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Received - 2021-10-27 01:09:21 PM
Control Number - 52758
ItemNumber - 1

PUC DOCKET NO. _____

**PETITION OF McALLEN PUBLIC
UTILITY APPEALING WHOLESALE
WATER RATES CHARGED BY
HIDALGO COUNTY WATER
IMPROVEMENT DISTRICT NO. 3 IN
HIDALGO COUNTY, TEXAS**

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**BEFORE THE

PUBLIC UTILITY COMMISSION

OF TEXAS**

ORIGINAL PETITION

TO THE HONORABLE PUBLIC UTILITY COMMISSION OF TEXAS:

McAllen Public Utility (“MPU”) files with the Public Utility Commission of Texas (the “Commission”) this Original Petition appealing wholesale water rates (the “Petition”) charged by Hidalgo County Water Improvement District No. 3 (the “HCWID 3”), in Hidalgo County, Texas.

I. INTRODUCTION

This Petition presents the Commission with an unprecedented example of a wholesale service provider’s abuse of its monopoly power. HCWID 3 has a long and documented history of mismanagement, self-dealing, and noncompliance with numerous applicable statutory requirements. Significant deficiencies in HCWID 3’s financial and operational management have rendered McAllen and MPU unable to verify that HCWID 3 has undertaken or adopted any reasonable operations, policies, or practices that are statutorily required of water control and improvement districts.

The rate charged to MPU by HCWID 3 for raw water delivery service is nearly double the average rate charged to MPU by similarly situated districts and is 8.5 times the rate charged by HCWID to its other customers. The disproportionate rate, viewed in the context of HCWID 3’s history of mismanagement, demands a public interest hearing conducted by the Commission under its statutory jurisdiction over raw water delivery rates. Under its statutory duty to fix reasonable rates for raw water delivery service, the Commission should, at a minimum, (1) establish an interim rate to be charged by HCWID 3 to MPU during the pendency of this proceeding, (2) find that the rate set by HCWID 3 pursuant to the Contract harms the public interest, and (3) order HCWID 3 to charge MPU a raw water delivery rate based on a fair-market value of raw water in the Lower Rio Grande Valley region.

I. PARTIES

MPU is the municipally owned utility for the City of McAllen, a home-rule municipality (“McAllen” or the “City”). HCWID 3 is a water control and improvement district subject to Texas Water Code (“TWC”) Chapters 49 and 51. Exhibit A to this Petition includes the contract by which MPU purchases water from HCWID 3 as amended (the “Contract”).

III. STATUTORY AUTHORITY

By this Petition, MPU invokes TWC § 12.013.¹

IV. FACTUAL ALLEGATIONS

In support of the requests for relief enumerated in Section V of this Petition, MPU respectfully shows the following.

1. McAllen Public Utility

MPU is a municipally owned utility created in 1945 to supply retail water and wastewater utility service to the citizens of McAllen and portions of its surrounding area.² It is governed by a five-member Board of Trustees—four members of which are elected by McAllen’s citizens and one who is appointed by the City’s mayor.³ MPU owns and operates two drinking water treatment plants, two wastewater treatment plants, several ground and elevated storage tanks, and hundreds of miles of water transmission, distribution, and wastewater collection lines.⁴ Through that municipal water and wastewater system, MPU provides safe and reliable water service to over 150,000 people and sewer service to more than 200,000 at just and reasonable rates in accordance with TWC Chapter 13, Water Certificate of Convenience and Necessity (“CCN”) No. 11352, and Sewer CCN No. 20524.

¹ While MPU is not invoking the Commission’s jurisdiction under TWC § 13.043(f), the scope of the Commission’s jurisdiction under both statutes is substantively similar. There is, however, one important procedural difference. TWC § 12.013 does not establish any limitation on the timeliness of a petition requesting the Commission’s exercise of its duty to fix reasonable rates for the furnishing of raw water as provided in TWC Chapter 11. TWC § 13.043(f), on the other hand, requires that a retail public utility that receives water service from a political subdivision must initiate an appeal within 90 days after the date of notice of the decision of the provider of water service affecting the amount paid for the service. Exhibit B to this Petition includes HCWID 3’s notice of rate increase to MPU dated July 29, 2021. If MPU invoked TWC § 13.043(f), which it does not, the 90-day deadline for this appeal would be October 27, 2021.

² McAllen Public Utility, 2020 Consumer Confidence Report, 2 (2020), <http://mcallenpublicutility.com/wp-content/uploads/2021/06/2020-Water-Quality-Report-Booklet.pdf> [hereinafter Water Quality Report].

³ *Id.*

⁴ *Id.* at 3; MPU, <https://mcallenpublicutility.com/departments/water-systems/water-plants/> (last visited Oct. 18, 2021).

MPU essentially buys all of the raw water needed for its municipal supply system pursuant to contracts with four districts: Hidalgo County Irrigation District No. 1 (“HCID 1”), Hidalgo County Irrigation District No. 2 (“HCID 2”), HCWID 3, and United Irrigation District (“United”).⁵ Each of those four districts diverts the raw water for delivery to MPU pursuant to water rights administered by the Texas Commission on Environmental Quality (“TCEQ”) through the Rio Grande Watermaster program.⁶ MPU treats the water purchased from the districts in compliance with public drinking water standards before distributing the water to its customers.⁷ MPU does not purchase treated water from any of the four supply districts.⁸

Since 2012, HCWID 3 has raised its raw water delivery charges to MPU pursuant to the Contract 70.6 percent—from \$66.80 per acre-foot in 2012⁹ to \$113.96 in 2021.¹⁰ For comparison, the rates charged by the four districts to MPU per acre-foot of water authorized under the respective contracts during 2012 and 2022 are as follows:

<u>District</u>	<u>2012 Rate</u>	<u>2022 Rate</u>
HCID 1	N/A ¹¹	\$65.89
HCID 2	\$51.26	\$51.26
HCWID 3	\$66.80	\$113.97
United	\$53.44	\$59.96

⁵ MPU sources a small percentage of its municipal supply from a privately owned groundwater well.

⁶ Exhibit C to this Petition includes copies of MPU’s current contracts with HCID 1, HCID 2, and United; *See* Tex. Water Code § 11.3271.

⁷ Water Quality Report at 3.

⁸ Affidavit of Marco A. Vega, P.E., General Manager of MPU, at 1 (included as Exhibit D to this Petition).

⁹ HCWID 3 raised MPU’s rate under the Contract in 2012 and 2014. In 2012, HCWID 3 raised MPU’s rate 33 percent from \$66.80 to \$88.79. In 2014, HCWID 3 raised MPU’s rate an additional 10 percent from \$88.79 to \$97.67. TWC § 12.013 requires the Commission to “fix reasonable rates for the furnishing of raw or treated water for any purpose mentioned in Chapter 11 or 12” of the TWC. The statute does not set any minimum time frame during which the Commission may act to fix reasonable rates. The rates charged by HCWID 3 in 2012 and 2014 were for service provided under the same Contract in Exhibit A. By this Petition, MPU is requesting the Commission—after making a final determination on the public interest—fix a reasonable rate for HCWID 3’s furnishing of raw water to MPU under permits issued to both entities under TWC Chapter 11. TWC § 12.013 does not limit the Commission’s consideration to the most recent rate adjustment.

