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Received - 2022-01-25 11:25:26 AM
Control Number - 50788
ItemNumber - 168

**SOAH DOCKET NO. 473-20-4071.WS
PUC DOCKET NO. 50788**

RATEPAYERS APPEAL OF THE	§	BEFORE THE STATE OFFICE
DECISION BY WINDERMERE OAKS	§	
WATER SUPPLY CORPORATION TO	§	OF
CHANGE WATER AND SEWER	§	
RATES	§	ADMINISTRATIVE HEARINGS

WINDERMERE OAKS WATER SUPPLY CORPORATION'S

REPLY BRIEF

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JANUARY 25, 2022

**WINDERMERE OAKS WATER SUPPLY CORPORATION'S
INITIAL BRIEF**

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TO THE HONORABLE CHRISTIAAN SIANO AND DANIEL WISEMAN,
ADMINISTRATIVE LAW JUDGES (ALJs), STATE OFFICE OF ADMINISTRATIVE
HEARINGS (SOAH):

COMES NOW, Windermere Oaks Water Supply Corporation (WOWSC) and files this Reply Brief in the above-styled and numbered docket. Pursuant to SOAH Order No. 15, this reply brief is timely filed, and in support WOWSC shows the following:¹

I. INTRODUCTION

As stated in all parties’ Initial Briefs, this appeal boils down to one issue: whether outside legal expenses may be included in rates charged by a water supply corporation for provision of water and wastewater service. However, Public Utility Commission of Texas (Commission) Staff and Ratepayers of Windermere Oaks Water Supply Corporation (Ratepayers) make inaccurate statements in an attempt to cast WOWSC’s Board members and their decision-making in a negative and false light. More importantly, Commission Staff’s recommendation to exclude outside legal expenses creates negative and potentially dangerous policy implications for utilities. Commission Staff goes so far as to argue that the central issue is whether it was “reasonable to contract for legal services...at all.”² The repercussions of Commission Staff’s proposal to prohibit utilities from contracting for outside legal services extends far beyond this case and exceeds the Commission’s jurisdiction. As Commission Staff recognizes, 16 Tex. Admin. Code § 24.41(b)(2)(I) lists legal expenses as a type of expense the Commission may disallow in calculating a utility’s cost of service. Is Commission Staff recommending that *all*

¹ SOAH Order No. 15—Post-Hearing Briefing; Guidelines (Dec. 6, 2021).

² Commission Staff’s Initial Brief at 3 (Dec. 30, 2021) (Staff’s Brief).

water and wastewater utilities subject to the Commission's jurisdiction, original and/or appellate, be prohibited from including outside legal expenses in its cost of service? If indeed that is the recommendation, then the impacts of approving that policy decision will spread beyond water supply corporations to investor-owned utilities, and all other types of water and wastewater utilities in between.

Looking at the impacts on this specific utility, removing the outside legal expenses from rates will financially devastate WOWSC and leave the Board, and by extension the ratepayers, exposed to a certain risk of extreme financial hardship. Texas law is clear: the Board was authorized to advance defense costs to directors of WOWSC and WOWSC was justified in defending its board members and including those costs in its rates.³ Texas law is also clear that the Commission must consider the financial integrity of a utility when conducting its *de novo* review.⁴

Looking at the impacts of Commission Staff's and Ratepayers' recommendation on a macro level, removing all outside legal expenses from rates as unreasonable and unnecessary to provide service to ratepayers⁵ will impact all water and wastewater utilities. For utilities with volunteer boards, risk of personal financial responsibility for acts committed in the course of performing utility duties will almost certainly chill voluntary board participation. Contracting for outside legal expenses is part of the course of doing business for all utilities. Unless a utility is large enough to employ in-house counsel to handle *all* legal matters, it must rely on outside counsel to handle regulatory, civil, and criminal matters. By law, the Commission is allowed to evaluate outside legal expenses to determine whether they are reasonable, necessary, and in the public interest. Commission Staff's recommendation would presume to strip the Commission's authority and assume that all outside legal expenses are unreasonable, unnecessary, and not in the public interest.

Furthermore, Commission Staff's and Ratepayers' recommendation completely disregards the Commission's requirement to preserve the financial integrity of the utility in setting rates. The record shows that without the approved rates, WOWSC cannot maintain binding loan covenants, make required repairs and improvements to aging equipment, react to

³ Tex. Bus. Org. Code Ann. § 8.051.

⁴ Tex. Water Code Ann. § 13.043(j).

