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PUC DOCKET NO. 50788
SOAH DOCKET NO. 473-20-4071.Ws

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RATEPAYERS APPEAL OF THE	§	PUBLIC UTILITY COMMISSION
DECISION BY WINDERMERE OAKS	§	OF TEXAS
WATER SUPPLY CORPORATION TO	§	
CHANGE WATER AND SEWER RATES	§	

ORDER REMANDING PROCEEDING

This Order addresses the appeal by the ratepayers of the Windermere Oaks Water Supply Corporation of the increase in water and sewer rates adopted by Windermere. The ratepayers of Windermere filed the appeal under Texas Water Code (TWC) § 13.043(b).¹ After a hearing, the administrative law judges (ALJs) of the State Office of Administrative Hearings (SOAH) filed a proposal for decision recommending the Commission deny the appeal and award Windermere rate-case expenses. For the reasons discussed in this Order, the Commission rejects the proposal for decision and remands this docket to SOAH for further proceedings to address the issues identified in this Order. A proposal for decision after this remand must address all elements of TWC § 13.043(j), which must include the reasonableness of the legal expenses included in the revenue requirement of the appealed rates.

I. Background

Windermere is a non-profit, member-owned and controlled water supply and sewer service corporation managed by a five-member board of directors elected by its members.² The corporation provides retail water and sewer service to over 250 customers within the Windermere Oaks subdivision in Spicewood, Texas.³ In March 2016, Windermere closed a sale of property owned by the corporation to a business owned by a board member of the corporation.⁴ In the years following, Windermere hired outside counsel to litigate three lawsuits arising out of the property

¹ Ratepayers' Petition for Review of Windermere's Rates (Mar. 23, 2020).

² Proposal for Decision, Proposed Conclusion of Law No. 1 (PFD) (Mar. 31, 2022); *id.* at 5 (citing Direct Testimony of Joe Gimenez, II, WOWSC Ex. 2, at 5:22–6:1 (Gimenez Direct)).

³ PFD, Proposed Finding of Fact No. 9; *id.* at 5 (citing WOWSC Ex. 2 (Gimenez Direct) at 5:5-6, 8:5, 9:3-6).

⁴ *Id.* at 6; Rebuttal Testimony of Joe Gimenez, WOWSC Ex. 3, Attachment JG-21 at 11.

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sale.⁵ In one of those suits, individual board members in addition to Windermere were named defendants.⁶ In that case, Windermere paid the legal costs of defending the individual board members.⁷

In late 2019, the board of directors consulted with the Texas Rural Water Association and obtained a rate analysis.⁸ Using this rate analysis, the board of directors determined Windermere had a revenue requirement of \$576,192, including \$171,337 in legal expenses incurred in the three lawsuits.⁹ Subsequently, the board of directors increased the monthly base rates for Windermere's sole customer class from \$50.95 to \$90.39 for water service and from \$40.12 to \$66.41 for sewer service.¹⁰ On April 27, 2020, Windermere's ratepayers appealed the rate increase to the Commission under TWC § 13.043(b)(4).

As stated by the ALJs, the primary issue in this case is whether Windermere's rates should include the outside legal expenses related to these three lawsuits stemming from the sale of the corporation's property.¹¹

II. Discussion

The Commission has appellate jurisdiction over rates set by retail public utilities under TWC § 13.043.¹² The Legislature, recognizing that "retail public utilities are by definition monopolies in the areas they serve,"¹³ granted the Commission this power, and other powers under chapter 13 of the Texas Water Code, "to protect the public interest inherent in the rates and services

⁵ WOWSC Ex. 2, at 13:16-15:3 (Gimenez Direct); Direct Testimony of Maxine Gilford, Staff Ex. 4 at 10:8-13, 11:2-10, 11:20-12:1 (Gilford Direct); Direct Testimony of Kathryn E. Allen, Ratepayers Ex. 5 at 11:11-15 (Allen Direct).

⁶ PFD at 6 (citing WOWSC Ex. 2 at 19 (Gimenez Direct)); WOWSC Ex. 3 at 9 (Gimenez Rebuttal).

⁷ PFD at 6 (citing WOWSC Ex. 3 at 7, 11 (Gimenez Rebuttal)).

⁸ Direct Testimony of Mike Nelson, WOWSC Ex. 7, at 6:18-20 (Nelson Direct).

⁹ *Id.*, Staff Ex. 4 at 9:4-5 (Gilford Direct).

¹⁰ WOWSC Ex. 7, at 6:13-15 (Nelson Direct).

¹¹ PFD at 1, 6.

¹² Tex. Water Code § 13.043 (TWC).