¹⁰ Exhibit B.

¹¹ Because of the lack of useful delivery point, the City did not purchase water from HCID 1 in 2012 and has no records of HCID 1’s rates in 2012.

2. Hidalgo County Water Improvement District No. 3

HCWID 3 was created in 1921 and, by resolution of its governing board, converted to a water control and improvement district on March 9, 1926.¹² Over 90 percent of HCWID 3's bounded area is within McAllen's corporate limits.¹³ HCWID 3 owns Certificate of Adjudication No. 23-848, as amended ("COA 848"). Pursuant to its contract with MPU, HCWID 3 also diverts water under a separate water right owned by McAllen—Certificate of Adjudication No. 23-353 ("COA 353"). COA 848 and COA 353 (collectively, the "Permits") are water rights that authorize HCWID 3 to divert raw water on behalf of McAllen from the Rio Grande under municipal-use accounts managed by the Watermaster.¹⁴ The Permits are included as Exhibit G.

Unlike in many wholesale rate appeals, the Contract at issue in this case is not the legal instrument that entitles McAllen to the water delivered under it. As recognized in the Contract, over time HCWID 3 has converted portions of its irrigation-use rights to municipal use as McAllen's needs have increased and irrigation demands have decreased.¹⁵ The effect is that McAllen is legally entitled under state-administered water rights authorizations to the water delivered by HCWID 3. In other words, the terms of the Contract—including the price for delivery—are for HCWID 3's delivery of water intended specifically under the Rio Grande adjudication for McAllen's own use and formally designated as such by the Rio Grande Watermaster.

While HCWID 3 was originally created to serve both as the supplier of water to McAllen for municipal purposes and as a raw water supplier to irrigation users, the region it serves has urbanized significantly since its formation.¹⁶ Today, HCWID 3 serves only a nominal amount of

¹² State Auditor's Office, An Audit Report on The Hidalgo County Water Improvement District No. 3, Report No. 12-034, i (May 2012) [hereinafter Audit Report] (a copy of the Audit Report is included as Exhibit E to this Petition).

¹³ Exhibit D, Affidavit of Marco A. Vega, P.E., at 2; Exhibit F to this Petition includes a map depicting HCWID 3's boundaries relative to the City's corporate limits and identifies acreage areas where HCWID 3 serves irrigation customers.

¹⁴ Exhibit A at 1-2; *see* TWC § 11.3271.

¹⁵ *See* Exhibit A at 1-2 (explaining that HCWID 3 delivers municipal-purpose water to which McAllen is directly entitled, that HCWID 3 has obtained through amendments to its water rights, and that the Contract requires HCWID 3 to deliver water under any additional water rights acquired by the City (e.g. COA 353)); Exhibit G at 8-9, 11-12 (memorializing conversion of HCWID 3 irrigation-purpose water to municipal-purpose water).

¹⁶ Exhibit D, Affidavit of Marco A. Vega, P.E., at 2.

irrigation customers to irrigate a maximum of 1,278 acres in total based on MPU's calculations.¹⁷ Most times, however, MPU understands that HCWID 3 provides irrigation water to far less area than that.¹⁸ HCWID 3 charges a rate of \$13.40 per acre-foot for water delivered to its irrigation¹⁹ customers.²⁰ As far as MPU is aware, there is functionally no difference²¹ between the raw water diverted and delivered to HCWID 3's irrigation customers and the raw water diverted and delivered to MPU for municipal use.²² HCWID 3 uses the same diversion pump station and canal/pipeline system to deliver the water to all customers.²³

The City of McAllen, through MPU, is HCWID 3's only municipal water customer, and MPU annually purchases a substantial majority of water delivered by HCWID 3 to all of its customers.²⁴ MPU is unaware of any other significant sources of revenue for HCWID 3.²⁵ MPU is unaware of any bonded indebtedness or plans to issue bonds by HCWID 3.²⁶ Consequently, McAllen effectively pays to HCWID 3 an annual equivalent of almost the entirety of HCWID 3's annual operating budget.²⁷

The full scope of service HCWID 3 provides to MPU is, essentially, to pump raw water that McAllen is already legally entitled to receive from the Rio Grande under the Permits into a canal and pipeline system, whereby the water flows by gravity to MPU's metered delivery

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ MPU does not argue that HCWID 3's irrigation rate is unreasonable, preferential, or should be increased. Under the adjudication of water rights in the Rio Grande, water for municipal, industrial, and domestic uses is prioritized over irrigation use. *State v. Hidalgo Cnty. Water Control and Improvement Dist. No. 18*, 443 S.W.2d 728, 731 (Tex.Civ.App.—Corpus Christi 1969, writ ref'd n.r.e.); 30 TAC § 303.22(a), .43. When HCWID 3 converted its irrigation supply to municipal use, TCEQ's rules required reduction of the authorized volume of water. Exhibit G at 11-12; see 30 TAC § 303.43. Because the water designated in the Permits for municipal use is a more protected class within the Rio Grande adjudication system, MPU does not contend that it is of equal value to the irrigation water. MPU merely contends that the rates demanded by HCWID 3 for the permitted municipal-use water are unreasonable.

²⁰ Exhibit D, Affidavit of Marco A. Vega, P.E., at 2.

²¹ As noted in note 19, *supra*, MPU's municipal-use water is classified as "a higher order of preference" than irrigation-use water. Exhibit G at 11. While MPU's municipal-use water is legally different, the physical characteristics do not differ from the water HCWID 3 diverts for irrigation customers.

²² Exhibit D, Affidavit of Marco A. Vega, P.E., at 2.

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.* at 3.

points. The distance from HCWID 3's diversion point on the Rio Grande to the Contract delivery points is the shortest of all districts that supply water to MPU.²⁸ Consequently, HCWID 3 must maintain a transmission canal and pipeline that is shorter than those maintained by the other districts. HCWID 3 does not treat water and it does not own any treatment works sufficient to supply potable water.²⁹

Despite this relatively limited functionality, MPU calculates that the Contract with HCWID 3 will require MPU to pay HCWID 3 as much as \$1,752,476.88 for 13,980 acre-feet of raw water every annual period from September 1 through August 31.³⁰ The Contract requires MPU to pay the full cost of that volume of water every year regardless of whether HCWID 3 actually delivers the full allotment.³¹ The Contract further obligates HCWID 3 to divert and deliver up to 678.84 acre-feet of water under McAllen's COA 353. If McAllen exercised its rights under the Permits in full, its annual payment obligation to HCWID 3 under at newly instituted rate, including the impact of transportation loss as allowed for in the contract, would be \$1,837,573.55.³²

3. 2011 and 2012 Legislative Actions and State Audit Report

In 2011, the Texas Legislature passed Senate Bill 978 ("S.B. 978"), which would have allowed McAllen's citizens to vote to dissolve HCWID 3 and transfer its assets to the City.³³ The Governor vetoed S.B. 978 on the basis that it "would set a troubling precedent" by allowing the citizens of a city to effectively dissolve a special purpose district.³⁴ Concurrent with his veto, the Governor noted that the concerns giving rise to S.B. 978 should not be ignored and requested that the State Auditor conduct an audit of HCWID 3's finances and practices as authorized by TWC Chapter 49.³⁵ The resulting Audit Report documented numerous "weaknesses in the

²⁸ Exhibit D, Affidavit of Marco A. Vega, P.E., at 2.