⁵ Staff's Brief at 3.

and mitigate environmental challenges, and retain current legal counsel or find subsequent counsel to defend it in ongoing legal battles.⁶ The policy implications of ignoring record evidence regarding a utility's ability to continue to operate would be disastrous for not only WOWSC, but for all other utilities under the Commission's jurisdiction. Additionally, Commission Staff makes bold assertions that WOWSC's Board of Directors approved legal expenses *carte blanche*,⁷ and that WOWSC cannot "include unlimited legal fees" related to a "questionable land transaction"⁸ in its rates. These statements mischaracterize the Board's actions and ignore record evidence to the contrary. The Commission must consider the financial integrity of the utility when evaluating a rate appeal brought under Texas Water Code (TWC) § 13.043, regardless of Commission Staff's recommendations and inappropriate judgments to the contrary.

As stated throughout the evidence presented in this proceeding and its Initial Brief, WOWSC acted appropriately in approving the rate increase that is the subject of this appeal. At the time the utility approved the rate increase, it knew it would have recurring extraordinary legal expenses. WOWSC hired an outside consultant to analyze its financial metrics and was left with only one option to keep operating: to raise its rates.⁹ In conducting its review of this appeal, the Commission may consider only the information that was available to the governing body at the time it made its decision.¹⁰ The Commission must ensure that the appealed rates are just and reasonable, and not unreasonably preferential, prejudicial, or discriminatory.¹¹ The record shows that the appealed rates are just and reasonable and apply uniformly to all customers. Therefore, the appealed rates are not preferential, prejudicial, or discriminatory. Furthermore, the Commission must use a methodology in setting rates that preserves the financial integrity of the utility.¹² The record shows that approving rates that do not allow for recovery of outside legal expenses will prevent the utility from continuing to provide safe and adequate service while

⁶ WOWSC Ex. 8, Rebuttal Testimony of Mike Nelson at 5:17-20 and 6:1-2.

⁷ Staff's Brief at 2.

⁸ *Id.* at 9

⁹ WOWSC Initial Brief at 9-11 (Dec. 30, 2021) (WOWSC's Brief).

¹⁰ Tex. Water Code Ann. § 13.043(e) (TWC).

¹¹ TWC § 13.043(j).

¹² *Id.*

maintaining its financial obligations. Therefore, the Commission must deny this appeal and allow WOWSC to continue to charge the rates effective March 2020.

II. EVALUATING WOWSC'S RATES UNDER § 13.043(J) AND 16 TAC § 24.101(I) (ISSUE 4)

A. The Appealed Rates Are Not Unreasonably Preferential, Prejudicial, or Discriminatory

Commission and case law precedent is clear: an appeal brought under TWC § 13.043 undergoes a two-phase process.¹³ First, the Commission must determine whether the rates in this case are unreasonably preferential, prejudicial, or discriminatory before it may set just and reasonable rates.¹⁴ This threshold issue must be overcome and affirmative in nature in order to reach the second phase of setting rates.¹⁵ Although Commission Staff and Ratepayers argue that WOWSC's rates do not satisfy the requirements of TWC § 13.043(j), their arguments are based on improper policy arguments and blatant mischaracterization of the facts. Ratepayers even allege that TWC § 13.043(j) does not require a threshold finding before the Commission can set rates.¹⁶ Ratepayers argue that because the appeal at issue in *Tex. Water Comm'n v. City of Fort Worth (City of Fort Worth Lawsuit)* involved a contractual rate, that the finding in that case does not apply here.¹⁷ Ratepayers are incorrect—the court held that the appropriate scope of appellate review under TWC § 13.043, regardless of the type of rate appealed, requires that the Commission first make a finding that the rates affected by a decision of the provider adversely affect the public interest by being unreasonably preferential, prejudicial, or discriminatory.¹⁸

As discussed in its Initial Brief, the record shows that WOWSC's rates are not prejudicial or discriminatory, as it has only one class of ratepayers.¹⁹ Furthermore, WOWSC only adjusted

¹³ *Texas Water Comm'n v. City of Fort Worth*, 875 S.W.2d 332, 336 (Tex. App.—Austin 1994, writ denied) (*City of Fort Worth*); Transcript (Tr.) at 13:1-25 and 14:1-14; *Ratepayers' Appeal of the Decision by Bear Creek Special Utility District to Change Rates*, Docket No. 49351, Order on Rehearing at 9 (Nov. 19, 2021).

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ Ratepayers Brief at 4.

¹⁷ *Id.*

¹⁸ *City of Fort Worth*, 875 S.W.2d at 336.

