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

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| APPLICATION OF THE CITY OF AUSTIN DBA AUSTIN WATER FOR AUTHORITY TO CHANGE WATER AND WASTEWATER RATES | § § § § | BEFORE THE PUBLIC UTILITY COMMISSION OF TEXAS |
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**CITY OF AUSTIN D/B/A AUSTIN WATER'S
RESPONSE TO JOINT APPEAL OF
INTERIM ORDER NO. 7**

TO THE HONORABLE PUBLIC UTILITY COMMISSION OF TEXAS:

COMES NOW, the City of Austin (City) d/b/a Austin Water (AW or Austin Water) and files this Response to the Joint Appeal of Interim Order No. 7 (Appeal) filed on October 24, 2019. Pursuant to 16 Tex. Admin. Code (TAC) § 22.123(a)(4) a response to an appeal of an interim order is due within five working days of the filing of the appeal. Therefore, this response is timely filed. For the reasons contained in Austin Water's initial objections and in this response, the Public Utility Commission (Commission) should deny the Appeal.

I. BACKGROUND / INTRODUCTION

After an extended proceeding, the Commission established AW's wholesale water and wastewater rates for 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 (collectively Districts) after they appealed AW's rates in Docket No. 42857.¹ The Commission also ordered AW not to increase wholesale water and wastewater rates applicable to the Districts without prior Commission approval. The Application of the City of Austin d/b/a Austin Water for Authority to Change Water and Wastewater Rates (Application) in this matter is in response to the Commission's Order on Rehearing in Docket No. 42857.

¹ See *Petition of the 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 from the Ratemaking Actions of the City of Austin and Request for Interim Rates in Williamson and Travis Counties*, Docket No. 42857, Order on Rehearing (Jan. 14, 2016).

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Prior to considering the merits of the Appeal, it is important for the Commission to consider the case before it in a broader context. As mentioned previously, this case is unique in many material and fundamental aspects.

1. Austin Water is a non-profit municipally-owned utility (MOU) that does not earn a regulatory established rate of return like an investor-owned utility (IOU).

2. Austin Water utilizes a cash-needs methodology, rather than a return method, to establish its revenue requirement. The cash-needs approach does not rely upon rate base as a means of setting rates. The Commission has previously approved the use of such method for MOUs generally and the City of Austin specifically.²

3. After the Commission establishes rates in an appeal by a special district, 16 TAC § 24.45(c) states that “a municipality desiring to increase rates must provide the commission with updated information in a format specified in the current rate data package developed by the Rates Section.” Unfortunately, the Commission has not developed a rate data package for this proceeding. Accordingly, pursuant to direction from the Commission’s Rates Section, Austin Water used the Class A Investor-Owned Utilities Water and/or Sewer Rate Filing Package for Cost-of-Service Determination (Class A RFP) in the preparation of this Application. Nevertheless, Austin Water is not normally subject to the Commission’s requirements for Class A Water Utilities. Significantly, large portions of the Class A RFP are irrelevant to Austin Water. For example, large sections of the Class A RFP relating to rate of return, capital structure, depreciation, federal income taxes, affiliate expenses, rate design for retail customers and invested capital simply do not apply to a cash-needs MOU.³ An index identifying those schedules that are not applicable as well as explanations why they are not applicable was included in the Application.

² See e.g. *Application of City Austin d/b/a Austin Energy to Change Rates for Wholesale Transmission Service*, Docket No. 31462, Order at 2 (Jun. 9, 2006).

³ Despite the obvious challenges of trying to file an application using an RFP for Class A utilities, AW and its consultants endeavored to respond to the RFP to the fullest extent possible. For example, AW does not use the NARUC chart of accounts for its own accounting, and therefore, did not use it in this case. However, AW does have a similar chart of accounts method that provides a level of detail which is consistent with the NARUC system and provided that to the parties.

4. The Commission's jurisdiction over MOUs is limited to appellate review of rates and services charged to customers residing outside the city, and to certain special districts. As such, unlike an IOU, a MOU is not required to obtain Commission approval before or after making capital investment or before including the associated costs in rates.

5. This case is the first instance in which a utility has filed for approval of rates following the filing of a challenge to its rates. As a result, there is no precedent as to how such a case is to be processed. The Commission has, however, considered numerous other MOU appeal cases, including Docket No. 42857, and never conducted a review of invested capital in those cases.

6. The requested rate increase of \$3,179,475 impacts just four wholesale customers.

7. Neither the Commission nor the Legislature has adopted any procedural or substantive laws or rules directing the processing of this case.⁴ For example, the law contains no jurisdictional deadlines or express authority for the Commission to set rates.⁵ Additionally, there is no indication as to the standard of review or scope of review in a Section 13.044(b) "follow up" proceeding.

