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PUC DOCKET NO. 49189
SOAH DOCKET NO. 473-19-6297.WS

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APPLICATION OF THE CITY OF	§	BEFORE THE STATE OFFICE
AUSTIN FOR AUTHORITY TO	§	
CHANGE THE WATER AND	§	
WASTEWATER RATES FOR NORTH	§	
AUSTIN MUNICIPAL UTILITY	§	
DISTRICT NO. 1, NORTHTOWN	§	
MUNICIPAL UTILITY DISTRICT,	§	OF
TRAVIS COUNTY WATER CONTROL	§	
AND IMPROVEMENT DISTRICT NO.	§	
10, AND WELLS BRANCH	§	
MUNICIPAL UTILITY DISTRICT IN	§	
WILLIAMSON AND TRAVIS	§	
COUNTIES	§	ADMINISTRATIVE HEARINGS

JOINT APPEAL OF INTERIM ORDER NO. 7

North Austin Municipal Utility District No. 1, Northtown Municipal Utility District, Travis County Water Control & Improvement District No. 10, and Wells Branch Municipal Utility District (the “Districts”) and the Staff of the Public Utility Commission of Texas (“Staff”) (collectively, “Appellants”) file this Appeal of Order No. 7 issued by the State Office of Administrative Hearings (“SOAH”) Administrative Law Judges (“ALJs”) on October 14, 2019. Under the Commission’s procedural rules, the Appellants have ten days from the date of the issuance of SOAH Order No. 7 to file an appeal on that interim order.¹ Therefore, the Districts and Staff have filed this Appeal timely. In support of this Appeal, Appellants respectfully show the following:

I. BACKGROUND

On April 15, 2019, the City of Austin dba Austin Water (the “City”) filed a rate application seeking Commission approval to change its water and wastewater rates. Under the requirements of the Texas Water Code (“TWC”), a municipality must obtain Commission approval before the municipality may increase rates that the Commission set as the result of an appeal.² In January 2016, the Commission set the wholesale water and sewer rates that the City may charge the

¹ 16 Tex. Admin. Code (TAC) § 22.123(a)(2).

² TWC. § 13.044(b).

Districts.³ Once those rates were set, both TWC § 13.044 and the Order on Rehearing required the City to receive Commission approval before increasing those rates.

In the prior rate case in Docket No. 42857, the City used the cash needs basis to develop its revenue requirement.⁴ The Districts, who were the petitioners in that case, contended that Water Treatment Plant No. 4 (“WTP4”)⁵ was not used and useful in providing service to the Districts.⁶ In the Order on Rehearing in that matter, the Commission disallowed 14 different cost categories from the City’s revenue requirement, stating those costs categories were not “reasonable and necessary costs for providing water and wastewater services to petitioners.”⁷ One of the disallowed cost categories incorporated all of the costs associated with WTP4, which the Commission excluded from the costs for debt service, debt service coverage, and operations and maintenance expenses recovered through the City’s rates.⁸ The Commission concluded that because the City did not use WTP4 to provide service to the Districts in 2013, “the costs should be excluded from the revenue requirements when setting rates for [the Districts].” The Commission did not have to address the question of whether WTP4 was useful... whether it was prudent to expend funds to construct and operate the plant.⁹ Since the 2013 rate year at issue in Docket No. 42857, the City has begun operations at WTP4,¹⁰ so the City now uses the plant. Thus, the City must now meet its burden to show that WTP4 is useful... whether the City knew or should

³ *North Austin Municipal Utility District No. 1, Northtown Municipal Utility District, Travis County Water Control and Improvement District No. 10, and Wells Branch Municipal Utility District Appealing the Wholesale Water and Wastewater Rates Imposed by the City of Austin*, Docket No. 42857, Order on Rehearing (Jan. 14, 2016).

⁴ Docket No. 42857, Proposal For Decision at 20 (Jul. 10, 2015) (PFD), *adopted in* Docket No. 42857, Order at 2.

⁵ The City of Austin has recently renamed this plant the “Berl Handcox Sr. Water Treatment Plant.” With all due respect to Mr. Handcox, this Appeal will continue to refer to the plant as Water Treatment Plant No. 4 or WTP4 to avoid confusion and ensure consistency between this and prior dockets involving Austin and the Districts.

⁶ Docket No. 42857, Ex.DM-1, at 16-19; Docket No. 42857, Ex. TA-1, at 10-13.

⁷ Docket No. 42857, Order on Rehearing at Finding of Fact No. 52.

⁸ Docket No. 42857, PFD at 45.

⁹ See Docket No. 42857, PFD at 46 (declining to address the broader issue of whether WTP would be used and useful to provide service to the Districts on a going-forward basis).