²⁹ *Id.* at 1.

³⁰ *Id.* at 3; *see* Exhibit A at 3.

³¹ Exhibit A at 4. In years where MPU's demands are less than the full 13,980 acre-foot allotment, the unused portion will not include the 1.10 times loss factor. Consequently, MPU's annual payments will fluctuate slightly depending on MPU's annual demand. In any event, the overall cost fluctuation will necessarily amount to less than 10 percent.

³² $((13,980 \text{ acre-feet} + 678.84 \text{ acre-feet}) \# 1.1) * \113.96 .

³³ Tex. S.B. 978, 82nd Leg., R.S. (2011) (attached hereto as Exhibit D).

³⁴ Veto Message of Gov. Perry, Tex. S.B. 978, 82nd Leg., R.S. (2011); Audit Report app. 2.

³⁵ Audit Report app. 2; *see* Tex. Water Code § 49.199(b).

management” of HCWID 3’s finances and operations and “significant deficiencies in its controls over accounting and financial reporting that could negatively affect its operations.”³⁶ The Audit Report concluded the following:

Those weaknesses exist largely because HCWID 3 has not established a framework to provide for effective governance, oversight, and planning. Examples of specific weaknesses identified include a lack of financial controls, the absence of a formal, comprehensive, long-term master plan; noncompliance with procurement requirements; and noncompliance with certain requirements of the Texas Water Code.³⁷

Among the most troubling findings documented in the Audit Report was that “[f]rom fiscal year 2008 through fiscal year 2011, [HCWID 3] spent \$106,000 for services provided by businesses that were owned by or controlled by the individual who is both HCWID 3’s general manager and the president of HCWID 3’s board.”³⁸ The Audit Report also documented this:

HCWID 3 did not comply with statutory requirements to have written policies and procedures for selection, monitoring, or review and evaluation of professional services; it procured more than \$500,000 in professional services in fiscal year 2008 through fiscal year 2011. HCWID 3 also could not provide documentation demonstrating compliance with Texas Government Code Chapter 2254, which requires HCWID 3 to undertake a selection process for professional services.³⁹

In other words, the State Auditor’s Office could not reasonably estimate how much HCWID 3 may have overpaid for professional services because HCWID 3 has no policy or procedure to solicit or receive competitive bids for such services as required by law.⁴⁰ Nearly all of those expenses were ultimately paid by MPU’s retail service customers.⁴¹

4. 2021 Legislative Actions

During the 2021 regular session, the Legislature passed Senate Bill 2185 (“S.B. 2185”) intended to, once again, force HCWID 3 to correct many of the same management practices as

³⁶ Audit Report at i, 1.

³⁷ *Id.*

³⁸ *Id.*, at ii.

³⁹ *Id.*, at ii, 10.

⁴⁰ The same individual identified as the president of HCWID 3’s board continues to serve in that role today.

⁴¹ Exhibit D, Affidavit of Marco A. Vega, P.E., at 3.

noted in the Audit Report and improve transparency.⁴² The following are included in that legislation's requirements:

- Prohibition of District general manager serving as a director on the board of directors of HCWID 3;⁴³
- Establishment of an education program for HCWID 3's directors, including information on laws applicable to HCWID 3, legal developments related to water district governance, duties and responsibilities of the board of directors, conflict of interest laws, ethics policies adopted by the TCEQ or the Texas Ethics Commission;⁴⁴
- Specific prohibition of District director and employee conduct related to undue influence, self-dealing, conflicts-of-interest, and bribery;⁴⁵
- Establishment of an internet-based searchable database of District expenditures;⁴⁶ and
- Specific requirement for HCWID 3 to publish notice of board member elections.⁴⁷

5. HCWID 3 Rate Increases

Despite the State Auditor's and Legislature's unambiguous direction for HCWID 3 to take specific steps to bring its financial and operational management into compliance with applicable laws, MPU is unaware of any action taken by HCWID 3 to implement the recommendations of the Audit Report or the requirements of S.B. 2185.⁴⁸ In fact, MPU understands that HCWID 3 has taken actions apparently in circumvention of these requirements, including simply eliminating the general manager position to the effect that the president and chief executive are now effectively the same position.⁴⁹ HCWID 3's Board of Directors continues to meet without posting public notices, meets in an undisclosed location, and charges McAllen a rate that is 56 to 122 percent higher than rates charged by similar entities in the region

⁴² Act of May 29, 2021, 87th Leg., R.S., S.B. 2185 (to be published in General and Special Laws of Texas, Acts 2021, 87th R.S., ch. 1022).

⁴³ *Id.* § 2.

⁴⁴ *Id.* § 3.

⁴⁵ *Id.* § 5.

⁴⁶ *Id.* § 6.

⁴⁷ *Id.* § 7 (While the City welcomes the Legislature's efforts to improve the District's practices, it is important to note that these extraordinary measures would not be necessary to impose on a political subdivision that operates in accordance with the law.).

⁴⁸ Exhibit D, Affidavit of Marco A. Vega, P.E. at 4.

⁴⁹ *Id.*

for essentially identical service.⁵⁰ HCWID 3's rate is also 8.5 times the rate charged by HCWID 3 to its irrigation customers.⁵¹

Because HCWID 3's Board of Directors effectively meets in secret—if it meets at all, MPU lacks any ability to formally address its concerns to HCWID 3, to obtain any information or data supporting HCWID 3's revenue requirement and rate increases, or to engage in any process to resolve rate disputes.⁵² On July 29, 2021, HCWID 3 notified the City that it will raise its rate for raw water service nearly 17 percent from \$97.67 per acre-foot to \$113.96 per acre-foot effective September 1, 2021 through August 21, 2022. That increase will result in MPU paying approximately \$250,000 of additional revenue to HCWID 3 every year.⁵³ In years where MPU fully exercises its rights under both Permits, its additional payments will increase that additional annual revenue amount to \$262,672. MPU is unaware of any publicly noticed meeting at which HCWID 3's Board of Directors considered and approved this rate change.⁵⁴

One day after sending the rate increase notice, HCWID 3 sent a second letter to MPU that stated HCWID 3's justification for the more than \$250,000 in additional annual revenue.⁵⁵ Remarkably, HCWID 3 characterized the directives in S.B. 2185 to correct HCWID 3's noncompliance with applicable laws as “new Legislative responsibilities” to partially justify the nearly 17 percent rate increase. HCWID 3 also cited two capital improvement projects that have yet to be undertaken: “flood control structure modification to the District's Major Canal Delivery System[,]” and “Electrical upgrade to the District's Primary Pump Station on the river.”

V. REQUESTED RELIEF

Invoking the Commission's jurisdiction under TWC § 12.013 is the appropriate legal recourse for HCWID 3's open defiance of clearly defined statutory duties, which were reinforced through state-level action nearly a decade ago and as recently as September 1, 2021 through S.B. 2185. The Legislature has expressly delegated to the Commission the State's authority over

⁵⁰ *Id.*

⁵¹ *Id.* at 3.

⁵² *Id.* at 4.

⁵³ *Id.* at 3.

⁵⁴ Exhibit D, Affidavit of Marco A. Vega, P.E. at 3-4.