With regard to the specific discovery requests at issue in this Appeal (i.e. Districts RFI Nos. 6-4 through 6-7), Austin Water objected to responding because Districts sought information that is not relevant to the subject matter of the proceeding, as is required by 16 TAC § 22.141(a). Specifically, Districts' questions relate to the prudence of the Berl Handcox Water Treatment Plant (Handcox WTP)(formerly Water Treatment Plant No. 4). Such a review is beyond the scope of this case and would require significant time and effort. There are literally hundreds of thousands of pages related to the Handcox WTP. Austin Water is under no obligation to retain those

⁴ The Commission did adopt a Preliminary Order in this matter on August 8, 2019. That Order, however, does not mention prudence, rate base, return, or invested capital. Additionally, the Commission has adopted alternative rate methods that include the cash needs method in 16 TAC § 24.75(c), but that rule applies only to retail service.

⁵ Austin Water met with Commission Staff twice prior to the filing of this application in an attempt to obtain guidance as to what materials to include with the filing, what RFP to utilize, and how to address such issues as rate case expenses and invested capital.

documents or otherwise defend the construction of the facility. Although there are portions of the Application that support the reasonableness of Austin Water's investment in the Handcox WTP, neither the law, the Commission's rules, Commission precedent, the Order in Docket No. 42857, nor ratemaking principals for a cash-needs utility dictate that Austin Water obtain a prudence finding with respect to its debt service or capital costs related to the Handcox WTP or any of Austin Water's invested capital.⁶

After considering extensive arguments, the State Office of Administrative Hearings (SOAH) Administrative Law Judges (ALJs) determined in SOAH Order No. 7 that "prudence review is beyond the scope of this proceeding."⁷ The ALJs based their ruling on the fact that a prudence review of invested capital is not relevant to a cash-basis utility, and the Commission's Order in Docket No. 42857.⁸ As noted, neither the Commission, nor the ALJs in Docket No. 42857 mentioned or referenced a prudence review of Austin Water's invested capital. Additionally, the Commission has never required a prudence review of invested capital in an appeal of a MOU's rates. Finally, no party directly raised these issues in their filings establishing the scope of this proceeding.

In summary, the factors described above require a different perspective than if Austin Water was an IOU. It is against this backdrop the Commission should consider this appeal.

II. ARGUMENT

As a municipally-owned utility, Austin Water is not normally subject to the Commission's requirements for Class A Water Utilities. Indeed, the Commission's jurisdiction over Austin Water is limited to appeals by outside city customers and wholesale customers. As such, Austin Water is not typically obligated to seek Commission approval of its rates except in limited

⁶ Because the Commission found in Docket No. 42857 that the Handcox WTP was not in service at the time that rates were set for the Districts, Austin Water included limited testimony in the Application verifying that the plant is now operational.

⁷ SOAH Order No. 7 at 4 (Oct. 14, 2019).

⁸ *Id.*

circumstances.⁹ Significantly, unlike investor-owned utilities, Austin Water is under no obligation to seek Commission approval of its invested capital (i.e. rate base).

In the event the Commission were to determine that Austin Water is obligated to justify its invested capital it would logically mean all invested capital going back to the Commission's decision in Docket No. 42857 would be subject to review. There are two problems with this reasoning, however, that highlight the failings in the Districts' argument. First, the Districts have made it clear in their discovery and argument that they are only interested in the Handcox WTP. Even if Austin Water were obligated to present prudence evidence, there is no basis to single out that one investment.

Austin Water has water and wastewater facilities, some of which have been in service for over 60 years. For example, the Davis Water Treatment Plant was built in 1954 and the Ulrich Water Treatment Plant was built in 1969. Because of the Commission's limited jurisdiction over Austin Water, AW was not required to get Commission approval of that investment. Other invested capital whose entire service life occurred prior to this case were also never subject to the same scrutiny. For example, the Green Treatment plant went into service in 1924. It was decommissioned in 2008 without any prudence review because no such review is required. If the Districts are successful in their Appeal, Austin Water would be required to retain information on these facilities justifying the prudence of their capital investment—despite never having an obligation to seek regulatory approval—simply because of the *possibility* of an appeal.¹⁰ The Districts are attempting to use this appeal as an opportunity to conduct a full prudence review of Handcox WTP. However, it makes no sense to arbitrarily assert five months into the proceeding

⁹ Indeed, because Austin Water is typically under no obligation to substantiate its invested capital there is no obligation to retain any of the records or other documents related to the decision to acquire assets or the costs. Moreover, Austin Water is not obligated to consider alternatives or otherwise defend its “decisional prudence” as an IOU would.

¹⁰ Significantly, the Commission has never subjected any MOU to such a test including in Docket No. 42857. If such a review were required, logically, the Commission would have made Austin Water present such evidence in that case. It did not however. In setting rates in Docket No. 42857, without any examination of invested capital, the Commission approved all of Austin Water's invested capital in service at the time of that decision.

that one investment is subject to a special review.¹¹ Not only are such efforts irrelevant, they would also be overly burdensome and harassing.