¹⁰ Docket No. 42857, PFD at 45.

have known at the time it committed to the extra capacity provided by WTP4 that such capacity was unnecessary to meet the City's water treatment needs.¹¹

At issue in this Appeal is whether discovery questions related to the prudence of WTP4 are relevant to this proceeding. In SOAH Order No. 7, the ALJs sustained the City's objection to responding to any questions about the prudence of constructing the plant.

In their Sixth Request for Information ("RFI") to the City, the Districts asked four questions that dealt with WTP4, to which the City objected solely on the basis of relevancy. The ALJs sustained the City's objections and denied the District's Motion to Compel, concluding that a prudence review of WTP4 was beyond the scope of this proceeding.¹² Appellants respectfully disagree and file this Appeal of SOAH Order No. 7 to the Commission. With all due respect, the ALJs' ruling was unjustified and immediately prejudiced a substantial or material right of the Appellants, in addition to materially affecting the course of this hearing.

II. ARGUMENT

Under the Commission rules and the Texas Rules of Civil Procedure, a party may obtain discovery regarding any matter not privileged and relevant to the subject matter of the pending action, and a party may obtain discovery of information reasonably calculated to lead to the discovery of admissible evidence.¹³ The Districts served RFI Nos. 6-4 through 6-7, which related to the City's decision to construct WTP4 as follows:

DISTRICTS' REQUEST TO CITY 6-4. Please identify all documents provided in *Application of AW for Authority to Change Water and Wastewater Rates*, (April 15, 2019), that would permit a prudence evaluation to be conducted on WTP4 debt service and capital costs.

DISTRICTS' REQUEST TO CITY 6-5. Please provide AW's original economic analysis supporting the construction of WTP4, along with any updated analyses that were performed to assess the impact of changing conditions on the original decision to construct the facility. If no such analyses were performed, please so state.

¹¹ See *Gulf States Util. Co. v. Pub. Util. Comm'n of Tex.*, 841 S.W.2d 459, 477 (Tex. App.—Austin 1992, writ denied).

¹² SOAH Order No. 7 Ruling on Districts' Motions to Compel Austin Water to Respond to Districts' Sixth, Seventh, and Eighth RFIs, and Discussing Motions Pending for Sanctions at 4 (Oct. 14, 2019) (SOAH Order No. 7).

¹³ Tex. R. Civ. Proc. 192.3; 16 TAC § 22.141(a).

DISTRICTS' REQUEST TO CITY 6-6. Please describe in detail and identify and produce all documents concerning all alternatives to constructing WTP4 that were considered, including the costs of those alternatives.

DISTRICTS' REQUEST TO CITY 6-7. Provide the results of any sensitivity analyses that evaluated the construction of WTP4 versus other alternatives.¹⁴

Because (1) the rates charged to the Districts must be just and reasonable, and (2) the City must base the revenue requirement on costs that are reasonable and necessary to provide service to the Districts, the Districts were inquiring whether the costs associated with WTP4 were reasonable or necessary ... whether the City's decision to spend the funds to increase the City's water treatment capacity was prudent.

The Commission should reverse the ALJs ruling sustaining AW's objections to District RFI Nos. 6-4 through 6-7, because the prudence of AW's capital investments is relevant to this proceeding. The legal standard for determining prudence in an electric rate case is well established:

Prudence is the exercise of that judgment and the choosing of one of that select range of options which a reasonable utility manager would exercise or choose in the same or similar circumstances given the information or alternatives available at the point in time such judgment is exercised or option is chosen.¹⁵

This standard is derived from the statutory requirement that the burden of proof to show that a rate change is just and reasonable lies with the public utility.¹⁶ The Austin Court of Appeals has concluded that this standard explicitly incorporates the reasonableness of a utility while implicitly recognizing that expenses must be necessary.¹⁷ The specific circumstances of a case will determine what is prudent, reasonable, and necessary, and there may be more than one prudent option in a range of available options considered by a utility.¹⁸ A utility may establish prudence

¹⁴ Districts' Sixth Request for Information to City of Austin dba Austin Water at 6-7 (Sep. 11, 2019).

¹⁵ *Gulf States*, 841 S.W.2d at 475.

¹⁶ PURA § 36.006; *Gulf States*, 841 S.W.2d at 475.

¹⁷ *Nucor Steel v. Pub. Util. Comm'n of Tex.*, 26 S.W.3d 742, 748 (Tex. App. Austin 2000, pet. denied).