¹⁹ Tr. at 82:16-20 and 94:2-5; *See* WOWSC Ex. 2, Direct Testimony of Joe Gimenez III at 5:6-7; *See also* WOWSC Ex. 3, Rebuttal Testimony of Joe Gimenez III at 24:18-22.

its base rates in order to ensure that its customers share costs equally.²⁰ The WOWSC rates do not benefit one customer over another, do not discriminate against any customers, are not prejudicial, apply equitably among the class of customers, and are consistent in application to one class. Ratepayers argue that the only customers who benefit from the increased rates are the named defendants in the underlying lawsuits and that those costs should have been directly assigned to those specific ratepayers. Ratepayers point to WOWSC's tariff for support.²¹ However, WOWSC's tariff is referring to the cost of providing additional utility services for individual members, not legal defense funds, when addressing direct assignment of costs.²²

As discussed further below, WOWSC is, by law, allowed to pay for legal defense costs of its directors. The utility and its ratepayers benefit by protecting volunteer board members from both legal costs or exposure to hundreds of thousands of dollars tacked on to a bill for providing said legal defense. Spreading the costs to all ratepayers equally creates sufficient, equitable, and consistent rates among the utility's class of customers.²³ Therefore, it is unnecessary for the Commission to move to the second phase and set new rates.

B. The Appealed Rates Are Just and Reasonable

Commission Staff justifies its exclusion of outside legal expenses by characterizing WOWSC's Board of Directors as recklessly approving legal expenses without limit and without check.²⁴ This is false and blatantly ignores record evidence to the contrary. Further, Commission Staff repeatedly applies inappropriate or irrelevant standards in evaluating WOWSC's rates. As such, the Commission should reject these arguments and deny the appeal.

1. Decisions Relating to Incurrence of Legal Expenses Are Justified

As detailed in WOWSC's Initial Brief, when the Board approved the rate increase in 2020, it evaluated the ongoing legal disputes, numerous Public Information Act (PIA) requests related to those disputes, and the utility's purchasing and repair obligations for service.²⁵

²⁰ See WOWSC Ex. 8 at 11:7-14.

²¹ Ratepayers Initial Brief—Amended at 6 (Dec. 30, 2021) (Ratepayers Brief).

²² WOWSC Ex. 12, WOWSC's Response to Ratepayers RFI 3-6 at 46.

²³ TWC § 13.043(j).

²⁴ Staff's Brief at 3.

²⁵ WOWSC's Brief at 9-11.

WOWSC hired Texas Rural Water Association (TRWA) to perform a rate analysis.²⁶ The Board of Directors adopted a revenue requirement and rate design based upon TRWA's analysis, just as it had in 2018.²⁷ TRWA is a well-known, statewide educational and trade association that represents the full spectrum of the rural water community and has experience performing rate and financial analyses for small water and wastewater utilities.²⁸ As a small water supply corporation with a volunteer board, WOWSC must rely on outside resources to analyze and set rates.

When the Board made the decision to raise rates, it had several pieces of information that indicated that these legal costs would extend beyond 2019, into 2020, and almost certainly beyond then. In December 2019, the utility received invoices from two law firms handling the underlying lawsuits—which had just entered into the discovery stage—totaling \$44,500.33.²⁹ The Board also knew it was required to pay \$40,000 for a TCEQ-required generator, among other financial commitments related to conservation projects.³⁰ So, overall, in January of 2020, WOWSC knew of \$136,079 in binding expenses with only \$150,000 of liquid assets in the bank. These binding expenses did not include the December 2019 legal invoices and the prospect of having to continuously respond to the numerous demands resulting from plaintiffs' persistent litigation against the utility. This left the Board with raising monthly base rates as the only and most reasonable option to maintain WOWSC's financial integrity and serve its members.³¹

The Board also acted in the best interest of the ratepayer members in avoiding additional litigation. The plaintiffs in *Rene Ffrench, et al. v. Friendship Homes & Hangers, LLC, et al.* (*Double F Hanger Lawsuit*) demanded that WOWSC seek to break the land sale contract at the heart of the underlying legal matters.³² Since 2017, three different sets of attorneys have advised three different WOWSC Boards that any attempt to use legal processes to coerce the land's return to the original sale price could, at the very least, subject WOWSC to a lawsuit or

²⁶ *Id.* at 13.

²⁷ *Id.*

²⁸ *Id.*

²⁹ WOWSC Ex. 3 at 7:1-12.

³⁰ *Id.* at 8:9-20.

