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COMMISSIONER MEMORANDUM

MEETING DATE: December 14, 2023

DATE DELIVERED: December 13, 2023

AGENDA ITEM NO.: 1


CAPTION: Docket No. 50788; SOAH Docket No. 473-20-4071.WS –
Ratepayers Appeal of the Decision by Windermere
Oaks Water Supply Corporation to Change Water and
Sewer Rates

DESCRIPTION: Memorandum of Commissioner Cobos

Public Utility Commission of Texas

Commissioner Memorandum

TO: Interim Chair Kathleen Jackson
Commissioner Will McAdams
Commissioner Jimmy Glotfelty

FROM: Commissioner Lori Cobos 

DATE: December 13, 2023

RE: December 14, 2023 Open Meeting – Agenda Item No. 1
PUC Docket No. 50788, SOAH Docket No. 473-20-4071.WS, Ratepayers Appeal of the Decision by Windermere Oaks Water Supply Corporation to Change Water and Sewer Rates

Before the Commission is a State Office of Administrative Hearings (SOAH) proposal for decision (PFD) recommending the Commission grant a ratepayer appeal of rates fixed by the board of directors (board) of Windermere Oaks Water Supply Corporation (Windermere).

After further review of the issues in this proceeding, I recommend the Commission adopt the PFD, in part, and reject the PFD, in part. Specifically, I recommend the Commission make the following key determinations that modify the PFD:

- Texas Water Code (TWC) § 13.043(j), read in harmony with subsection (e), requires the Commission to preserve Windermere's financial integrity at the time the appealed rates were set. Therefore, the scope of the evidence that the Commission may consider in this proceeding should be limited to the information that was available to Windermere's board on February 11, 2020 and evidence of the reasonable expenses incurred by Windermere in this appeal proceeding.
- Windermere failed to carry its burden of proof demonstrating that the appealed rates are in the public interest.
- The net revenue requirement that Windermere's board should have used to fix Windermere's rates on February 11, 2020 is \$359,378 (\$356,378 in net other operating expenses + \$3,000 in legal expenses).
- To preserve Windermere's financial integrity at the time the appealed rates were set, Windermere should be authorized to recover its outstanding 2019 legal debt through a monthly surcharge collected over 12 months beginning from the first billing period after March 23, 2020.
- New volumetric and fixed rates should be calculated using the net revenue requirement. Sixty percent of the net revenue requirement should be allocated to water service. The remaining 40% should be allocated to sewer service. Commission Staff should identify

which costs in the net revenue requirement are fixed and variable and those costs should be assigned to fixed and variable rates accordingly.

I. SCOPE OF THE EVIDENCE THAT MAY BE CONSIDERED BY THE COMMISSION

As an initial matter, I recommend the Commission first address the evidentiary requirements in TWC § 13.043(e) and the financial integrity requirement in TWC § 13.043(j). The PFD does not directly address how subsections (e) and (j) interact with each other. However, importantly, addressing this interaction provides a framework for the scope of the evidence that the Commission may consider in this appeal proceeding.

A. TWC § 13.043(e) – Information that May Be Considered by the Commission

TWC § 13.043(e) states that the Commission may consider “only the information that was available to the governing body [of the retail public utility] at the time the governing body made its decision and evidence of reasonable expenses incurred by the retail public utility in the appeal proceedings.”¹ Windermere’s board set the appealed rates at its February 11, 2020 board meeting.²

Pursuant to the Commission’s practice in previous rate appeals, I recommend the Commission consider only information that was available to Windermere’s board on February 11, 2020 and evidence of reasonable expenses incurred by Windermere in this proceeding.³ The Commission should not consider information originating after February 11, 2020, unless it shows or tends to show: (1) the information that was available to Windermere’s board on February 11, 2020; or (2) the information is related to Windermere’s reasonable expenses incurred in this proceeding.⁴ Stated differently, the Commission should consider information originating after February 11, 2020 only to determine whether the information was known to Windermere’s board on February 11, 2020 and the reasonable expenses incurred by Windermere in this proceeding.