¹⁸ *Id.* at 749; *Application of Southwestern Electric Power Company for Authority to Change Rates*, Docket No. 46449, Conclusion of Law No. 16 (Mar. 19, 2018).

using contemporaneous evidence of its decision making process or a retrospective analysis; however, the retrospective analysis is “inherently defensive and hence more suspect.”¹⁹

The City filed this case pursuant to TWC § 13.044, which includes a very similar provision to PURA § 36.006 as follows: “...the municipality shall have the burden of proof to establish that the rates are just and reasonable.” Additionally, Issue No. 8 from the preliminary order adopted by the Commission in this proceeding expressly asks: “What is the reasonable and necessary cost of providing water and sewer service to the districts?”²⁰ Thus, the two fundamental tenets of ratemaking that form the foundation of the prudence analysis—just and reasonableness of the rate change and reasonableness and necessity of expenses—are present in this case.

The preliminary order also put the prudence of WTP 4 directly at issue stating the following:

Does the City's proposed revenue requirement in this docket include any category of cost that in Docket No. 42857 the Commission disallowed because it was not a reasonable and necessary cost of providing water and wastewater services to the districts?²¹

As discussed above, the Commission previously found all costs associated with WTP4 to be unreasonable or unnecessary for the provision of water service to the Districts. In this pending docket, the City has again included costs for WTP4 in the rates requested. In doing so, the City has put the costs of WTP4 at issue. Whether the City believes it is “under no obligation to seek Commission approval of its invested capital”²² is unimportant. The City must prove that WTP4 costs are reasonable and necessary to justify the inclusion of those costs in the revenue requirement. By the City’s own attempt to recover costs that the Commission previously disallowed, the reasonableness and necessity of the cost of WTP4 became a central issue in this matter.

¹⁹ *Gulf States*, 841 S.W.2d at 476.

²⁰ Preliminary Order at Issue No. 8 (Aug. 8, 2019) (PO).

²¹ PO at Issue No. 3 (citing Docket No. 42857, Order on Rehearing at Finding of Fact No. 52).

²² Austin Water’s Objections to Districts’ Sixth Request for Information at 4-7 (Sep. 23, 2019) (AW Objections).

In making their decision, the ALJs' relied on the City's argument that permitting a review of the prudence of WTP4 opens the door to a prudence review of each and every asset owned by the City.²³ That is simply not the case. The Districts made discreet requests for information about WTP4 only. As discussed above, WTP4 has become operational since the rate year in question during the prior case. Therefore, an analysis of WTP4 costs and whether it was prudent for the City to add that capacity is now ripe for Commission consideration. Additionally, both Staff and the Districts had the opportunity to challenge the prudence of the City's assets that were in service by the end of the test year in Docket No. 42857 (the City's fiscal year 2013: October 1, 2012 through September 30, 2013).²⁴ Consequently, it would be reasonable to limit the scope of the prudence review allowed in this proceeding to those assets that the City placed into service on or after October 1, 2013. This limited review is the common practice in both electric retail base rate cases²⁵ and electric wholesale base rate cases for transmission service providers,²⁶ the definition of which includes municipally-owned utilities.²⁷

The ALJs' ruling on the relevance of the information sought in District RFI Nos. 6-4 through 6-7 was also based on the conclusion that "because [Austin Water] is a cash-needs retail public utility, there is no prudence review of its capital investments."²⁸ In support of this conclusion, the ALJs looked to 16 TAC § 24.75(c) as instructive even though the rule is not applicable to the City.²⁹ Dismissing the reference to "prudently incurred debt service," the ALJs

²³ SOAH Order No. 7 at 4.

²⁴ Docket No. 42857, Order on Rehearing at Finding of Fact No. 17.

²⁵ See, e.g., *Application of CenterPoint Energy Electric Houston, LLC for Authority to Change Rates*, Docket No. 49421, Proposal for Decision at 14 ("In this case, CenterPoint's requests include (1) a prudence determination on all capital investments it made between January 1, 2010, and December 31, 2018..."); see also, *Petition by Homeowners United for Rate Fairness to Review Austin Rate Ordinance No. 20100607-055*, Docket No. 40627, Preliminary Order at Issue No. 10 (Nov. 16, 2012) ("What amount, if any, of the utility's invested capital used to determine the utility's reasonable cash needs has not previously been subject to prudence review? If there are any such amounts, what are the amounts, for what facilities, property, or equipment was the investment made, and were the amounts prudently incurred?").

²⁶ See 16 TAC § 25.192(h) (requiring the Commission to review "the costs of the interim transmission plant additions [made by a TSP] to determine if they were reasonable and necessary" at the next complete review of the TSP's transmission cost of service).

²⁷ 16 TAC § 25.5(140).

²⁸ SOAH Order No. 7 at 3.

²⁹ *Id.*

focused on the fact that the rule does not reference the review of past capital investments.³⁰ However, this reasoning overlooks the reality that debt service can only be prudently incurred if the decision to construct the asset necessitating the issuance of the debt was prudent.

