) at 1-2 (Sep. 9, 2019) and Exhibit A to Lynn Sherman Response.

<sup>13</sup> See Docket 48650, Attachments to Letter titled “Term Sheet for entry of Agreed Temporary Injunction Order;” Temporary Wholesale Rate Contract Between Seguro (sic) Water Co., LLC and Temporary Manager at 2; and Temporary Wholesale Rate Contract Between San Pedro Water Resources and Temporary Manager at 2.

<sup>14</sup> Ms. Whaley served as the first temporary manager for Blue Cereus from August 30, 2018 until Mr. Sherman replaced her with his appointment as temporary manager in February 2019. During her time as temporary manager, Ms. Whaley failed to consistently issue monthly bills to Blue Cereus customers and did not make wholesale payments. As a result, many customers owed six months-worth of retail bills to Blue Cereus resulting in significant debt to the wholesalers accrued specifically during Ms. Whaley’s time as temporary manager. See Lynn Sherman Response at 1 (Sep. 9, 2019).

<sup>15</sup> See Docket 48650, Lynn Sherman Response at 1-2 (Sep. 9, 2019); see also Exhibit A to Lynn Sherman Response (Please note that Mr. Sherman’s report indicates that a total of \$9,248.97 has been paid to San Pedro Canyon Water Resources; however, his report also indicates that one back-payment of the base fee (\$1,100) has been made for September 2018. Accordingly, Commission Staff believes that a total of \$9,257.97 has actually been paid).

<sup>16</sup> Mr. Sherman’s financial records for Blue Cereus indicate that part of these volumetric charges were actually an overpayment, which was adjusted in the volumetric charges for the month of June.

June 2019	\$1,487.43 (\$1,100 base + \$387.43 volumetric)	\$3,400 base fee
July 2019	\$1,100 base fee	\$3,400 base fee
August 2019	\$1,100 base fee	\$3,400 base fee
September 2019	\$1,100 base fee	\$0 to-date
<b>Totals</b>	<b>\$9,257.97</b>	<b>\$19,135.55</b>

<b>Back Pay for Jane Whaley TM Period</b>		
	San Pedro	Seguro
September 2018	\$1,100 base fee	\$3,400 base fee
October 2018	\$0	\$3,400 base fee
<b>Totals</b>	<b>\$1,100</b>	<b>\$6,800</b>

As demonstrated above, though Commission Staff agrees that a wholesale contract should be negotiated at some point during Mr. Sherman’s temporary management, Commission Staff rebukes any implication that Mr. Sherman is holding payment to the wholesalers hostage by not yet executing such an agreement.

**B. Efforts to Negotiate a Wholesale Contract**

The Letter implies that while counsel for the wholesalers has made exhaustive efforts to negotiate a wholesale contract with Mr. Sherman, these efforts have yielded little to no cooperation from Mr. Sherman:

“During the course of this proceeding, I have provided draft wholesale rate contracts to you *via* e-mail on June 17, July 20, and August 13, 2019. When my clients and I met with you on August 14, I again provided you with drafts of the contracts... To date, you have not provided any proposed modifications to the draft contracts.”<sup>17</sup>

The letter further asserts that the wholesalers “are not obligated to provide water to Blue Cereus” and that the wholesalers

“agreed to work with [Mr. Sherman] to operate under the rates established under the 2009 Wholesale Rate Contracts to provide wholesale potable

<sup>17</sup> Docket 48650, Letter at 1 (Sep. 5, 2019).

water under those rates until new rates can be established and new contracts executed.”<sup>18</sup>

Commission Staff disagrees that Mr. Sherman’s reluctance to sign a wholesale contract mirroring the 2009 agreements demonstrates lack of good-faith negotiation. The Letter and its attached Term Sheet suggest that the wholesalers insist upon wholesale contracts that carry over the monthly flat base fees and volumetric fees set forth in the 2009 wholesale agreements *in addition to* the emergency rate imposing an additional \$20 per month, per connection.<sup>19</sup> The Letter fails, however, to discuss the discrepancies Mr. Sherman has repeatedly raised with the wholesale meter readings and the retail meter readings.