¹³ *Id.* § 13.001(b)(1).

of retail public utilities.”¹⁴ In the *City of Fort Worth*, the Austin Court of Appeals determined that, in an appeal under TWC § 13.043, the initial inquiry of the Commission is whether the appealed rates conform to the statutory standards identified in TWC 13.043(j), which have collectively been referenced as the *public interest standard*.¹⁵

A. Initial Inquiry

In an appeal under TWC § 13.043, the Commission must ensure that every rate appealed is just and reasonable.¹⁶ In addition, the Commission must ensure that the appealed rates are not unreasonably preferential, prejudicial, or discriminatory.¹⁷ Further, the Commission must ensure that the appealed rates are sufficient, equitable, and consistent in application to each class of customers.¹⁸ As noted above, the initial inquiry of the Commission under this section is whether the appealed rates conform to these statutory standards identified in TWC 13.043(j).

The ALJs split this initial inquiry into a two-step process, which was apparently based on the Commission’s decision in Docket No. 49351¹⁹ and their assignment of burdens of proof in this case.²⁰ The ALJs stated that the Commission has construed the language in subsection (j) “to require an initial finding that the appealed rates are “unreasonably preferential, prejudicial, or discriminatory before the Commission may fix just and reasonable rates.”²¹ Consequently, the ALJs concluded that before reaching the question of whether Windermere's rates are just and reasonable, the appealed rates must be shown to be unreasonably preferential, prejudicial, or discriminatory, and the ratepayers, as appellants, have the burden of proof on this point.²² The ALJs further concluded that, if the ratepayers meet their burden on this point, Windermere then

¹⁴ *Id.* § 13.001(a).

¹⁵ *Tex. Water Comm’n v. City of Fort Worth*, 875 S.W.2d 332, 336 (Tex. App. Austin 1994, writ denied).

¹⁶ TWC § 13.043(j).

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Ratepayers’ Appeal of the Decision by Bear Creek Special Utility District to Change Rates*, Docket No. 49351, Order on Rehearing (Nov. 19, 2021).

²⁰ PFD at 4.

²¹ *Id.* at 4 (citing Docket No. 49351, Conclusion of Law No. 8).

²² *Id.* at 4–5 (citing 1 TAC § 155.427 and 16 TAC § 24.317).

has the burden to show that the rates are just and reasonable.²³ Because the ALJs found that the ratepayers failed to meet their burden to show that the appealed rates are unreasonably preferential, prejudicial, or discriminatory, the ALJs did not address whether the appealed rates are just and reasonable.

The ALJs reliance on the Commission's decision in Docket No. 49351 was misplaced. The ALJs are correct that the Commission concluded in that docket that "the Commission must find that the appealed rates are unreasonably preferential, prejudicial, or discriminatory before the Commission may fix just and reasonable rates."²⁴ The Commission did not, however, conclude that the appealed rates must be determined to be unreasonably preferential, prejudicial, or discriminatory *before* it could address whether the appealed rates were just and reasonable. The fact that the retail public utility in that case did not defend the appealed rates may be the cause of the misunderstanding of the Commission's decision in that case. However, as part of the initial inquiry, the Commission found that the appealed rates were not just and reasonable,²⁵ and this finding was not dependent on finding those rates were unreasonably preferential, prejudicial, or discriminatory. All of the standards prescribed by subsection (j) must be addressed in an appeal under TWC § 13.043.

The Commission also notes that in a two-step initial inquiry, based simply on an assignment of the burden of proof, one could have concluded that Windermere must establish that the appealed rates are just and reasonable, and only then would the ratepayers have to establish that the appealed rates were unreasonably preferential, prejudicial, or discriminatory. The ALJs rationale for why the standards prescribed by subsection (j) must first be addressed by the ratepayers instead of Windermere are not supported by statute, rule, or Commission order. More importantly, there is no requirement in statute, rule, or Commission order, or the *Fort Worth* court's decision, that the initial inquiry is a two-step process or that the appealed rates must be shown to violate the unreasonably preferential, prejudicial or discriminatory standards (or the sufficient, equitable, and consistent standards) laid out in subsection (j) before the just and

²³ *Id* at 5.

²⁴ Docket No. 49351, Conclusion of Law No. 8.

²⁵ Docket No. 49351, Conclusion of Law No. 8A.

reasonable standard can be addressed. The Commission concludes that the two-step process used by the ALJs violates all applicable legal standards.

In the initial inquiry in an appeal under TWC § 13.043, the Commission must ensure that all of the standards set out in subsection (j) of that section are met, including whether the appealed rates are just and reasonable. No standard takes precedence over another. As the *Fort Worth* court stated, the “reasonableness of the rates demanded by Fort Worth[, the appealed rates,] is the initial inquiry under section 13.043(j) defining the scope of agency review.”²⁶ That court further stated the Commission must “first find that [the appealed] rate was unreasonable in some manner,” and that the “reasonableness requirement is a jurisdictional requirement”²⁷ for the Commission itself to set rates.

