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PETITION BY OUTSIDE CITY § BEFORE THE STATE OFFICE OF
RATEPAYERS APPEALING THE § PUBLIC UTILITY COMMISSION
WATER RATES ESTABLISHED BY § FILING CLERK
THE CITY OF CELINA § ADMINISTRATIVE HEARINGS

CITY OF CELINA'S INITIAL BRIEF IN OPPOSITION TO INTERIM RATES

TO THE HONORABLE ADMINISTRATIVE LAW JUDGE:

COMES NOW, the City of Celina, Texas (the "City") and files this brief on the issue of interim rates and would respectfully show as follows:

I. SUMMARY

Petitioners have requested interim rates in this case, essentially arguing that the City's rates for customers outside the City limits are arbitrarily higher than the rates for the customers inside the City limits. In fact, the rates for customers both inside the City as well as outside the City are all based on their costs and represent just and reasonable rates for all. The City has already provided a lengthy, thorough rate and cost study establishing this fact.

The Commission may only set interim rates where the proposed increase in rates could result in an "unreasonable economic hardship on the utility's customers."¹ Petitioners' factual arguments in support of this fundamental requirement are notably absent. The fact is the rates will not result in an economic hardship on the customers. The City has only raised the rates by

¹ 16 TAC § 24.37 (d) ("Interim rates may be established by the commission in those cases under the commission's original or appellate jurisdiction where the proposed increase in rates could result in an unreasonable economic hardship on the utility's customers, unjust or unreasonable rates, or failure to set interim rates could result in an unreasonable economic hardship on the utility.") This legal standard is consistent with the stated purpose of the State's regulatory scheme, as set forth in the Texas Water Code, to establish a regulatory system that ensures that rates, operations and services of retail public utilities "are just and reasonable to the consumers and to the public utilities," thus balancing the interests of both consumers and providers of utility services. (See Tex. Water Code. Ann. § 13.001 (West 2008 and Supp. 2014) (TWC)).

approximately 3% for each class of customers.² The City, on the other hand, would suffer important economic hardship if interim rates are ordered.

The City's economic hardship begins with the fact that the rates in question do not fully recover the City's costs until after the *third year* after the scheduled rate increases have taken effect. Regardless of whether the ALJ would set interim rates at the City's immediately prior rates or at the new rate level but requiring the City to set aside the increased revenue into escrow during the pendency of this case, both scenarios would exacerbate the problem of the City's rates being below cost because it immediately removes a critical revenue stream. Such a loss of revenue during the pendency of this case would likely lower the City's debt coverage, which in turn could lower the City's credit rating. A lower credit rating would increase the risk that lenders would assign to the City's debt, which would result in higher debt costs to the City. This would be a serious economic hardship for the City if interim rates were imposed.

Finally, the Petitioners apparently are seeking an illegal level of interim rates, implicitly requesting an interim rate level of 50% lower, far below the rates in effect immediately prior to the new rates. The Commission's rule on interim rates is clear on this issue. Interim rates must be "not lower than the authorized rates prior to the proposed increase nor higher than the requested rates."³ This language is unambiguous and is not subject to the presiding officer's discretion. This is the floor for interim rates in this case.

II. THERE IS NO UNREASONABLE ECONOMIC HARDSHIP TO PETITIONERS

The actual real-world impact to Petitioners is extremely small. For example, the new rates for residential customers who reside inside the City who use 5,000 gallons of water and wastewater

² See City of Celina, Tex., Ordinance No. 2019-08, Exhibit A (2019).

³ 16 TAC § 24.37 (e)(1) ("In making a determination under subsection (d) of this section, the commission may limit its consideration of the matter to oral arguments of the affected parties and may: (1) set interim rates not lower than the authorized rates prior to the proposed increase nor higher than the requested rates"). The Administrative Law Judge has declined to hold an evidentiary proceeding, so this section controls.

service would pay approximately \$80.43 per month. (This does not include taxes, solid waste or other peripheral charges.) This represents an increase of \$3.08 per month. A residential customer who is outside the City who uses 5,000 gallons pays \$100.17 for this service, an increase of \$3.66. This does not constitute an unreasonable economic hardship that warrants the imposition of interim rates to the serious detriment of the City.