Secondly, Austin Water uses the “cash needs” method to establish its return dollar requirement; therefore, rate base is not relevant in the same manner that it is for an IOU. For MOUs, the rate of return is often said to be a “fall-out” value because the amount of return dollars is typically determined on the basis of a coverage method, and the resulting amount is divided by the utility’s rate base. For these types of entities, the rate of return is simply a mathematical consequence (rather than a driver) of the process. While debt service coverage is subject to a reasonableness review, Austin Water’s invested capital is not subject to a prudence review.

In contrast, return dollars for an IOU are computed by determining a market-based rate of return and then multiplying this figure by the rate base. Because Austin Water uses the “cash flow” method, it does not depend on the precise amounts of invested capital as the market based rate of return method used by utilities; therefore, the cost of planning, developing, and constructing is not relevant to whether the rates established by Austin Water are just and reasonable.

In a three year proceeding that spanned two agencies, Docket No. 42857 never addressed the prudence of Handcox WTP, or any of Austin Water’s invested capital. The Commission approved Austin Water’s debt service coverage in Docket No. 42857, and only disallowed the costs associated with Handcox WTP because it had not yet been placed in service. The Commission went to great lengths to describe the elements of the revenue requirement for a cash-basis utility, without including the prudence of capital investments. The Commission even adopted a conclusion of law about the cash-needs basis without including prudence of capital investments.¹² It is clear that the Commission did not conduct a prudence review concerning any of Austin Water’s invested capital, and its Order on Rehearing did not reflect any finding regarding

¹¹ Even if the Commission finds that Handcox WTP is subject to a prudence determination, it isn’t clear what specific investment is being referred to. Handcox WTP consists of the treatment plant itself, an intake valve in Lake Travis, a raw water tunnel and pump station, the Jollyville Transmission Main, and other investment.

¹² Docket No. 42857, Conclusion of Law No. 16 (citing *Black v. City of Killeen*, 78 S.W.3d 686, 694 (Tex. App.—Austin 2002, pet. denied)).

the prudence of any of Austin Water's invested capital. Additionally, Austin Water has not identified a single docket where the Commission reviewed the prudence of a MOU's invested capital. Finally, in Docket No. 40627, regarding Austin Energy's rates, Commission Staff and all parties agreed that a prudence determination on invested capital was inappropriate for the same reasons that it is inappropriate in this case.¹³

In their Appeal, the parties provide little basis for permitting their requested discovery. Significantly, they cite no statute, rule or case requiring a review of a MOU's invested capital. Moreover, parties have had the Application since April 15, 2019. Despite sufficient time to review the filing, no party suggested that the Application was insufficient with respect to this issue. For example, in their list of issues the Districts included no reference to rate base, prudence or invested capital. They mention Handcox WTP twice but only in a list of other items that were disallowed in Docket No. 42857. Similarly, Commission Staff made no reference to rate base, prudence, or invested capital in their list of issues. Instead, Commission Staff stated that the list of issues for this proceeding should be the same as those incorporated in the Commission's Preliminary Order in *Application of Monarch Utilities I, L.P. for Authority to Change Rates*, Docket No. 45570 (March 25, 2016). Although that Order addresses invested capital, it clearly applies to an IOU and provides little guidance for this case. Commission Staff also filed a detailed Recommendation on Administrative Completeness on May 16, 2019, recommending that additional information related to *fifteen* issues be submitted. Notably, the list did not contain any data related to rate base or prudence. The Districts did not file a pleading suggesting the filing was materially deficient. Finally, although Austin Water mentioned this issue at the August 7, 2019 prehearing, no party set forth a position on these issues.

¹³ *Petition by Homeowners United for Rate Fairness to Review Austin Rate Ordinance No. 2012607-055*, Docket No. 40627 (Apr. 29, 2013).

III. CONCLUSION

Austin Water respectfully requests that the Joint Appeal of Interim Order No. 7 be denied, that SOAH Order No. 7 be affirmed, and that Austin Water be granted any other relief to which it may be entitled.

Notwithstanding the foregoing arguments, in the event the Commission grants the Appeal, Austin Water respectfully requests a stay of the procedural schedule and leave to file supplemental testimony addressing the merits of the issues raised by the Appeal. Additionally, Austin Water requests the Commission permit Austin Water to implement interim rates until the Commission establishes final rates.

Respectfully submitted,

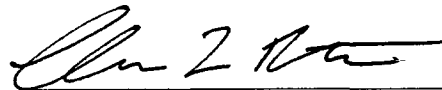
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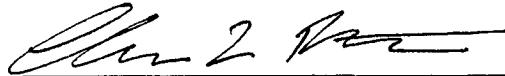
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ATTORNEYS FOR AUSTIN WATER

CERTIFICATE OF SERVICE

I hereby certify that on October 31, 2019, a true and correct copy of the foregoing document has been served on all parties of record via electronic mail.

A handwritten signature in black ink, appearing to read "Chris L. Brewster", written over a horizontal line.

CHRISTOPHER L. BREWSTER