⁵⁵ HCWID 3's letter stating its rate-increase justification is included as Exhibit H to the Petition.

economic regulation of entities within the Commission's jurisdiction.⁵⁶ In light of HCWID 3's unprecedented abuse of its monopoly power and the Commission's statutory authority to fix reasonable rates for the furnishing of raw water,⁵⁷ MPU respectfully requests that the Commission grant MPU the following relief.

1. Establish an Interim Rate

MPU requests the Commission establish an interim rate and order HCWID 3 to charge the interim rate to MPU during the pendency of this proceeding, including the Public Interest Phase. This petition presents an extraordinary set of circumstances which may—and likely will—result in MPU's retail water customers incurring unreasonable expenses to finance HCWID 3's legal defense of its abusive practices. As explained, the amount paid by MPU for water under the terms of the Contract effectively constitutes HCWID 3's entire operating budget. Costs incurred by HCWID 3 to defend its long history of abusing MPU's retail customers should not be passed through to those customers during the pendency of this proceeding and subsequent judicial appeals, which could last for years. If the Commission declines to exercise its authority to establish interim rates, it will effectively force MPU's customers to continue bearing the burden of HCWID 3's mismanagement.

MPU's retail water customers should only pay more than comparable fair market rates for water delivered by HCWID 3 after HCWID 3 finally justifies its financial management practices and affirmatively demonstrates a reasonable need to charge, in some cases, more than double what other similar districts charge for raw water service. As demonstrated by the State Auditor's Report, neither the Commission nor MPU can rely on a refund order to make MPU whole at the conclusion of this proceeding because HCWID 3 has no effective system for managing or accounting for its revenues.

TWC § 12.013(e) expressly authorizes the Commission to establish interim rates “during the pendency of *any rate proceeding*.”⁵⁸ Rate proceedings under TWC § 12.013 include

⁵⁶ TWC § 13.041.

⁵⁷ *Id.* § 12.013(a).

⁵⁸ *Id.* § 12.013(e) (emphasis added). The Commission has adopted a rule expressly allowing the Commission to establish interim rates in proceedings brought under TWC § 13.043(f). 16 TAC § 24.37(a). There is, however, no Commission rule that establishes a standard for setting interim rates as authorized by TWC § 12.013(e). Despite the lack of reference to TWC § 12.013 in the Commission's interim rate rule, TWC § 12.013 plainly authorizes the Commission to establish interim rates during the pendency of a proceeding to fix reasonable rates for

challenges, like MPU's, to rates for the furnishing of raw water for any purpose mentioned in Chapter 11.⁵⁹ Because this case is within the Commission's jurisdiction under TWC § 12.013, the Commission has authority to establish interim rates at the outset of the proceeding. No legal authority prohibits the Commission from establishing interim rates during the public interest phase conducted under TWC § 12.013(g) and 16 TAC §§ 24.307(b), .309.⁶⁰

The Commission has adopted standards for establishing interim rates.⁶¹ The Commission may establish interim rates in cases “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.”⁶² The Commission may limit its consideration of interim rates to oral arguments of the affected parties.⁶³ Interim rates remain in effect until a final decision is made.⁶⁴

This case is unique among contract rate appeals because, as explained, the petitioning customer is the only municipal utility who purchases water from the seller and effectively pays all of the seller's annual operating revenue. The Audit Report notes that in 2011 alone, HCWID 3 spent over \$450,000 on professional, legal, and consulting fees to fight McAllen's efforts to force HCWID 3 to comply with applicable legal requirements and on lobbying efforts.⁶⁵ Because MPU pays nearly all of HCWID 3's annual revenue, those costs were

HCWID 3's furnishing of raw water. For that reason, MPU relies on the 16 TAC § 24.37 interim rate standards to support this Petition.

⁵⁹ As explained in Section III, the water rights certificate owned by the District is administered by the TCEQ under TWC Chapter 11.

⁶⁰ See, e.g., TWC § 12.013 (providing the Commission authority to establish interim rates in any rate proceeding); *Texas Water Comm'n v. City of Fort Worth*, 875 S.W.2d 332 (Tex. App.—Austin 1994, writ denied) (holding that the scope of the Commission's rate jurisdiction requires the Commission to make a finding that the protested rates adversely affect the public interest without holding that the Commission may not establish interim rates during any phase of a rate proceeding); 16 TAC § 24.319(a) (requiring the Commission to include in a final rate order a provision requiring the Commission to set an interim rate in successive rate appeals but not providing any requirement or guidance for interim rates during an initial rate appeal).

⁶¹ 16 TAC § 24.37.

⁶² *Id.* § 24.37(d).

⁶³ *Id.* § 24.37(e). The rule also provides that the Commission may set interim rates not lower than the authorized rates prior to the proposed increase. *Id.* MPU has never invoked the Commission's rate jurisdiction for rates set by HCWID 3. Exhibit D, Affidavit of Marco A. Vega, P.E., at 1. Consequently, there are no “authorized rates prior to the proposed rate increase” that limit the Commission in establishing interim rates in this matter.

⁶⁴ 16 TAC § 24.37(a).

⁶⁵ Audit Report, *supra*, at 2.

ultimately passed on to MPU's end-use retail water service customers.⁶⁶ Likewise, any costs incurred by HCWID 3—reasonable or otherwise—in this case will necessarily be directly passed onto MPU through rates set by HCWID 3 pursuant to the Contract and will ultimately be paid by MPU's retail water customers.

Based on HCWID 3's long history of mismanagement and abusive practices, this Petition at least raises serious concerns that the proposed rate increase *could* result in unjust or unreasonable rates.⁶⁷ Moreover, forcing MPU to pay HCWID 3's disproportionate rate unquestionably *could* result in an unreasonable economic hardship for MPU's customers.⁶⁸ For these reasons, the Commission should establish interim rates as authorized in its rules.

Exhibit I to this Petition includes a Comparative Rate Analysis developed at MPU's request to demonstrate a range of reasonable rates that are charged by similar entities to HCWID 3. Exhibit I is supported by the affidavit of Chris Ekrut, an experienced rate design consultant in Texas who is familiar with Texas law and national guidance on establishing rates for water service.⁶⁹ As shown in Exhibit I, HCWID 3's current rate is significantly higher than rates charged by similar entities. Based on the contract rate calculation methodologies used by MPU's other district water suppliers, the Commission should set an interim rate within the range of market values shown in Exhibit I.

HCWID 3's previous rate of \$97.67 per acre-foot is also unreasonable as compared against rates charged in the region. However, in the alternative, the Commission should—at a minimum—establish an interim rate no higher than the rate charged by HCWID 3 prior to the rate increase noticed in its July 29, 2021 letter. In other words, the absolute highest interim rate the Commission should establish is \$97.67 per acre foot.⁷⁰

Finally, MPU requests that the Commission exercise its authority to establish interim rates at the outset of this proceeding and establish such rates in its preliminary order rather than refer the issue to the State Office of Administrative Hearings (“SOAH”) for hearing.

⁶⁶ Exhibit D, Affidavit of Marco A. Vega, P.E., at 3.

⁶⁷ See 16 TAC § 24.37(d).

⁶⁸ See *id.*

⁶⁹ Exhibit I, Affidavit of Chris Ekrut, at 1-2.