³¹ *Id.*

³² *Id.* at 12:1-3.

counterclaim asserting a breach of the land sale contract.³³ WOWSC even received correspondence from counsel of Friendship Homes that if WOWSC bailed on the land transaction, then Friendship Homes may assert a breach of contract action against WOWSC.³⁴ Thus, such action, as desired by the plaintiffs, would have very likely invited separate litigation—enabling countersuits, costing hundreds of thousands of dollars and exposing WOWSC to loss and damages—with no guarantee of success.³⁵ Any potential benefit to WOWSC for recovery of the land at issue (and to then resell it at prices which the plaintiffs believe possible) would not justify WOWSC’s legal costs for an expensive and utility-initiated lawsuit, especially when those legal costs would not be recoverable in court.³⁶

Furthermore, the Board has continued to act in ways that benefit the ratepayers and limit legal costs. The decision for WOWSC to appeal the denial of insurance coverage was made in an effort to recover funds spent in order to ultimately benefit ratepayers.³⁷ When WOWSC decided to release the legal invoices in which it had authority to keep confidential pursuant to an Attorney General’s ruling, it was in an effort to avoid additional legal costs related to keeping those invoices confidential.³⁸

Commission Staff claims that ratepayers should not be responsible for paying the defense against allegations of bad behavior.³⁹ Commission Staff ignores that the court in the *Double F Hangar* Lawsuit granted summary judgment and dismissed the claims against all the current and former directors, except one.⁴⁰ Therefore, the allegations are proven to be baseless. Importantly, Chapter 8 of the Texas Business Organizations Code authorizes—in conjunction with what WOWSC’s Bylaws arguably require—the advancement of defense costs to directors and officers of WOWSC.⁴¹ The Order Granting Motion for Summary Judgment issued on May 3, 2021 in the *Double F Hanger* Lawsuit now requires the utility to fully pay for the named directors’ legal

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ Tr. at 363:11-14.

³⁸ *Id.* at 362:22-363:8.

³⁹ Staff’s Brief at 3.

⁴⁰ WOWSC Ex. 3 at 10:8-17 and 19:6-14.

⁴¹ Tex. Bus. Org. Code § 8.051.

costs.⁴² Furthermore, volunteer boards would not exist if non-profit corporations such as WOWSC did not defend its board members and directors from legal attacks. Foreseeing the need to protect volunteer directors to ensure enough community members are willing to step into those roles, both the Texas Legislature and Congress have enacted multiple measures to provide volunteer directors of non-profit corporations with robust protections from personal liability in the absence of the most egregious abuses. As indicated by the recent order in the *Double F Hanger* Lawsuit, seven of the eight named directors did not come close to such level of abuse and thus these measures of protection are designed specifically for the current scenario.⁴³ This requires WOWSC to pay for all of the legal expenses these seven directors had to incur and—without any other means available—it is reasonable for WOWSC to recover these costs in its rates.

Put simply, Commission Staff and Ratepayers have the luxury of judging the Board's decision with 20/20 hindsight. However, thanks to this hindsight, both parties now know that the legal costs the directors voted to put into the rates have: 1) recurred every year since 2019; and 2) continually exceeded \$171,000.⁴⁴

2. Commission Staff and Ratepayers Apply Inapplicable Standards to WOWSC

Commission Staff cites 16 TAC § 24.41(b) as a guide for examining whether WOWSC's rates are just and reasonable, but importantly notes that there is no similar rule governing water supply corporations. Indeed, the Commission only has appellate jurisdiction over water supply corporations and therefore, the utility may design its rates however best fits its needs. Therefore, 16 TAC § 24.41(b) is truly only a guide for setting new rates. The Commission may only set new rates if it determines that the appealed rates are unreasonably preferential, prejudicial, or discriminatory.⁴⁵ Commission Staff then asks the Commission to compare the facts of this case to Docket No. 35717, *Application of Oncor Electric Delivery Company, LLC for Authority to Change Rates*.⁴⁶ In that proceeding, the Commission did not allow recovery of self-insurance

⁴² *Id.*, Attachment JG-22 at 19-20.

⁴³ *Id.*

⁴⁴ WOWSC Ex. 9, Rebuttal Testimony of Grant Rabon, Attachment GR-2 at 6; Tr. at 545:10-24.

⁴⁵ TWC § 13.043(e).

⁴⁶ *Application of Oncor Electric Delivery Company, LLC for Authority to Change Rates*, Docket No. 35717 (Jun. 27, 2008); Staff's Brief at 3.

funding for expenses related to intentional torts or for employee misconduct. However, in that case, the utility was an electric investor-owned utility (IOU) and thus, the equity investors selected the board members of the IOU and should therefore bear the financial costs related to intentional torts or employee misconduct, rather than the ratepayers.