B. TWC § 13.043(j) – The Financial Integrity Requirement

TWC § 13.043(j) requires the Commission to fix rates “using a methodology that preserves the financial integrity of the retail public utility.” In two previous fully litigated rate appeals, the Commission made clear that new rates must preserve a retail public utility’s financial integrity.⁵ However, in previous rate appeals, the Commission has not directly addressed whether new rates must preserve a retail public utility’s current financial integrity or a retail public utility’s financial integrity at the time the appealed rates were set by the retail public utility’s governing body. If

¹ Tex. Water Code (TWC) § 13.043(j).

² Direct Testimony of Joe Gimenez III, WOWSC Ex. 2 at 11:3-6, Attachment JG-7.

³ TWC § 13.043(e).

⁴ *Ratepayers’ Appeal of the Decision by Bear Creek Special Utility District to Change Rates*, Docket No. 49351, Order on Rehearing, Conclusion of Law No. 7A (Nov. 19, 2021).

⁵ Docket No. 49351, Order on Rehearing, Conclusion of Law 11 (“The rates fixed by this Order will preserve the financial integrity of Bear Creek SUD in compliance with TWC § 13.043(j).”); *Appeal of Water and Sewer Rates Charged by the Town of Woodloch CCN Nos. 12312 and 20141*, Docket No. 42862, Order, Conclusion of Law No. 13 (Mar. 17, 2016) (“When setting rates, the Commission must use a ‘methodology that preserves the financial integrity of the retail public utility.’ Tex. Water Code § 13.043(j). Considerations of financial integrity cannot, however, be treated as a trump card that overrides the utility’s obligation to comply with the standard requirements for proving [its] water and sewer rates.”).

new rates are required to preserve a retail public utility's current financial integrity, the Commission would have to consider information that originated after the time the appealed rates were set by the retail public utility's governing body. However, if new rates are required to preserve a retail public utility's financial integrity at the time the appealed rates were set by the retail public utility's governing body, the Commission would be able to stay within the evidentiary scope required by TWC § 13.043(e), by considering only the information available to the governing body of a retail public utility at the time the governing body set the appealed rates.

Although the PFD does not directly address the interaction between subsections (e) and (j) of TWC § 13.043, the SOAH ALJs' recommendation appears to ensure a retail public utility's financial integrity at the time of the Commission's order.⁶ Based on my review of the financial integrity requirement of TWC § 13.043(j), however, I recommend the Commission interpret subsection (j) to require preserving a retail public utility's financial integrity at the time the appealed rates were set by the retail public utility's governing body. Interpreting TWC § 13.043(j) to require rates that preserve a retail public utility's financial integrity at the time of the Commission's order would require the Commission to consider information originating after the time the appealed rates were set by a retail public utility's governing body, which is prohibited by TWC § 13.403(e). A more appropriate statutory interpretation of TWC § 13.043(e) and (j) would require the Commission to fix rates that will preserve a retail public utility's financial integrity at the time the appealed rates were set by a retail public utility's governing body. This reading harmonizes both subsections, is administratively efficient, and best aligns with the Commission's previous decisions in rate appeals.⁷

II. PUBLIC-INTEREST DETERMINATION

In an appeal under TWC § 13.043, the Commission must find the appealed rates are against the public interest before setting just and reasonable rates.⁸ Windermere, as a retail public utility, has the burden of proof to show the appealed rates serve the public interest.⁹

In this initial public-interest inquiry, the Commission must ensure all standards set forth in TWC § 13.043(j) are met.¹⁰ No standard takes precedence over another.¹¹ Specifically, the Commission is statutorily obligated to ensure that every appealed rate is just and reasonable; is sufficient,

⁶ See Proposal for Decision at 47–50 (describing the ALJs' analysis and evaluation of Windermere's financial integrity).