⁷⁰ Considering the District's extensive history of mismanagement and violation of important financial management regulations, any rate established by the District under the Contract in the last 10 years evidences an abuse of monopoly power, including the \$97.67 rate charged in 2021.

Implementation of interim rates at the Commission's initial open meeting in this proceeding is authorized in the Commission's interim rate rule.⁷¹ Historically, the Commission has referred the issue of interim rates to SOAH.⁷² The record established through this Petition and its accompanying exhibits demonstrate a sustained pattern of abusive practices reaching back more than a decade. Whether interim rates are warranted in this proceeding should not be a matter subject to briefing and hearing before a delegated presiding officer because that process would likely last at least one to two months, thus requiring MPU to pay the unjustified rate increase in multiple Contract payment periods. A simple comparison of rates charged to MPU by the most similarly situated of districts should conclusively demonstrate that interim rates are appropriate and necessary.

2. Compel Continuing Service

Section 12.013(e) also authorizes the Commission to compel continuing service during the pendency of any rate proceeding. HCWID 3 supplies over half of MPU's annual municipal water demand on average.⁷³ The take-or-pay nature of the Contract requires MPU to annually pay for its entire raw water allotment regardless whether HCWID 3 delivers water to MPU. Also, as noted, MPU is legally entitled to the water that HCWID 3 delivers under the terms of the Contract. MPU and its end-use customers would be severely harmed if, as a result of MPU's exercise of its legal rights under TWC § 12.013, HCWID 3 reduced or ceased performing its duties under the Contract and the Permits. For that reason, MPU requests the Commission issue an order compelling HCWID 3 to continue providing raw water service to MPU in accordance with the terms of the Contract and Permits.

3. Determine the Protested Rates Adversely Affect the Public Interest

Under its rules, the Commission shall determine the protested rate adversely affects the public interest if the protested rate evidences HCWID 3's abuse of monopoly power in its

⁷¹ See *id.* § 24.37(e) ("the [C]ommission may limit its consideration of the matter to oral arguments of the affected parties").

⁷² E.g., *Petition of the Beeville Water Supply City Appealing the Decision by the City of Corpus Christi to Change Wholesale Raw Water Rates*, Docket No. 47920, Preliminary Order at 3 (April. 27, 2018); *Petition of the City of Star Harbor Appealing the Decision by the City of Malakoff to Increase Wholesale Sewer Rates*, Docket No. 50433, Preliminary Order on Phase I Issues at 2 (April 17, 2020).

⁷³ Because of the exorbitant rates charged by HCWID 3 and the take or pay nature of the Contract, MPU prioritizes use of water delivered by HCWID 3 to avoid even more excessive additional cost burdens born by MPU's retail customers. In other words, MPU annually uses, to the extent possible, HCWID 3 water first before relying on water supplied by the other districts under less onerous terms. Exhibit D, Affidavit of Marco A. Vega, P.E., at 4.

provision of water service to MPU.⁷⁴ MPU is unaware of any wholesale rate appeal that has presented either the Commission or its predecessor agencies with a more clear and obvious pattern of abuse of monopoly power by a political subdivision than that demonstrated by the facts recited in this petition and evidenced by the exhibits.⁷⁵ In truth, none has even come close.

Under applicable Commission rules, the Commission shall determine the protested rate adversely affects the public interest if after evidentiary hearing the Commission concludes that at least one of four public interest criteria have been violated.⁷⁶ Among those criteria is “the protested rate evidences the seller’s abuse of monopoly power in its provision of water service to the purchaser.”⁷⁷ In making this inquiry, the Commission shall weigh all relevant factors, including those listed in the Commission’s rule as follows:

- (A) the disparate bargaining power of the parties, including the purchaser's alternative means, alternative costs, environmental impact, regulatory issues, and problems of obtaining alternative water or sewer service;
- (B) the seller's failure to reasonably demonstrate the changed conditions that are the basis for a change in rates;
- (C) the seller changed the computation of the revenue requirement or rate from one methodology to another;
- (D) where the seller demands the protested rate pursuant to a contract, other valuable consideration received by a party incident to the contract;

⁷⁴ 16 TAC § 24.311(a).

⁷⁵ MPU again notes that HCWID 3’s rate charged to MPU for delivery of raw water used for municipal purposes is 8.5 times the rate charged by HCWID 3’s irrigation customers. Exhibit D, Affidavit of Marco A. Vega, P.E., at 3. That is despite the fact that there is functionally no difference in the level of service required of HCWID 3 to deliver water to MPU and its irrigation customers. *Id.* at 2. While this disparity is blatantly prejudicial and discriminatory, the relevant public interest criterion in the Commission’s rules only requires the Commission to determine a rate adversely affects the public interest if it “is unreasonably preferential, prejudicial, or discriminatory, compared to the wholesale rates the seller charges *other wholesale customers*.” 16 TAC 24.311(a)(4) (emphasis added). Because HCWID 3 does not have any wholesale customer other than MPU, there are no rates which can properly be compared as the Commission’s rule is written. Notwithstanding that fact, the list of factors to be considered in evaluating whether a rate evidences an abuse of the seller’s monopoly power is not exhaustive. *See id.* § 24.311(a)(3) (“The factors *may include*” the enumerated list.) (emphasis added). For that reason, MPU requests the Commission consider the extreme difference in HCWID 3’s rates for municipal and irrigation use as further evidence of HCWID 3’s abuse of monopoly power.

⁷⁶ *Id.* § 24.311(a).

⁷⁷ *Id.*

- (E) incentives necessary to encourage regional projects or water conservation measures;
- (F) the seller's obligation to meet federal and state wastewater discharge and drinking water standards;
- (G) the rates charged in Texas by other sellers of water or sewer service for resale; or
- (H) the seller's rates for water or sewer service charged to its retail customers,⁷⁸ compared to the retail rates the purchaser charges its retail customers as a result of the wholesale rate the seller demands from the purchaser.⁷⁹

In this case, the most relevant of the listed factors are (A) MPU's alternative costs of obtaining alternative water service from the other three supply districts, (B) HCWID 3's failure to reasonably demonstrate the changed conditions that are the basis for its changes in rates, and (G) the rates charged by other sellers of water service for resale.⁸⁰

Again, MPU's costs of obtaining the same level of service as that provided by HCWID 3 from the other three districts contracted to supply water to MPU is dramatically lower than its costs to obtain service under the Contract. The rates charged by HCWID 3 far exceed the rates charged by other districts in the same area where HCWID 3 supplies its water.⁸¹ While HCWID 3 summarily stated to MPU's General Manager that the 2021 rate increase is due to HCWID 3's "new Legislative responsibilities" and other needed capital improvement projects,⁸² MPU does not know, and has no way of knowing, whether those activities are truly necessary or

⁷⁸ While HCWID 3 does have retail customers, those customers use raw water delivered by HCWID 3 for irrigation purposes. Because HCWID 3 only delivers raw water, and MPU incurs significant expenses in treating, storing, and transmitting its municipal water to its retail customers, MPU does not argue that a comparison of HCWID 3's retail rates with MPU's retail rates evidences an abuse of monopoly power. *See supra* note 19 and accompanying text.