WOWSC does not have shareholders to pay for disallowed costs the utility must incur. It has volunteer board members who are duly elected by the members. Commission Staff seemingly assumes that allegations of bad behavior rise to the level of “intentional torts or employee misconduct,” just as in Docket No. 35717. However, as discussed above, seven out of eight directors were dismissed from the litigation on summary judgment.⁴⁷ Commission Staff inappropriately relies on the insurance carrier’s denial instead of a court decision.

Furthermore, Ratepayers rely on the Commission’s prudence standard in an effort to discredit the Board’s decisions.⁴⁸ While the prudence standard generally applies to investor-owned utilities over which the Commission has jurisdiction, it only supports the Board’s decision to increase rates. “The standard for determining prudence is the exercise of that judgment or the choosing of one of a 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 chosen.”⁴⁹ The “prudence standard” allows for a range of options and, within those options, it defers to a utility’s business judgment:

[This standard] contemplates that (1) there may be more than one prudent option within the range available to a utility in any given context; (2) any choice within the select range of reasonable options is prudent; (3) the Commission should not substitute its judgment for that of the utility; and (4) the reasonableness of a decision must be judged in light of the circumstances, information, and available options existing at the time, without benefit of hindsight.⁵⁰

The standard is flexible enough to consider that multiple prudent options may be available to a reasonable utility manager under the circumstances. Applying this standard to the Board’s decision to increase rates is well within the range of a reasonably prudent decision,

⁴⁷ WOWSC Ex. 3 at 10:8-17 and 19:6-14.

⁴⁸ Ratepayer’s Brief at 5.

⁴⁹ *Pub. Util. Comm’n of Tex. v. Tex. Indus. Energy Consumers*, 620 S.W.3d 418, 428 (Tex. 2021).

⁵⁰ *Id.*

given all the record evidence showing that the utility could not stay solvent if it had not raised rates.

C. Financial Integrity

If the Commission sets rates in an appeal filed under TWC § 13.043, The Commission *must* consider the financial integrity of the utility.⁵¹ As detailed in WOWSC’s Initial Brief, granting this rate appeal and adopting Commission Staff’s proposed rates will risk financial ruin for the utility.⁵² Commission Staff cites Docket No. 42862 to support its position that considerations of financial integrity cannot be treated as a “trump card” and that a “utility’s rates are not just and reasonable simply because the utility has debts to pay.”⁵³ Commission Staff’s dismissal of the record evidence proving that the utility will be unable to operate if Commission Staff’s rates are adopted is alarming. The Board president testified at hearing that if Commission Staff’s rates are adopted, WOWSC could not remain financially stable and continue to provide adequate service to its members.⁵⁴ One would assume that the inability to operate a safe and reliable water system rises to the level of severe damage to a utility’s financial integrity.

There is no definition or standard of “financial integrity.” However, the Supreme Court of Texas has found that an IOU must be allowed to recover its operating expenses together with a reasonable return on invested capital, and that requirement is “only met if the return is sufficient to ensure confidence in the financial integrity of the enterprise, *so as to maintain its credit and to attract capital.*”⁵⁵ The record shows that removing the outside legal expenses from rates could lead to the utility violating loan covenants with its lender, CoBank.⁵⁶ WOWSC has already been informed that it was difficult for CoBank to approve the loan requests given the impact of legal fees on WOWSC’s revenue stream.⁵⁷ Commission Staff’s primary recommendation would jeopardize all three loans WOWSC has through CoBank.⁵⁸ WOWSC

⁵¹ TWC § 13.043(j).

⁵² WOWSC’s Brief at 16-20.

⁵³ Staff’s Brief at 2.

⁵⁴ Tr. at 364:21-25.

⁵⁵ *Suburban Util. Corp. v. Public Util. Comm’n of Texas*, 652 S.W.2d 358, 362 (Tex. 1983).

⁵⁶ WOWSC Ex. 3 at 5:14-6:9.

⁵⁷ *Id.*

⁵⁸ *Id.*

still needs a clarifier and, without the CoBank loan, WOWSC would be forced to seek commercial loans, likely at higher rates and shorter durations, and requiring more in monthly principal and interest charges.⁵⁹ CoBank specializes in lending to non-profit corporations like WOWSC at low, long-term rates because it has federal government support.⁶⁰ The Commission and case precedent support denying Commission Staff's proposed rates because the alternative would lead to lowering WOWSC's credit and force them to violate loan covenants. The Commission must not adopt rates that place a utility in such a position.