⁷ See e.g., *Ratepayers' Appeal of the Decision by Bear Creek Special Utility District to Change Rates*, Docket No. 49351, Order on Rehearing at 7-8 (Nov. 19, 2021) (omitting consideration of information originating after the appealed rates were set when fixing rates that would preserve the financial integrity of Bear Creek Special Utility District).

⁸ See TWC § 13.043(j) ("In an appeal under this section, the utility commission shall ensure that every appealed rate is just and reasonable. Rates shall not be unreasonably preferential, prejudicial, or discriminatory but shall be sufficient, equitable, and consistent in application to each class of customers."); see also *Tex. Water Comm'n v. City of Fort Worth*, 875 S.W.2d 332, 336 (Tex. App.—Austin 1994, writ denied) (interpreting TWC § 13.043(j) to expressly require the Commission to make a finding that the appealed rates are unreasonably preferential, prejudicial, or discriminatory before modifying the rates so that they are just and reasonable).

⁹ 16 Tex. Admin. Code § 24.12.

¹⁰ Order Remanding Proceeding at 5 (Jun. 30, 2022) (citing *City of Fort Worth*, 875 S.W.2d at 335).

¹¹ Order Remanding Proceeding at 5.

equitable, and consistent in application to each class of customers; and is not unreasonably preferential, prejudicial, or discriminatory.¹² If the Commission finds in its initial public interest inquiry that any standard in TWC § 13.043(j) has been violated, the Commission would then establish rates that meet these required standards using a methodology that preserves the financial integrity of the retail public utility.¹³

The SOAH ALJs recommend that the Commission find the appealed rates are not in the public interest. Specifically, the SOAH ALJs find that the appealed rates are not just and reasonable, because Windermere failed to offset its revenue requirement for the appealed rates to account for late- and standby-fee revenues.¹⁴ By failing to adjust its revenue requirement to account for non-rate revenues, Windermere set rates that collect more than its cost of service in violation of the public interest.

Therefore, I agree with the SOAH ALJs that the appealed rates are not in the public interest, but I recommend that the Commission make this determination based on the broader grounds that Windermere failed to carry its burden of proof demonstrating that the appealed rates are in the public interest. Windermere failed to provide sufficient evidence to support the revenue requirement or rate design that it used to set the appealed rates. The parties in this proceeding have competing theories on how the appealed rates were set by Windermere's board. However, the Commission cannot find that the appealed rates are in the public interest, if it cannot determine, from the evidentiary record, the revenue requirement or rate design that was used to set the appealed rates.

Windermere failed to carry its burden of proof, because it did not provide evidence of the revenue requirement and rate design that was used to set the appealed rates. Therefore, I recommend the Commission find the appealed rates are neither just and reasonable nor in the public interest, and fix just and reasonable rates for Windermere.

III. FIXING THE RATES WINDERMERE'S BOARD SHOULD HAVE FIXED

A. Net Revenue Requirement

Both the SOAH ALJs and Windermere recommend that the Commission set new rates that allow Windermere to recover a net revenue requirement of \$527,714 annually.¹⁵ Commission Staff recommends the Commission allow Windermere to recover a net revenue requirement of \$356,377 annually,¹⁶ rounded down from \$356,377.67.¹⁷ The SOAH ALJs, Windermere, and Commission

¹² TWC § 13.043(j).

¹³ TWC § 13.043(j).

¹⁴ Proposal for Decision at 37.

¹⁵ Proposal for Decision at 37, Finding of Fact No. 68.

¹⁶ Supplemental Direct Testimony of Anna Givens, Staff HOM-2 Ex. 2 at 6:17-26 (recommending a net revenue requirement of \$356,377).

¹⁷ Supplemental Direct Testimony of Anna Givens, Staff HOM-2 Ex. 2, Supplemental Attachment AG-1 (recommending a net revenue requirement of \$356,377.67 and providing a list of the costs, long-term debt, and other revenues included in the net revenue requirement).