III. INTERIM RATES WOULD CAUSE UNREASONABLE ECONOMIC HARDSHIP ON THE CITY

As explained earlier, a loss of revenue associated with interim rates during the pendency of this case would likely lower the City's debt coverage, which in turn could lower the City's credit rating. A lower credit rating would increase the risk that lenders would assign to the City's debt, which would result in higher debt costs to the City.

In addition to the substantial harm that interim rates would cause for the City's access to debt, interim rates would also cause significant harm to the City's ability to fund critical infrastructure improvements associated with the area's rapid growth and development.⁴ This is a critical time in the City's growth in which a sudden reduction in revenues brought on by interim rates would wreak havoc on the City's ability to prepare for infrastructure needs in the near and distant future.

IV. NON-APPEALABLE NATURE OF INTERIM RATES MAGNIFIES HARM TO THE CITY

Petitioners sought interim rates without factual support in their First Amended Petition.⁵ At the first prehearing conference in this case, the Administrative Law Judge (ALJ) requested

⁴ Population for the City and its broader utility service area grew from approximately 6,000 in 2010 to an estimated 22,000 in 2020, and is projected to more or less continue doubling each decade over the next 30 years to reach an estimated population of 143,425 by 2050. See "Celina" at https://www3.twdb.texas.gov/apps/reports/Projections/2022%20Reports/pop_WUG_Search. Furthermore, the Texas Water Development Board currently projects that the City's annual municipal water demand will reach 4,716 acre feet in 2020, then more than double over the coming decade to reach 9,889 acre feet in 2030, then roughly double in each of the following decades to reach 18,303 acre feet in 2040 and 30,828 acre feet in 2050. See "Celina" at https://www3.twdb.texas.gov/apps/reports/Projections/5-demand_city.

⁵ First Amended Petition at 3,4 (March 15, 2019).

briefing on the matter of interim rates. It is important to note that an interlocutory order on interim rates is, by rule, non-appealable.⁶ Therefore, the gravity of the matter at hand and the serious economic hardship that would befall the City if interim rates were imposed can not be overstated. It is equally important to note that a key function of interim rates is to ameliorate the adverse impacts of administrative delay. In this case, the adverse impacts of administrative delay are being directly addressed by both the ALJ, in setting an expeditious procedural schedule (that is acceptable to the Petitioners) and the City, which stands ready to quickly issue any refunds that are ordered by the Commission at the conclusion of this case should the City's new rates be ordered to be lowered. Taken together, these actions already ameliorate the adverse impacts of administrative delay, however small, obviating the need for interim rates.

V. THE RATES ARE COST-BASED, NOT BASED ON ANY "MULTIPLIER"

Petitioners' bare assertion that higher rates outside the City are based on a "multiplier," implying that they are arbitrary, is not only completely unsubstantiated, but entirely false. The City has provided in voluminous discovery, a complete, detailed rate study showing that the rates match the costs of providing service to each class of customers. The higher rates for customers residing outside the City are based on higher costs to provide them service.

Petitioners' primary argument implies that *any* differentiation among ratepayers on the basis of location is *per se* unreasonably discriminatory, preferential or prejudicial – an argument that has no basis in law and contravenes basic ratemaking principles. Petitioners enthusiastically claim the Commission has rejected rates for outside city customers in other cases which were based on arbitrary multipliers. However, those rulings simply do not apply in the instant case. The

⁶ 16 TAC § 24.37 (f) ("The presiding officer shall issue a non-appealable interlocutory ruling setting interim rates to remain in effect until a final rate determination is made by the commission.").

City's rates are cost-based and the higher rates for outside City customers are based on higher costs to provide service to them. The City has provided a thorough rate study detailing this fact.

VI. LEGAL ARGUMENTS

A. A higher rate for out-of-City customers is not unreasonable, unjust, or unreasonably discriminatory, preferential or prejudicial, and the City's methodology for determining such rates is not arbitrary.