⁷⁹ *Id.*

⁸⁰ By relying on these factors to evidence the District's abuse of its monopoly power, MPU does not intend to waive its rights to allege additional violations of the abuse of monopoly power criterion at hearing. The remainder of those factors, however, do not appear to apply to HCWID 3. As far as MPU is aware, HCWID 3 does not follow any particular methodology in calculating a revenue requirement. *See* 16 TAC § 24.311(a)(3)(C). MPU and HCWID 3 are the only parties to the Contract, so there is no consideration other than HCWID 3's charges to MPU. *See id.* § 24.311(a)(3)(D). MPU is unaware of any incentives necessary to encourage regional projects or water conservation measures that significantly impacts HCWID 3's operations in a way that would justify its high rates. *See id.* § 24.311(a)(3)(E). HCWID 3 does not treat water or wastewater and, thus, does not have any obligation to meet federal and state wastewater discharge and drinking water standards. *See id.* § 24.311(a)(3)(F). HCWID 3 has no retail municipal water service customers. *See id.* § 24.311(a)(3)(H).

⁸¹ Exhibit I, Affidavit of Chris Ekrut, at 3, Table 1.

⁸² Exhibit H.

what their reasonable costs are.⁸³ HCWID 3 has not quantified or otherwise reasonably demonstrated that the cited expenses truly warrant any amount of rate increase.⁸⁴ Consequently, as a result of HCWID 3's mismanagement and lack of transparency, it has failed to reasonably demonstrate the changed conditions that are the basis for a change in rates. Considering that the rate charged by HCWID 3 to MPU prior to the September 1, 2021 rate increase was already severely disproportionate as compared to rates charged by the other districts, HCWID 3 cannot reasonably demonstrate a need for the additional nearly 17 percent rate increase it has imposed on MPU.

The list of factors for determining whether a rate evidences HCWID 3's abuse of monopoly power is not exhaustive.⁸⁵ As demonstrated by the Audit Report and the Legislature's imposition of extraordinary financial and managerial controls through S.B. 2185, the most important factor that evidences an abuse of monopoly power is HCWID 3's own internal failure to properly manage its finances and accounting for at least the last decade.

4. Fix a Reasonable Rate

Under TWC § 12.013, the Commission has jurisdiction to fix reasonable rates for the furnishing of raw water for any purpose mentioned in Chapter 11.⁸⁶ In reviewing and fixing reasonable rates under that statute, the Commission may use any reasonable basis for fixing rates as may be determined by the Commission to be appropriate under the circumstances of the case being reviewed.⁸⁷

MPU believes that the most reasonable basis for fixing raw water delivery rates in this proceeding is to base rates on a comparative analysis of rates charged by similar furnishers of raw water in the region. MPU does not request the Commission fix reasonable rates for HCWID 3's raw water delivery based on a cost-of-service determination using the cash or utility basis traditionally used for fixing retail rates. MPU requests that the Commission require HCWID 3 to charge MPU a rate that is no higher than the range of acceptable rates charged by

⁸³ Exhibit D, Affidavit of Marco A. Vega, P.E. at 4.

⁸⁴ Exhibit I, Affidavit of Chris Ekrut, at 2-3.

⁸⁵ 16 TAC § 24.311(a)(3) ("The factors *may include*" the enumerated list.) (emphasis added).

⁸⁶ TWC § 12.013(a).

⁸⁷ *Id.* § 12.013(c).

similarly situated districts.⁸⁸ The Commission may exceed that range if HCWID 3 can reasonably justify a higher rate. However, considering HCWID 3's documented history of mismanagement and failure to properly account for its finances, it is unlikely HCWID 3 will be able to do so.

As explained, MPU purchases raw water for municipal retail supply from three other districts. Exhibit I illustrates the rates charged for raw water service to MPU by each of those three districts for Fiscal Year 2021. By this Petition, MPU requests, upon a final determination that the protested rate harms the public interest and all reasonable efforts to renegotiate the contract rate methodology as required by TWC § 12.013, the Commission and SOAH conduct an evidentiary hearing on the rate as authorized under TWC § 12.013(k) and 16 TAC § 24.313(b)-(c). At the conclusion of the evidentiary rate hearing, the Commission should order HCWID 3 to use a basis similar to that used by the other districts to adjust its rates under the Contract.

5. Order Refunds if Final Rate Exceeds Interim Rate

Section 12.013 also authorizes the Commission to order a refund or assess additional charges from the date a petition for rate review is received by the Commission of the difference between the rate actually charged and the rate fixed by the Commission, plus interest at the statutory rate.⁸⁹ Accordingly, MPU requests the Commission order HCWID 3 to refund all charges by HCWID 3 paid by MPU equal to the difference between either the rate set by HCWID 3 pursuant to the Contract or the interim rate set by the Commission, as appropriate, and the just and reasonable rate ultimately fixed by the Commission. MPU further requests that such refunds include interest calculated at the then-applicable statutory rate.

VI. CONCLUSION & PRAYER

For the foregoing reasons, MPU respectfully requests that the Commission (1) establish interim rates during the pendency of this proceeding, (2) issue an order compelling HCWID 3 to

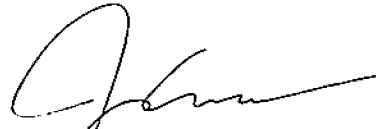
⁸⁸ While the Commission's rules governing wholesale water service will, upon the Commission's determination that the protested rate adversely affects the public interest, require HCWID 3 to file a cost of service study, that requirement is only related to HCWID 3's support of the protested rate. 16 TAC § 24.313(c). Likewise, while the same rules require the Commission to calculate the annual cost of service, the rules do not expressly require the Commission to use cost of service as the basis for fixing reasonable rates under TWC § 12.013. *Id.* § 24.315. Similarly, the same rule requires the Commission to rely on any reasonable methodologies set by contract which identify costs of providing service and/or allocating such costs in calculating the cost of service. *Id.* As explained, the Contract does not include any such methodologies.

⁸⁹ TWC § 12.013(f).

continue to provide service to MPU as required under the Contract, (3) determine, after an evidentiary hearing, that the amount charged by HCWID 3 pursuant to the Contract harms and adversely affects the public interest, (4) establish a reasonable rate and order HCWID 3 to charge it, and (5) order HCWID 3 to refund all payments by MPU in excess of the reasonable rate fixed by the Commission. MPU further prays for all legal and equitable relief to which it is entitled.

Respectfully submitted,

LLOYD GOSSELINK
ROCHELLE & TOWNSEND, P.C.
816 Congress Ave., Suite 1900
Austin, Texas 787012
(512) 322-5800
(512) 472-0532 (Fax)



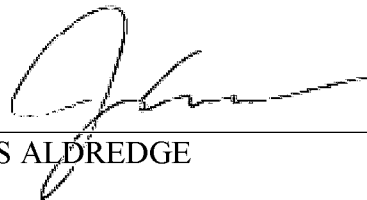
JAMES ALDREDGE
State Bar No. 24058514

ATTORNEY FOR
McALLEN PUBLIC UTILITY

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing document was transmitted by first class mail on this the 27th day of October, 2021 to Hidalgo County Water Improvement District No. 3 at the following address, in accordance with 16 TAC §§ 22.74 and 24.305.