Staff considered information unavailable to Windermere's board on February 11, 2020 to determine their net revenue requirements.

For the reasons provided below, I recommend the Commission reject the SOAH ALJs' recommended net revenue requirement and authorize Windermere to recover a net revenue requirement of \$359,378, consisting of a net water-service revenue requirement of \$215,626.80 and a net sewer-service revenue requirement of \$143,751.20. The net revenue requirement includes \$3,000 in legal expenses; \$404,855 in other non-legal operating expenses; and an offset of negative \$48,477 to account for non-rate revenues. I also recommend the Commission authorize Windermere to recover its outstanding 2019 legal debt through a monthly surcharge collected over 12 months beginning from the first billing period after March 23, 2020.

1. Legal expenses

The SOAH ALJs recommend that the Commission allow Windermere to include legal expenses of \$171,337 in its annual revenue requirement,¹⁸ which is the amount of legal expenses provided in the Texas Rural Water Association's initial rate study.¹⁹ The SOAH ALJs found that this amount, although extraordinary, could not have been avoided and point to Windermere's success in defending a Texas Open Meetings Act lawsuit, its increasing expenses in an *ultra vires* lawsuit, and its receipt of dozens of Public Information Act requests.²⁰ The SOAH ALJs assert it was appropriate to include extraordinary legal expenses in the revenue requirement, because the expenses are actually realized or can be anticipated with reasonable certainty.²¹ The SOAH ALJs relied on information that was not known to Windermere's board on February 11, 2020 to justify their recommendation.²² As discussed above, TWC § 13.043(e) expressly limits the Commission to considering only information available to a retail public utility's governing body at the time it set the appealed rates.

A retail public utility's governing body must exercise great care to set base rates, surcharges, pass-through charges, and fees that collect only reasonable and necessary costs that have been actually realized or can be anticipated with reasonable certainty. Recurring expenses should be recovered through a retail public utility's base rates (i.e., the retail public utility's monthly minimum charge and gallonage rates). Large and extraordinary, non-recurring expenses should be deferred and recovered through surcharges over a reasonable period of time to ensure these expenses are recovered transparently without distorting a retail public utility's annual revenue requirement and base rates.

Therefore, I recommend the Commission reject the SOAH ALJs' recommendation, which would allow Windermere to recover \$171,337 in legal expenses annually through its base rates. These large legal expenses are almost 50% of Windermere's other non-legal operating expenses. In the year leading up to the Windermere board's February 11, 2020 ratemaking decision, the Windermere board pursued a legal strategy across four lawsuits that resulted in extraordinary legal

¹⁸ Proposal for Decision at 37.

¹⁹ Direct Testimony of Mike Nelson, with attachments, including voluminous attachments, WOWSC Ex. 7, Attachment MN-2 at 1.

²⁰ Proposal for Decision at 30–31.

²¹ Proposal for Decision at 31.

²² Proposal for Decision at 33.

expenses, of which only \$166,583.46 were paid in 2019.²³ The duration, outcome, and expense of a lawsuit is rarely predictable. Accordingly, these legal expenses, while actually realized, were extraordinary non-recurring costs that should not have been included in Windermere's annual revenue requirement and base rates. The ratepayers that appealed Windermere's rates in this proceeding demonstrated that including such extraordinary legal expenses in base rates inflated the revenue requirement.

A retail public utility must be allowed to recover some amount annually to cover miscellaneous legal costs, such as contract negotiation, business certification, and other similar legal matters. However, Windermere's extraordinary litigation expenses and litigation-related expenses (e.g., legal expenses arising from the 46 Public Information Act requests Windermere received in 2019) are distinguishable from such general legal expenses. Notably, in 2017, before the onset of the litigation at issue, Windermere incurred less than \$3,000 in legal expenses.²⁴ Consequently, given this information, I recommend the Commission find it was reasonable for Windermere's board on February 11, 2020 to include \$3,000 in general legal expenses in its base rates.