As explained above, the Commission in Docket No. 42857 disallowed the City's costs for WTP4 even though the City was also using the cash basis for determining its rates at that time. Whether a utility uses the cash basis or the utility basis for determining its revenue requirement is unrelated to the determination of whether the costs included in the revenue requirement were reasonable and necessary in the establishment of just and reasonable rates. Moreover, the revenue requirement for a utility that uses the cash basis for accounting may include debt service,³¹ and the debt service the City will recover through the rates requested in its application includes debt issued to fund WTP4. Accordingly, District RFI Nos. 6-4 through 6-7 are relevant to this proceeding, because the City must demonstrate the prudence of its \$500 million decision to construct WTP4 in order to establish that the amount of debt service related to this project and included in its requested rates is a reasonable and necessary cost.

Another weakness in the ALJ's decision is their reliance on the City's unsubstantiated prefiled testimony, which the City has not yet offered into evidence, and is subject to objections up until November 1, 2019. The ALJs stated that City witnesses claimed that WTP4 is now "used and useful."³² Appellants will have the opportunity to file testimony demonstrating that WTP4 is not now nor will it ever be "used and useful" for providing service to the Districts. Therefore, the Commission does not have a fully-developed record on the issue of whether WTP4 is useful ... which is one of the questions germane to this case.

Finally, in its objections to the Districts' RFIs, the City also argued that a prudence review is beyond the scope of this proceeding because the Commission does not have ongoing jurisdiction over the utility's rates.³³ While the Commission does not have ongoing *original* jurisdiction, the

³⁰ *Id.*

³¹ Docket No. 42857 at Conclusion of Law No. 16 (citing to *Black v. City of Killeen*, 78 S.W.3d 686, 694 (Tex. App.—Austin 2002, pet. denied).

³² SOAH Order No. 7 at 4.

³³ AW Objections at 5.

City's rates are always subject to the Commission's appellate jurisdiction under TWC §§ 13.043(b) and 13.044. Although both sections call for a de novo review by the Commission, TWC § 13.043(b) restricts the Commission to considering "only the information that was available to the governing body at the time the governing body made its decision and evidence of reasonable expenses incurred by the retail public utility in the appeal proceedings," while TWC § 13.044 does not.³⁴ Also in contrast to TWC § 13.043(b), the Legislature has determined that original jurisdiction is warranted when the municipality desires to change the rates fixed by the Commission as a result of an appeal under TWC § 13.044.³⁵ Given the breadth of the authority granted to the Commission following an appeal under TWC § 13.044, it is reasonable to conclude that the Legislature intended for a full and robust review of a municipality's rates, including a prudence review of any capital investments the costs of which are included in the debt service recovered through those rates.

This case was referred to SOAH on July 22, 2019,³⁶ and a hearing on the merits is currently scheduled to begin on December 4, 2019. Because of the short procedural schedule, the Districts had limited time to seek discovery and synthesize the tens of thousands of pages of information produced by the City. The Districts have filed motions to compel in their effort to get the City to respond to questions like the one regarding WTP4.³⁷ The ALJs ruling, further delaying the production of relevant evidence necessary for the preparation of the Districts' direct case, immediately prejudices a substantial or material right of the Districts. Finally, the absence of information about WTP4, which the City itself resurrected and put at issue and which the Preliminary Order identified as an issue the ALJs must address, could materially affect the course of this hearing.

³⁴ TWC § 13.043(e).

³⁵ *Id.* § 13.044(b).

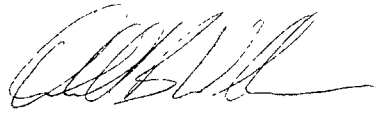
³⁶ Order of Referral at 1 (Jul. 22, 2019).

³⁷ The City has not objected to any of the discovery propounded by Staff, and Staff has agreed to withdraw its RFIs related to prudence with the opportunity to re-issue them should the Commission rule in the Appellants' favor.

II. PRAYER

WHEREFORE, PREMISES CONSIDERED, Appellants pray that the Commission grant this appeal of interim SOAH Order No. 7 and direct the City to answer District RFI Nos. 6-4 through 6-7, and grant Appellants other such relief to which they may be entitled.

Respectfully submitted,



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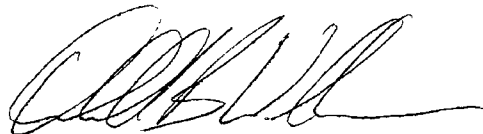
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CERTIFICATE OF SERVICE

I hereby certify that I have served or will serve a true and correct copy of the foregoing document via hand delivery, facsimile, electronic mail, overnight mail, U.S. mail, or Certified Mail Return Receipt Requested to all parties on this the 24th day of October 2019.



Randall B. Wilburn