D. Rates Not Unduly Prejudicial and Discriminatory

Ratepayers argue that the appealed rates are prejudicial and discriminatory because they only benefit the director defendants.⁶¹ As discussed in WOWSC's Initial Brief and above, the rate increase has kept, and is keeping, the utility viable. It allows WOWSC to maintain operations, complete repairs and improvements, and meet minimum obligations to the law firms defending the utility in several forums.⁶² Therefore, all ratepayers benefit from the rate increase by having a functional utility, an independent volunteer board, and legal protection for those volunteer board members. The appealed rates are universally applied to one class, and are therefore not prejudicial or discriminatory.⁶³

III. DISMISSAL IF THE APPEALED RATES SATISFY TWC § 13.043(J) (ISSUE 5)

As the evidence shows, WOWSC's rates are just and reasonable, are not unreasonably preferential, prejudicial, or discriminatory, and are sufficient, equitable, and consistent in application to each class of customers. Pursuant to the *City of Fort Worth* Lawsuit and Commission precedent, the Commission must dismiss this appeal.

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ Ratepayers Brief at 6.

⁶² Tr. at 222:1-10.

⁶³ WOWSC's Brief at 19.

IV. JUST AND REASONABLE RATES (ISSUES 6, 7, 8, AND 11)

A. The Information Available to the Board at the Time It Approved the Rate Increase (Issue 6)

In this appeal, the Commission's scope of review is limited to considering what the Board knew at the time it made the decision to increase rates.⁶⁴ Commission Staff mischaracterizes the Board's actions as giving the directors "*carte blanche*"⁶⁵ over "unlimited legal fees."⁶⁶ As detailed in WOWSC's Initial Brief, the record shows that the utility and some of the directors had been sued in two different lawsuits and were facing a drawn-out legal battle, had several financial commitments to the utility, and had investigated the best way to meet these obligations.⁶⁷ Even after the rate increase was approved, the Board continued to make decisions along the way to refrain from engaging in further litigation and protect the interests of the ratepayers.⁶⁸ The Board did what it needed to do to keep the utility afloat in the face of ever-increasing legal fees. And, as the record shows, if the appeal is granted and Commission Staff's proposed rates are approved, the utility will be unable to operate and provide service to its members.⁶⁹ This analysis does not equate to "*carte blanche*" approval over "unlimited legal fees." It equates to reasonable management of a water and wastewater utility.

Furthermore, a water supply corporation does not require Commission approval to change its rates.⁷⁰ As such, WOWSC is free to change its rates by board approval once the outstanding legal fees are paid. There is no evidence that the Board intended these rates to exist in perpetuity.

⁶⁴ TWC § 13.043(e).

⁶⁵ Staff's Brief at 2.

⁶⁶ Staff's Brief at 4.

⁶⁷ WOWSC's Brief at 9-11.

⁶⁸ Tr. at 362:18-363:14.

⁶⁹ *Id.* at 364:21-25.

⁷⁰ TWC § 13.004.

B. Revenue Requirement, Rate Design and Allocation (Issue 7)

As discussed in WOWSC's Initial Brief, Commission Staff's recommended revenue requirement of \$404,855 will risk financial ruin for the utility.⁷¹ Commission Staff came to this recommendation by subtracting the amount of the contested legal fees from WOWSC's annual revenue requirement.⁷² Commission Staff also recommends a water base rate of \$45.92 and a wastewater base rate of \$33.52.⁷³ However, these recommended base rates recover approximately \$49,000 less when one includes WOWSC's gallonage fees and 2019 usage.⁷⁴ Commission Staff significantly overestimates WOWSC's variable revenue from water sold and wastewater treated. As such, the base rates Commission Staff calculated do not actually align with Commission Staff's proposed revenue requirement.⁷⁵ Commission Staff erroneously assumed that any costs identified as variable in the TRWA rate analysis would be recovered via the volumetric rates. However, this is not consistent with how WOWSC established its rates. Only a small portion of WOWSC's overall rate revenue is generated by the volumetric charges, amounting to much less than the approximately 38.5% of the revenue requirement assumed by Commission Staff.⁷⁶ There are few truly variable costs for water and wastewater utilities. The TRWA rate analysis identifies a variable component of almost all expenses—even when the nature of the cost is not truly variable.⁷⁷ The intent of this allocation—to what is labeled as variable costs in the rate analysis—is to identify the portion of the overall revenue requirement that the utility wants to recover through volumetric charges. However, this need not be prescriptive, and it is acceptable for the utility to use policy judgement to set the fixed and variable rates in a manner that balances its, sometimes competing, policy objectives.⁷⁸

WOWSC has approximately 75 connections at airport hangars and they have limited demands, some serving only a sink and a toilet, so they use comparatively little water and, thus,

⁷¹ WOWSC's Brief at 18.