The primary argument made by Petitioners in support of their request for interim rates consists of a conclusory assertion that the City's differentiation among rates charged customer residing inside the City and those who reside outside the City is arbitrary and discriminatory and, therefore, automatically constitutes an unreasonable economic hardship.⁷ Petitioners fail to provide evidence of actual economic hardship arising from a 3% rate increase, and further fail to address the City's need to cover its basic cost of service contemplated in basic ratemaking principles.⁸ As codified in applicable rules and laws, the Texas Supreme Court has held that, "a fundamental principle of ratemaking is that regulated public utilities are entitled to rates which will allow them to collect total revenues equal to their cost of service."⁹ Interim rates would jeopardize the City's ability to recover revenues equal to their cost of service.

The City does not dispute that if some city failed to set rates based on its cost of service, and instead used an arbitrary multiplier of rates doubling the rates for customers outside a city, that would be held not just and reasonable.¹⁰ But in the City of Celina's case, the rate differential reflects the actual differential in the costs of providing service. Accordingly, the imposition of

⁷ First Amended Petition at 3,4 (March 15, 2019).

⁸ See e.g., *Black v. City of Killeen*, 78 S.W.3d 686, 692–93 (Tex. App. – Austin 2002); *Caldwell v. City of Abilene*, 260 S.W.2d 712, (Tex. Civ. App. - Eastland 1953, writ ref'd);

⁹ *Suburban Util. Corp. v. Pub. Util. Comm'n of Texas*, 652 S.W.2d 358, 362 (Tex. 1983).

¹⁰ See e.g., *Appeal of Water & Sewer Rates Charged by the Town of Woodloch CCN Nos. 12312 & 20141*, PUC Docket No. 42862, SOAH Docket No. 473-14-5139.WS (October 29, 2015)(holding small water utility with 27 customers could not arbitrarily charge handful of outside city customers *double* the rates of the inside city customers).

interim rates would render the City incapable of recovering revenues equal to their cost of service, violating the basic regulatory principle set out by the Texas Supreme Court.

For decades, the City has had rates for water service based on the costs of providing that service to each class of customers. Distinctions between classes of customers can be just and reasonable and indeed necessary if there is a reasonable basis in fact for such distinction. The court in *Black v. City of Killeen* held that “not all price discrimination is condemned, but only ‘discrimination that is arbitrary and without reasonable fact basis or justification.’” quoting an older case:

“It is well established that a municipal corporation operating its water works or other public utility has the right to classify consumers under reasonable classification based upon such factors as the cost of service, the purpose for which the service or product is received, the quantity or amount received, the different character of the service furnished, the time of its use or any other matter which presents a substantial difference as a ground of distinction....The interest and needs of the numerous water users served by a city are such that it is improbable, if not impossible, that any classification or rate basis could be devised which would not in some way discriminate against some of the users.”¹¹

Petitioners implicitly argue that *any* multiplier used to calculate higher rates for customers residing outside the City is arbitrary and discriminatory. This argument is fatally flawed because Petitioners fail to allege any facts supporting the idea that the costs of providing service to customers outside the City are the same as for those customers inside the City. The fact is the actual cost of providing utility service to customers that live outside the City is higher than the cost of providing the same services to those living within the City. Moreover, a rate structure that *failed* to take this fact into account would likely be deemed unreasonable and unjust, and discriminatory because customers residing inside the City would effectively be subsidizing the higher cost of providing service to customers outside the City.

¹¹ *Black v. City of Killeen*, 78 S.W.3d 686, 699 (Tex. App. – Austin 2002, pet. denied)(quoting *Caldwell v. City of Abilene*, 260 S.W.2d 712, 715 (Tex. Civ. App. - Eastland 1953, writ ref'd).

In order to meet a huge projected growth in demand for water service, the City has a legal obligation to construct facilities sufficient to provide “adequate and continuous utility service.”¹² The construction of such new facilities will be financed by revenues derived in part from rate increases, in part from new customers, and in part from new debt. Therefore, to maintain sufficient revenues, to maintain an appropriate debt coverage ratio, and to provide adequate and continuous utility service, the City must periodically increase its rates in a careful and well-thought out manner using a cost of service analysis like the one the City has provided in discovery.

B. The City’s proposed rates could not result in an unreasonable economic hardship on its customers because the proposed rate increase is just 3% per year over three years.

The proposed rates in this appeal will increase the rates charged for water service for all of the City’s customers, including Petitioners, by approximately 3% per year for the next three years.¹³ Based on a cost of service analysis, the City determined that these increases were necessary and in the public interest due, in part, to the significant growth in demand for water services that has occurred in recent years and which is expected to continue unabated for the next several decades.