President, Board of Directors
Hidalgo County Water Improvement District No. 3
1325 Pecan Blvd.
McAllen, Texas 78501



JAMES ALDREDGE

Exhibit A

Permanent Water Supply and Delivery Contract between
Hidalgo County Water Improvement District No. 3 and the City of McAllen as Amended

STATE OF TEXAS

§

**PERMANENT WATER SUPPLY
AND DELIVERY CONTRACT**

COUNTY OF HIDALGO

§

THIS AGREEMENT is entered into by and between **HIDALGO COUNTY WATER IMPROVEMENT DISTRICT NO. 3**, a water control and improvement district operating under the laws of the State of Texas and a political subdivision of the State of Texas, hereinafter referred to as "**DISTRICT**," and the **CITY OF McALLEN**, a municipality of the State of Texas, through the **McALLEN PUBLIC UTILITIES BOARD**, an agency of the City of McAllen, hereinafter jointly referred to as "**CITY**," terminating a prior Permanent Water Delivery Contract entered into between the parties which was effective September 1, 1983, and substituting in lieu thereof this Contract, wherein DISTRICT agrees to divert, furnish and deliver water to CITY, and CITY agrees to receive such waters from DISTRICT under the following terms and conditions:

Water Allocation

1. (a) The waters to be diverted, furnished and delivered by DISTRICT to CITY hereunder are those waters of the Rio Grande which CITY is entitled to receive from DISTRICT and use for municipal purposes, as allocated by the Texas Natural Resource Conservation Commission, Rio Grande Watermaster, or its successors ("Commission"), more particularly 8,980 acre feet per annum measured at the Rio Grande as reflected by Certificate of Adjudication No. 23-848, initially issued by the Commission's predecessor, Texas Water Rights Commission, of record in Volume 1, pages 627-628 of the Certificate of Adjudication Records of Hidalgo County, Texas, to which reference is hereby made; up to the amount of 3,000 acre feet per annum of Rio Grande water measured at the Rio Grande as allocated to DISTRICT by the Commission, being that water which DISTRICT is authorized to divert for municipal use under Amended Certificate of Adjudication No. 23-848A issued by the Commission on October 10, 1978, of record in Volume 2, pages 201-204 of the

Certificate of Adjudication Records of Hidalgo County, Texas, to which reference is hereby made for the purposes of this Contract; and an additional amount of water of up to a maximum of 2,000 acre feet per annum of Rio Grande water measured at the Rio Grande which District is authorized to divert under amendment to Certificate of Adjudication No. 23-848B issued by the Commission on September 8, 1995 and of record as Document No. 476966 in the Official Records of Hidalgo County, Texas.

(b) DISTRICT further agrees to deliver hereunder any amount of Rio Grande water, which CITY acquires and becomes entitled to divert from the Rio Grande when CITY provides necessary authorization to DISTRICT authorizing it to divert such waters from the Rio Grande and the DISTRICT is able to divert and deliver such water as needed by CITY without undue interference in DISTRICT'S then existing delivery commitments to CITY and others.

2. Water will be delivered as needed by CITY subject to DISTRICT's delivery system capability and taking into account water delivery commitments of DISTRICT to others entitled to water service from DISTRICT.

3. DISTRICT further agrees to divert and deliver hereunder any amounts of Rio Grande water whose purpose of use is designated as municipal or industrial, measured at the Rio Grande, which CITY acquires and becomes entitled to from other than DISTRICT, provided CITY provides necessary authorization to DISTRICT authorizing it to divert such municipal or industrial use waters from the Rio Grande, and provided further that DISTRICT is able to divert and deliver such waters without undue interference with DISTRICT's then-existing delivery commitments to landowners in DISTRICT, CITY and others.

Water Delivery Charge

4. CITY shall pay to DISTRICT monthly, at its office in McAllen, Texas, 9.5¢ cents (\$0.095) for each one thousand (1,000) gallons of water, or portion thereof, for all water diverted and delivered

1011/05 = .105
13.980 = 134
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13.980 = 134
13.980 = 134

by DISTRICT described in Paragraph 1(a) above, and for all water diverted and delivered by DISTRICT under paragraph 1(b), 7¢ cents (\$0.07), all measured as provided in paragraph 6 below, beginning on September 1, 1998 through August 31, 1999, and thereafter on an annual basis until such rates are adjusted as provided for in paragraph 10 below. CITY agrees to pay DISTRICT, on or before the fifteenth (15th) day of the month following the date of DISTRICT's monthly statement to CITY, the amount of water delivery charges due for the prior month's services.

Delivery Point

5. DISTRICT will deliver to CITY said waters from its First Lift Main Irrigation Canal for diversion by CITY at CITY's Boeye Reservoir located at the corner of 18th Street and Expressway 83 in CITY.

Measurement of Water

6. The amount of water delivered by DISTRICT hereunder shall be determined as follows: (a) water delivered to CITY shall be measured by CITY's meter located at CITY's intake diversion structure on DISTRICT's Main Canal at CITY's Boeye Reservoir, and (b) that amount shall be multiplied by a factor of 1.10 so as to take into account transportation losses occurring prior to delivery to CITY's Reservoir. CITY agrees to install and maintain such meter at its expense, subject to DISTRICT's approval as to the type of meter and construction and maintenance methods utilized. CITY shall read the meter monthly on the fourth Friday of each month and promptly certify in writing to DISTRICT the amount of water measured at the meter point and the date the meter was read each month. Access to the meter for reading and examination shall be free to all parties hereto.

Water Diversion Reports and Amounts

7. DISTRICT will make the necessary Rio Grande water diversion reports to the Commission, or its successors, of the amount of water diverted from the Rio Grande for CITY based upon the amount of water delivered and measured as provided in paragraph 6 above. DISTRICT will pay

assessments established by the Commission, or successors, relating to the administration of water rights of the Lower Rio Grande as such pertains to the 5,000 acre feet under Amended Certificates of Adjudication No. 23-848. CITY agrees to pay such assessment with respect to the 8,980 acre feet under Certificate of Adjudication No. 23-848.

Annual Use and Allocation

8. CITY agrees that amounts of raw water delivered to it by DISTRICT from the Rio Grande for municipal use during any calendar year during the term hereof shall be reported and considered as water used under this Contract and charged against the water allocation or allotment provided for in Paragraph 1 of this Contract before any of such water deliveries are considered used and charged against the allocation or allotment of Rio Grande water to which CITY is otherwise entitled.

9. The CITY agrees that it will order from and take delivery of all of the water to which CITY is entitled from the DISTRICT under Paragraph 1 of this Contract. In the event CITY fails to order and take delivery of such amount during the twelve (12) months' period ending December 31 of each year, then the CITY agrees to pay to the DISTRICT the then-existing delivery charge on the amount of water representing the difference in the amount actually received by the CITY from the DISTRICT and the amount of the CITY's entitlement under Paragraph 1 of this Contract.

Adjustments to Delivery Charges

10. The water delivery charges under this Contract is effective during the twelve (12) months period from September 1 through August 31 of the following year. The water delivery charges hereunder shall be annually reviewed by the Board of Directors of DISTRICT. In the event DISTRICT determines that an adjustment in said charges is necessary for the ensuing year, it shall give CITY written notice of such adjustment at least thirty (30) days prior to August 31. The new water delivery charges shall become effective the following September 1.

It is agreed that adjustments in the water delivery charges of CITY hereunder will be on the equivalent percentage basis as adjustments made in charges required of others receiving water service from DISTRICT.