⁷² Staff's Brief at 4.

⁷³ *Id.* at 5.

⁷⁴ WOWSC Ex. 8 at 5:9-12.

⁷⁵ WOWSC Ex. 9 at 7:6-15.

⁷⁶ *Id.* at 5:8-13.

⁷⁷ *Id.* at 5:14-23.

⁷⁸ *Id.*

pay modest amounts for water consumed based on the volumetric charges.⁷⁹ However, these accounts pay the base charges—the same as any other active connection. Thus, WOWSC has determined that it is equitable to rely more heavily on the base charge for revenue recovery to ensure these, and other low-use customers, pay their fair share of the service availability costs of the utility. Correspondingly, in order to signal customers to conserve water, WOWSC has balanced this policy decision with inclining block rates for its volumetric charges, which increase the cost of water use as water use increases.⁸⁰ In sum, WOWSC designed its rates to be equitable to all of its customers. The rate design ensures that all customers—even those with very low usage—pay the costs associated with legal fees and utility services.

Commission Staff's recommended rate design will not allow WOWSC to recover Commission Staff's recommended revenue requirement. As such, the Commission must retain WOWSC's revenue requirement and the rate design in order to allow WOWSC to recover enough funds to operate the utility.

C. Outside Legal Fees (Issue 8)

As discussed in its Initial Brief, WOWSC included outside legal expenses in its revenue requirement and was justified in doing so. First, at the time it approved the rate increase, the utility was involved in several ongoing legal challenges with no end in sight. Second, these fees are recurring, notwithstanding Commission Staff's arguments to the contrary.⁸¹ Commission Staff argues that it was impossible for WOWSC to know whether it would continue to incur \$171,000 in legal expenses every year and claims that all of its legal battles could have reached resolution in April 2020.⁸² The evidence shows that the Board knew it had the same, if not more, legal expenses anticipated for 2020.⁸³ Indeed, Commission Staff witness, Maxine Gilford, recognized that these costs have been recurring and are still ongoing.⁸⁴ Furthermore, Commission Staff's argument that it is impossible to predict the outcome of litigation cuts both ways. While it seemed extremely unlikely that all of the utility's litigation matters would be

⁷⁹ *Id.* at 6:1-11.

⁸⁰ *Id.*

⁸¹ Staff Brief at 6.

⁸² *Id.*

⁸³ WOWSC Ex. 3 at 7:1-8:8.

⁸⁴ Tr. at 545:1-6.

resolved in 2020, it is also impossible to predict when those litigation costs will end. At the hearing on the merits, Commission Staff likened getting sued to getting hit by a car, as in it often doesn't happen every year.⁸⁵ Ms. Gilford admitted that WOWSC has been getting hit by that proverbial car every year for 3 years now.⁸⁶ With the litigious nature of the Ratepayers, it is easy to envision that the utility may incur high legal fees for several more years.

Furthermore, Commission Staff exceeds the Commission's authority by suggesting that the Commission order WOWSC to sell assets not being used in the provision of service. The scope of this review is to examine the rates effective March of 2020, and, if the Commission determines those rates are not just and reasonable, set new rates.⁸⁷ Nowhere does the Texas Water Code grant the authority to the Commission to order a utility to sell assets in a rate appeal. Regardless, even if the Commission did possess such authority, the ratepayer litigants have placed a *lis pendens* on the subject property, thereby preventing the utility from selling these assets.⁸⁸ Commission Staff has far exceeded the Commission's authority in recommending it order WOWSC to sell assets to cover outstanding debts.

Ratepayers argue that the legal costs provide no benefits to utility customers.⁸⁹ This is untrue. Providing legal defense for volunteer board members is a key component to ensuring active participation in utility leadership and, importantly, an independent board.⁹⁰ Any litigious person could threaten board members to coerce action and behavior. Most individuals running for a board position likely do not have funds to protect him or herself from potential litigation. A board's ability to act independently is key to a water supply corporation's viability and the ability to provide safe and adequate service for the benefit of *all* customers. As such, all members benefit from an independent board—and a volunteer board keeps member costs down. Further, as discussed above, the utility was legally authorized to defend its directors and won on summary judgment against Ratepayers' claims to the contrary. Recurring legal fees must be included in rates for the benefit of all ratepayers.