This does not mean Windermere has no other recourse to recover its extraordinary litigation and litigation-related expenses. At the time it set the appealed rates, Windermere's board was aware of the outstanding 2019 legal debt. Under TWC § 13.043(j), the Commission is required to ensure Windermere's financial integrity at the time the appealed rates were set by Windermere's board. In order to preserve Windermere's financial integrity, Windermere would have to recover its outstanding legal debt from 2019. Because it is not appropriate to include these extraordinary legal costs in Windermere's base rates, I recommend the Commission find that Windermere's board should have allowed Windermere to recover its outstanding 2019 legal debt through a monthly surcharge collected from all customers over a 12-month period beginning from the first billing period after March 23, 2020,²⁵ instead of including these extraordinary legal costs in the appealed rates that would be recovered as base rates. For administrative efficiency, Windermere's future legal expenses could then be recovered through the surcharge until all disputes are resolved.

2. Other operating expenses, long-term debt, and non-rate revenues

The SOAH ALJs did not recommend a specific amount of other non-legal operating expenses. Instead, the SOAH ALJs recommended a net revenue requirement of \$527,714 that includes legal expenses of \$171,337 and a negative \$48,477 offset to account for non-rate revenues.²⁶ Windermere supports the SOAH ALJs' recommendation. Commission Staff recommends the Commission approve net other non-legal operating expenses of \$356,378. This amount includes a \$48,477 negative offset to account for non-rate revenues generated by Windermere's various

²³ WOWSC GL Detail – 2019, Ratepayers HoM-2 Ex. 74 at 59–61; *see* Direct Testimony of Mike Nelson with attachments, including voluminous attachments, WOWSC Ex. 7, Workpaper MN-1; Ratepayers HoM-2 Ex.17, Attachment Ratepayers 3-19.

²⁴ Direct Testimony of Joe Gimenez III, WOWSC Ex. 2 at 17:9-14; Proposal for Decision at 36.

²⁵ *See* WOWSC GL Detail – 2019, Ratepayers HOM-2 Ex. 74 at 72–74 (providing the legal expenses paid by Windermere from January through December 2019); Direct Testimony of Mike Nelson, with attachments, including voluminous attachments, WOWSC Ex. 7, Workpaper MN-1 (providing the invoices for legal expenses received by Windermere from January through December 2019).

²⁶ Proposal for Decision at 37.

fees. Commission Staff's recommendation is based on the costs in Windermere's 2019 profit and loss statement²⁷ and removes all non-recurring and legal expenses from the revenue requirement.

I recommend the Commission adopt Commission Staff's calculation of net other non-legal operating expenses in the amount of \$356,378.

B. Cost Allocation and Rate Design

1. Cost allocation

The SOAH ALJs recommend the Commission allocate 60% of Windermere's net annual revenue requirement to water service (i.e., \$316,628.40), and 40% of Windermere's net annual revenue requirement to sewer service (i.e., \$211,085.60).²⁸ The SOAH ALJs further recommend the Commission find Windermere's existing rate design reasonable and perform no reallocation of costs to the variable gallonage rates.²⁹ This is a recommendation to keep Windermere's volumetric rates the same and modify only its monthly minimum charges to account for changes to Windermere's net annual revenue requirement.³⁰

The SOAH ALJs' recommendation will result in inflated monthly minimum charges. From a practical standpoint, this would result in a significant amount of Windermere's variable costs being recovered through its fixed rates and decouples cost drivers from rate components. Such decoupling could result in over-recovery during periods of low consumption or under-recovery during periods of high consumption. It may also discourage water conservation.