Mr. Sherman’s temporary manager summary report illustrates a genuine concern that water leaks in the wholesale systems have contributed to inaccurate wholesale billing. His report states that a new wholesale meter was installed for the San Pedro system in April 2018, but that it was installed between the wholesaler’s groundwater supply well and its storage tank rather than after the storage tank and at the point of delivery and sale to the retail system.<sup>20</sup> Mr. Sherman identifies the placement of the wholesale meter as “a significant issue because the wholesaler’s storage tank leaks.”<sup>21</sup> He elaborates as follows:

“In fact, some of the leaks during the temporary managership of Blue Cereus have been significant enough to drain the wholesale storage tank to the point of triggering an automatic shutdown of the system. Because the meter is placed before the water enters the wholesale storage tank, the wholesale meter readings for San Pedro Village effectively charge the retail customers for these losses, which (should) not be the case. Moreover, the location of the wholesale meter makes it impossible to accurately determine how much water is actually delivered and sold to the retail system.”<sup>22</sup>

With respect to the wholesale meter at Seguro Water Co., Mr. Sherman’s report acknowledges that the meter was repaired in 2012 after initially improper installation; however, it

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

<sup>19</sup> Docket 48650, Attachment to Letter titled “Term Sheet for entry of Agreed Temporary Injunction Order” at 1 (Sep. 5, 2019) (stating “Before the entry of the Agreed Temporary Injunction Order, Lynn Sherman and the Wholesalers agree in writing on a temporary wholesale rate to be imposed during the temporary management and/or receivership of the Blue Cereus System, which will amount to and include the following [collectively the ‘temporary wholesale rate’]: i. The temporary wholesale rate established in the Wholesalers’ 2009 contracts with Blue Cereus plus the \$20 per connection per month emergency rate [and its associated terms and conditions] granted by the Public Utility Commission in its Order Establishing Emergency Rates, dated September 17, 2018.”).

<sup>20</sup> Docket 48650, Temporary Manager’s Summary Report at 3 (Aug. 9, 2019).

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

has not since been calibrated.<sup>23</sup> Due to discrepancies in the wholesale meter readings and retail meter readings for La Caleta Estates, Mr. Sherman suggests that the wholesale meter requires new calibration.

The effect of these discrepancies relates directly to Mr. Sherman's inability to negotiate the terms of a wholesale contract that are prudent and responsible for both the wholesalers and Blue Cereus's retail customers. As stated in his summary report, Mr. Sherman indicates that "[u]ntil the causes of these disparities and the system-specific issues...are resolved, **it is virtually impossible to determine with any accuracy how much water is actually delivered and chargeable to Blue Cereus and its retail systems and how much may or may not be owed for past deliveries.**" (emphasis added).<sup>24</sup>

Mr. Sherman reiterates this concern in his September 9, 2019 response to the Letter, and additionally highlights that (1) Mr. Sherman has discussed the placement issue of the wholesale meter at San Pedro Canyon Water Resources with the wholesalers but that the wholesalers have yet to relocate the meter to the point of delivery with San Pedro;<sup>25</sup> (2) Mr. Sherman has requested that the wholesalers calibrate the Seguro Water Co. master meter but they have not done so; and (3) the wholesalers have previously committed in sworn affidavits to this Commission to furnishing, installing, operating and maintaining necessary metering equipment at the point of delivery.<sup>26</sup>

In light of these concerns, Commission Staff agrees with Mr. Sherman it would be "imprudent to continue to pay the Wholesalers' volumetric charges, which are predicated on readings of the wholesale master meters."<sup>27</sup> Commission Staff also asserts that until it is determined how much water is actually being supplied to the retail systems it would be imprudent for Mr. Sherman to negotiate a wholesale water contract that includes charges for volumetric usage.

### **C. Emergency Rate Reallocation**

The Commission's emergency order establishing an emergency rate for Blue Cereus issued on September 17, 2018 states that an additional \$20 per connection per month should be charged

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<sup>23</sup> *Id.*

<sup>24</sup> *Id.*

<sup>25</sup> Docket 48650, Lynn Sherman Response at 3 (Sep. 9, 2019).