⁸⁵ Tr. at 534:9-17.

⁸⁶ Tr. at 545:19-24.

⁸⁷ TWC §13.043(j).

⁸⁸ Tr. at 514:4-13.

⁸⁹ Ratepayers Brief at 5.

⁹⁰ Tr. at 228:23-229:9.

As discussed in its Initial Brief, WOWSC is willing to revise its tariff to allow the use of a surcharge.⁹¹ As such, WOWSC could include the \$171,337 as a surcharge until its legal debts are paid.

D. Depreciation Expense

WOWSC does not contest Commission Staff's recommendation to use the amounts the utility recovers through annual depreciation expense to be held in a fund for future plant investment, and record those revenues in its Capital Expenditure Reserve as customer-contributed capital.⁹²

E. Refunds and Surcharges (Issue 11)

As discussed at length in WOWSC's Initial Brief, the utility is financially incapable of issuing refunds if the Commission orders them.⁹³ Disallowing outside legal expenses and ordering refunds would deplete the utility's cash balance and place the utility in a deficit.⁹⁴ In order to preserve the financial integrity of the utility, the Commission must refrain from authorizing refunds in the event it grants this appeal. To grant the appeal and then authorize refunds would render WOWSC unable to operate.

Also as discussed in its Initial Brief, WOWSC is willing to amend its tariff to authorize the use of a surcharge if the Commission feels it is necessary to remove the outside legal costs from base rates but allow WOWSC to recover them through a separate surcharge.⁹⁵ Indeed, it is Commission Staff's initial recommendation, as verified at the hearing on the merits, to remove outside legal costs from base rates and allow recovery through a surcharge.⁹⁶

⁹¹ WOWSC's Brief at 18.

⁹² Staff's Brief at 7.

⁹³ WOWSC's Brief at 20.

⁹⁴ *Id.*

⁹⁵ WOWSC's Brief at 18.

⁹⁶ *Id.*

V. RATE CASE EXPENSES (ISSUE 9)

Ratepayers argue that Commission Staff has applied the wrong standard in recommending that WOWSC be able to recover rate case expenses related to this appeal.⁹⁷ The Texas Water Code explicitly allows the Commission to grant recovery of expenses incurred in an appeal brought under § 13.043.⁹⁸ Commission Staff appropriately relied upon 16 TAC § 24.41 to recommend the reasonableness of WOWSC's rate case expenses incurred through October 31, 2021. Ratepayers further argue that WOWSC abused the appeal process without citing any evidence and use its dissatisfaction with the rates as a basis for this claim. WOWSC and its attorneys have incurred reasonable expenses related to the nature and extent of the work and the complex and novel legal issues present in this case. Ratepayers' arguments are wholly without merit and should be rejected.

Commission Staff proposes recovering rate case expenses through a surcharge, to be collected over five years.⁹⁹ Again, WOWSC has indicated that it would be amenable to amending its tariff to approve a surcharge for the collection of legal expenses, including rate case expenses.¹⁰⁰ However, WOWSC would urge recovering approved rate case expenses over a two-year period.¹⁰¹ WOWSC will update its rate case expenses as directed by the Commission, in order to recover costs incurred past October 31, 2021, as recommended by Commission Staff, including the costs required to draft and finalize briefs.¹⁰²

VI. CONCLUSION

For the foregoing reasons, WOWSC respectfully requests that the Commission deny Ratepayers' appeal, maintain the rates approved effective March 23, 2020, and grant WOWSC such other relief to which it may be entitled.

⁹⁷ Ratepayers Brief at 7.

⁹⁸ TWC § 13.043(e).

⁹⁹ Staff's Brief at 9.

¹⁰⁰ WOWSC Ex. 3 at 24:1-4.

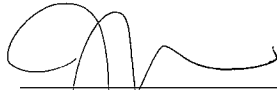
¹⁰¹ WOWSC's Brief at 21.

¹⁰² WOWSC filed supporting rate case expenses incurred between November 1, 2021 to December 15, 2021. *See* Third Supplemental Direct Testimony of Jamie L. Mauldin (Dec. 30, 2021).

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that, unless otherwise ordered by the presiding officer, notice of the filing of this document was provided to all parties of record via electronic mail on January 25, 2021, in accordance with the Order Suspending Rules, issued in Project No. 50664.



JAMIE L. MAULDIN