Accordingly, I recommend the Commission reject the SOAH ALJs' recommendation to keep Windermere's volumetric rates unchanged. Instead, I recommend the Commission direct Commission Staff to perform a number run consistent with this memorandum. The number run should allocate 60% of Windermere's net annual revenue requirement to water service and 40% of Windermere's net annual revenue requirement to sewer service. Because my recommended net annual revenue requirement is different from the net annual revenue requirement used by Windermere's board to set the appealed rates, as discussed above, the fixed and variable costs must be updated. Consequently, Commission Staff should identify fixed and variable costs based on the net annual revenue requirement and assign those costs to fixed and variable rates accordingly.

2. Rate classes

The SOAH ALJs recommend the Commission make no changes to the rate classes used to design the appealed rates.³¹ I recommend the Commission adopt the SOAH ALJs' recommendation.

²⁷ See Direct Testimony of Mike Nelson, with attachments, including voluminous attachments, WOWSC Ex. 7, Attachment MN-3 at 1.

²⁸ Proposal for Decision at 57.

²⁹ Proposal for Decision at 57.

³⁰ See Proposal for Decision at 64, Finding of Fact No. 77 ("The rate increase is applied to the base rate, rather than the volumetric rate, to provide equitable rates for all customers.").

C. Refunds and Surcharges

1. Refunds for Over-Recovery

Because the net annual revenue requirement that I recommend the Commission approve is lower than the revenues that Windermere collected under the appealed rates, I recommend that the Commission order Windermere to refund the difference to its ratepayers. The revenues that Windermere collected under the appealed rates should be calculated using Windermere's calendar-year 2019 utility usage data. The total refund amount should be determined based on the difference between the revenues that Windermere collected under the appealed rates, effective March 23, 2020, and the net annual revenue requirement approved by the Commission in this proceeding, effective December 14, 2023. I also recommend that the refund be offset by the 12-month surcharge for the outstanding 2019 legal debt and that any remaining amount be credited to Windermere's ratepayers over the same time period that the appealed rates were in effect. The total amount to be collected under the surcharge for the outstanding 2019 legal debt should be determined using Windermere's 2019 general ledger entries for category 63000 – *Legal/Appraisal*³² and Windermere's invoices for 2019 legal expenses.³³

2. Rate-Case Expenses

The SOAH ALJs recommend the Commission authorize Windermere to recover \$478,184.04 in rate-case expenses through a surcharge to be assessed over a 42-month period.³⁴ I recommend the Commission adopt the SOAH ALJs' recommendation, but assess the rate-case expense surcharge over the same number of months the appealed rates were in effect to reduce the impact of the surcharge on Windermere's ratepayers.

3. Compliance Docket

I recommend the Commission open a compliance docket to oversee the calculation and refund of the over-recovery to Windermere's ratepayers and the implementation of the rate-case expense surcharge.

IV. CONCLUSION

In sum, I recommend the Commission adopt the PFD, in part, and reject the PFD, in part, consistent with my memorandum. I further recommend the Commission direct Commission Staff to perform a number run consistent with my memorandum. Finally, I recommend the Commission direct Commission Advising to use Commission Staff's number run to prepare a draft final order consistent with my memorandum for the Commission's consideration at a future open meeting.

³² See WOWSC GL Detail 2019, Ratepayers HOM-2 Ex. 74 (providing Windermere's payments for legal expenses for the 2019 calendar year under category 63000 – *Legal/Appraisal*); see also Ratepayer Representatives' Seventh Request for Information to Windermere Oaks Water Supply Corporation at 071-073 (Jan. 30, 2023).

³³ See Direct Testimony of Mike Nelson, with attachments, including voluminous attachments, WOWSC Ex. 7, Workpaper MN-1 (providing invoices sent by Enoch Keever, PLLC; Lloyd Gosselink, Rochelle & Townsend, P.C.; and g3 Public Relations to Windermere); WOWSC's Response to Ratepayers' Third Request for Information, Ratepayers Ex. 17 at 069-096 (providing invoices sent by Enoch Keever, PLLC and Lloyd Gosselink Rochelle & Townsend, P.C. to Windermere).

³⁴ Proposal for Decision at 56.