Interim rates would not result in an unreasonable economic hardship to the customers because the annual rate increases proposed by the City amount to just 3% over prior rates. Per the example mentioned earlier, outside City customers using 5,000 gallons of water per month will experience an increase of just \$3.66 for their monthly water costs.¹⁴ This small amount clearly does not constitute an unreasonable economic hardship for these customers.

¹² TWC § 13.183(b).

¹³ See City of Celina, Tex., Ordinance No. 2019-08, Exhibit A (2019).

¹⁴ See *id.*

C. Interim rate relief requested by Petitioners is prohibited by law.

The authority of the ALJ in this case is limited to the applicable Commission rules, and the applicable Commission rule establishes that in the absence of an evidentiary hearing, interim rates may not be set at a rate that is less than the prior authorized rate.¹⁵ In this case, the prior authorized rate already contained the rate differential for outside City customers to which the Petitioners object. That rate differential came into existence over twenty years earlier, and is not within the scope of the ALJ's authority to set interim rates.

Furthermore, Petitioners' have implicitly requested interim rates that are not only directly prohibited under applicable law, but would result in unreasonably discriminatory and unjust utility rates, forcing inside City customer to subsidize outside City customers with higher costs of service who would be effectively receiving service substantially below cost. Such illegal interim rates would also cause even more severe economic hardship for the City and could lead to more catastrophic adverse effects on the City. In addition to violating the prohibition in PUC Rule § 24.37(e)(1), Petitioners' requested interim rate level would violate the basic principle of ratemaking for utilities that rates should be reasonably related to the cost of service.¹⁶

VII. CONCLUSION

The City urges the ALJ to reject the notion that interim rates are harmless and are so common as to be an automatic part of any rate proceeding. Had the Commission intended to establish interim rates during the pendency of every rate appeal, it would have adopted a rule to that effect. Instead, the Commission adopted the current rule, which is clearly intended to limit the use of interim rates by carefully using the phrase "economic hardship." Here, the economic

¹⁵ See 16 T.A.C. 24.37(e)(1).

¹⁶ See e.g., *Black v. City of Killeen*, 78 S.W.3d 686, 699 (Tex. App. – Austin 2002) ("It is well-established, however, that municipalities have the right to classify customers 'based upon such factors as the cost of service...'" (quoting *Gillam v. City of Fort Worth*, 287 S.W.2d 494, 497 (Tex. Civ. App. – Fort Worth 1956, writ ref'd n.r.e.).

hardship that would fall on the City by interim rates is real and would be long lasting. The economic hardship to the outside City customers of simply waiting until the final resolution of this case is almost nil.

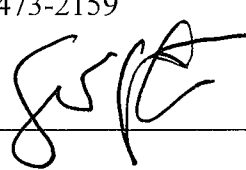
Petitioners have asserted that the burden of unjust rates should not rest on the individual ratepayers, and that argument applies equally to the ratepayers who reside inside the City limits.¹⁷ Granting Petitioners' request for interim rates at all, but especially at the illegal rate specified by Petitioners, will result in unjust rates because Petitioners will be charged a rate below their cost of service and that will cause the City to lose crucial revenue at a critical time needed to provide continuous and adequate service in a rapidly growing part of Texas. Again, if the final rates set in this case are lower, the City stands ready, willing, and able to refund such amounts.

The City respectfully prays that the ALJ deny the motion for interim rates and allow the parties to proceed expeditiously toward a full resolution of this case.

Respectfully submitted,

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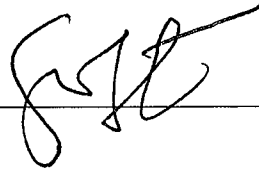
ATTORNEYS FOR CITY OF CELINA

¹⁷ See *Petition by Outside City Ratepayers Appealing the Water Rates Established by the City of Celina*, PUC Docket No. 49225, SOAH Docket No. 473-20-1554.WS (December 6, 2019).

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing document has been served on all parties of record on this 4th day of February, 2020, in accordance with 16 Tex. Admin. Code § 22.74.

Scott Smyth

A handwritten signature in black ink, appearing to read 'Smyth', is written over a horizontal line.