<sup>26</sup> *Id.* at 2-3 (Sep. 9, 2019) (citing Second Affidavit of Dina Robinson-Ferguson (Mar. 7, 2019)).

<sup>27</sup> *Id.* at 3.

to the retail customers and applied as follows: (a) \$6 per connection per month to be allocated as compensation for the temporary manager, (b) an amount equal to the interest and late fees owed to Seguro Water Co. and San Pedro Canyon Water Resources each month, and (c) the remainder to be allocated towards the current debt owed to Seguro Water Co. and San Pedro Canyon Water Resources each month.<sup>28</sup> This provision effectively requires that \$14 per connection per month be allocated toward paying amounts associated with the alleged back-owed debt claimed by the wholesalers – the alleged debt which initially prompted the wholesalers to file a notice with the Commission threatening Blue Cereus’s water supply, requiring Commission intervention.

Aside from the tenuous validity of the wholesalers’ claimed debt,<sup>29</sup> Mr. Sherman suggests that the \$14 ordered to offset the debt would be better allocated towards paying Blue Cereus’s debts accumulated during temporary management.<sup>30</sup> He specifically cites the outstanding balance that Blue Cereus owes to B&J tractor service for work performed on the La Caleta Estates system which was incurred during the prior temporary manager’s term.<sup>31</sup> If the \$14 per connection monthly fee could be reallocated toward paying Blue Cereus’s debts unrelated to the wholesalers’ claimed years-long balance, Mr. Sherman believes he could pay the amounts owed to B&J within four months.<sup>32</sup> Mr. Sherman also believes that reallocating this money could assist in bringing the San Pedro Village system close to breakeven by compensating the wholesalers for invoices submitted during temporary management.<sup>33</sup> Commission Staff supports Mr. Sherman in this request, and maintains that reallocation of the emergency rate in accordance with Mr. Sherman’s suggestion is in the best interest of the retail customers and would still serve to fairly compensate the wholesalers for their continuing supply of water to Blue Cereus.

### III. CONCLUSION

Commission Staff respectfully submits this response for informational purposes to the Commission, and states support for Mr. Sherman in his temporary management of Blue Cereus.

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<sup>28</sup> Docket 48650, Emergency Order Establishing Emergency Rate at Ordering Paragraph No. 2 (Sep. 17, 2018).

<sup>29</sup> See Lynn Sherman Response at 4 (Sep. 9, 2019) (Mr. Sherman opines that the alleged back-owed debt is not only unsubstantiated, but also highly questionable due to the historical inaccuracy of the wholesalers’ volumetric charges to Blue Cereus. Notably, the Commission did not have knowledge of this historical inaccuracy at the time the emergency rate was established).

<sup>30</sup> *Id.*

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

<sup>32</sup> *Id.*; see also Exhibit I to Lynn Sherman’s Response (Sep. 9, 2019).

<sup>33</sup> *Id.*

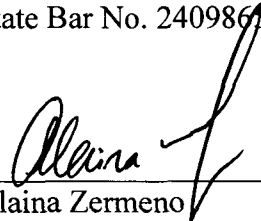


Dated: September 9, 2019

Respectfully Submitted,

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### CERTIFICATE OF SERVICE

I certify that on September 9, 2019, a copy of this document was sent via certified mail, return receipt requested, to the last known address of the headquarters of Blue Cereus, LLC in the Commission's records:

Blue Cereus's Last Known Address in Commission Records:

Blue Cereus, LLC  
4600 Mueller Blvd., Ste. 2121  
Austin, Texas 78723

cc: Steve Dickman  
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Also via email: [sdickmanlaw@att.net](mailto:sdickmanlaw@att.net)

Commission Staff also provided a copy of this document by certified mail, return receipt requested, to San Pedro Canyon Water Resources and Seguro Water Co., LLC:

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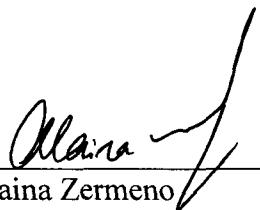
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Commission Staff also provided a copy of this document by certified mail, return receipt requested, to Lynn Sherman:

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