The initial inquiry of the Commission, as defined by the *Fort Worth* court, encompasses all of the standards mandated by subsection (j). Failure to meet one or more of the standards laid out in subsection (j) does not dispose of the Commission’s obligation under the statute to “ensure that every appealed rate” meets each of the standards prescribed in this initial inquiry.²⁸ The two-step process used by the ALJs does not comport with this requirement. If the Commission finds in this initial inquiry that any of the prescribed standards in subsection (j) are violated, then the next step is for the Commission to establish rates that do meet this standard.

Splitting this initial inquiry into two steps is inconsistent with the statutory requirement to determine whether the appealed rates violate any of the standards in subsection (j). Whether the appealed rates are just and reasonable must be addressed as part of this initial inquiry. Accordingly, this matter must be remanded to SOAH to address all of the standards prescribed in subsection (j) particularly whether the appealed rates are just and reasonable.

B. Preferential Rates

The SOAH ALJs found the appealed rates were not unreasonably preferential, prejudicial, or discriminatory for two reasons.²⁹ First, the ratepayers did not assert in their petition that the

²⁶ *City of Fort Worth*, 875 S.W.2d at 335.

²⁷ *Id* at 336–37

²⁸ TWC § 13.043(j).

²⁹ PFD at 9.

appealed rates are unreasonably preferential, prejudicial, or discriminatory.³⁰ Second, the ratepayers appealed only the base rates,³¹ and all customers have the same sized meter and are charged the same base rate.³² The SOAH ALJs' concluded that, although a single meter size alone is not enough to show inequity, "where, as here, all customers . . . pay the same rates, this affirmatively shows no preference, prejudice, or discrimination."³³ The Commission rejects this overly narrow reading of the statutory standards.

The Commission understands that the ratepayers assert that the board members of Windermere, who are also customers that take service at the same rate as other customers, are the only customers that receive the benefit of the increased rates.³⁴ The ALJs rejected this argument stating that is it "is unsupported by the evidence and is insufficient to support a finding that the rates are unreasonably preferential, prejudicial, or discriminatory."³⁵ The Commission agrees with the ALJ on this specific point: evidence must be brought forth to support a party's allegations.

However, just as the ALJs concluded that "a single meter size alone is not enough," the fact that the customers of a retail public utility take service under a single rate alone also is not enough. Without underlying facts regarding the characteristics of the customers, there is nothing to support the conclusion that it is appropriate that all customers should take service at the same rate. One may not conclude that a single rate meets any of the standards in subsection (j) simply because the retail utility charges a single rate. Rates must be designed to recognize the characteristics of the customers. If these characteristics differ in a meaningful manner, then the rates should reflect these differences. Thus, whether rates are just and reasonable; unreasonably preferential, prejudicial, or discriminatory; sufficient, equitable, and consistent in application cannot be determined unless the characteristics of the customers and their service are considered.

³⁰ PFD at 9.

³¹ *Id.* at 9; *id.*, Finding of Fact No. 15.

³² *Id.* at 9; *id.*, Finding of Fact Nos. 42, 43.

³³ *Id.* at 9.

³⁴ *See id.*

³⁵ *Id.*

This concept is not, however, limited in the initial inquiry to whether appealed rates are unreasonably preferential, prejudicial, or discriminatory; it also has application to whether rates are just and reasonable. On remand, Windermere must bring forth evidence in this initial inquiry regarding the characteristics of its customers to demonstrate that the single rates it charges customers for water and sewer service are just and reasonable.

III. Summary and Orders

For the reasons discussed in this Order, the Commission rejects the proposal for decision and remands this proceeding to SOAH to address in the initial inquiry all of the standards prescribed under TWC § 13.043(j). This necessarily includes evaluating whether allowing recovery of all expenses included in the proposed revenue requirement, including the \$171,337 in legal expenses, will result in just and reasonable rates. If, after a completing initial inquiry it is necessary for the Commission to set rates, then the rate-making issues identified in the Commission's preliminary order must be addressed.

Signed at Austin, Texas the 30th day of June 2022.

PUBLIC UTILITY COMMISSION OF TEXAS



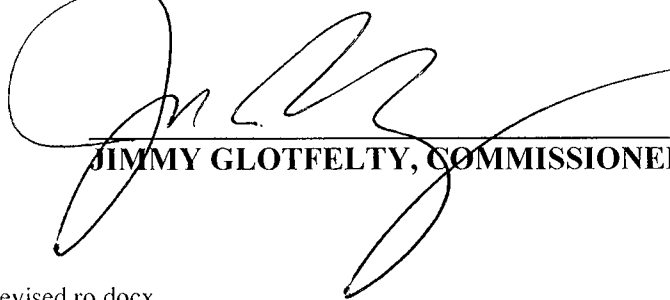
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