In the event CITY is dissatisfied with the adjustment in the water delivery rate established by DISTRICT, it may exercise any appeal rights that it may have under law.

Failure of Delivery

11. DISTRICT shall not be liable to CITY for failure of delivery in the event of mechanical failure, strikes, acts of God, or other occurrences beyond DISTRICT's control, nor shall DISTRICT be liable to CITY in any event so long as DISTRICT is taking reasonable steps to continue and maintain service to CITY. In the event drought conditions result in a limited amount of water available for allocation by the Commission or other applicable governing agency and there is implemented by said regulatory agency a proration of the available water supply, then in such event, the amount of water covered by this Contract will be prorated so that CITY will be treated on the same basis as other similar users upon the Lower Rio Grande.

Transfer of Contract

12. This Contract shall not be transferred by CITY without the express written approval of DISTRICT.

Term of Contract

13. This Contract shall be deemed effective on September 1, 1998, and shall remain effective, unless terminated by mutual agreement of the parties. In the event CITY fails to comply with any of the provisions hereof, DISTRICT, after giving CITY thirty (30) days advance written notice of the provisions so violated, may terminate the operation of this Contract pending the curing by CITY of its said default. Amendments to the water delivery charge rate shall be evidenced by DISTRICT's

notice of rate adjustment to CITY as provided in paragraph 10 hereof. All other amendments hereto shall be in writing and mutually agreed upon by both parties.

Enforcement

14. It is understood and agreed that either party hereto may demand specific performance of this Contract.

Laws and Regulations

15. This Contract shall be subject to the Rules and Regulations of the Commission, or its successors, as they presently exist or as they are hereafter amended, to the extent such Rules and Regulations pertain to the operations of the parties hereunder. This Contract shall be subject to all valid applicable state, federal and local laws, rules and regulations; provided, however, either party hereto shall be entitled to abide by this Contract and regard all laws, rules and regulations issued by any federal or state regulatory body as not in conflict herewith and may act in accordance herewith until such time as any provision hereof is held invalid or in conflict with such laws, rules and regulations by final judgment in a court of competent jurisdiction after all appeals have been exhausted.

Non-Waiver

16. The waiver by either party of any provision of this Contract shall not be construed as a precedent or waiver of such provision thereafter, unless this Contract is amended in writing reflecting such waiver.

Authorization

17. Those representatives of the parties executing this Contract below represent one to the other that they are authorized by action of the governing bodies of each party to execute this Contract.

Prior Contract Terminated

18. The parties entered into a Permanent Water Delivery Contract effective September 1, 1983, containing similar terms to this Contract. This Contract amends and terminates said prior 1983 Contract upon its effective date, and upon and after the effective date hereof of September 1, 1995, the said 1983 Permanent Water Delivery Contract shall be deemed void and of no further force and effect.


EXECUTED by the parties, through their authorized representatives on the dates indicated below.

HIDALGO COUNTY WATER
IMPROVEMENT DISTRICT NO. 3

Date: 5-12-99

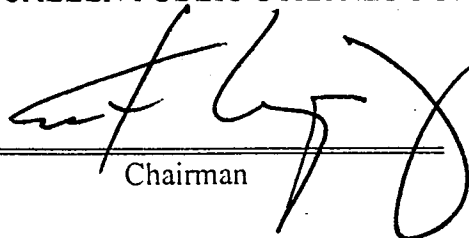
By: 
President, Board of Directors

ATTEST:

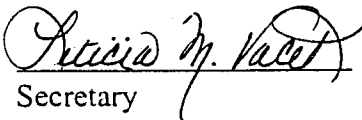

Secretary

MCALLEN PUBLIC UTILITIES BOARD

Date: 5-5-99

By: 
Chairman

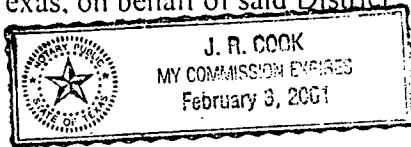
ATTEST:


Secretary

STATE OF TEXAS §

COUNTY OF HIDALGO §

This instrument was acknowledged before me on this the 12th day of May, 19 99, by Glassco Dyle, President of HIDALGO COUNTY WATER IMPROVEMENT DISTRICT NO. 3, a water district operating under the laws of the State of Texas, on behalf of said District.



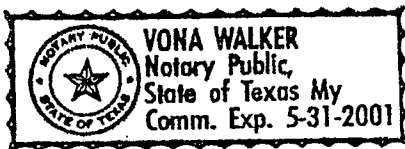
My Commission Expires:

J.R. Cook
Notary Public in and for The State of Texas
J.R. Cook
Notary's Printed Name:

STATE OF TEXAS §

COUNTY OF HIDALGO §

This instrument was acknowledged before me on this the 5th day of May, 19 99, by Lory Aguirre, Chairman of McALLEN PUBLIC UTILITIES BOARD, an agency of the City of McAllen, State of Texas, on behalf of said agency.



My Commission Expires:

Vona Walker
Notary Public in and for The State of Texas

Notary's Printed Name:

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STATE OF TEXAS §
 § **AMENDMENT TO PERMANENT WATER SUPPLY**
COUNTY OF HIDALGO § **AND DELIVERY CONTRACT**

WHEREAS, **HIDALGO COUNTY WATER IMPROVEMENT DISTRICT NO. 3**, a water control and improvement district operating under the laws of the State of Texas and a political subdivision of the State of Texas, hereinafter referred to as "**DISTRICT**" and the **CITY OF MCALLEN**, a municipality of the State of Texas, by and through the **McALLEN PUBLIC UTILITIES BOARD**, an agency of the City of McAllen, hereinafter jointly referred to as "**CITY**" entered into a **PERMANENT WATER SUPPLY AND DELIVERY CONTRACT** in May 1999 effective September 1, 1998, a true and correct copy of which is attached hereto as Exhibit "A" and incorporated herein for all purposes (the "**Contract**"); and

WHEREAS, the **CITY** desires to establish an additional diversion point on the **DISTRICT's** First Lift Main Irrigation Canal for diversion by **CITY** for the purpose of the delivery of water covered by the Contract from said point to a reservoir of the **CITY** located in Lots 5, Section 5 of the Hidalgo Canal Company Subdivision.

NOW, THEREFORE, the **DISTRICT** and the **CITY** agree to amend the Contract as follows:

1. Substitute the following Paragraph 5 in lieu of existing Paragraph 5 in the Contract to read as follows:

Delivery Points

5. ***DISTRICT will deliver to CITY said waters from its First Lift Main Irrigation Canal for diversion by CITY at a point located at the corner of 18th Street and Expressway 83 in CITY, and/or DISTRICT agrees to deliver to CITY said waters from its First Lift Main Irrigation Canal for diversion by CITY and delivery through a pipeline to the CITY's reservoir described above at an additional diversion point located on the said Canal near a point on its said Canal approximately 125 feet north of the southwest corner of Lot 5, Section 5 of the Hidalgo Canal Company Subdivision, Volume Q, Pages 175-177, Deed Records of Hidalgo County, Texas.***

2. Substitute the following Paragraph 6 in lieu of existing Paragraph 6 of the Contract to read as follows:

Measurement of Water

6. *The amount of water delivered by DISTRICT hereunder shall be determined as follows: (a) water delivered to CITY shall be measured by meters or measuring devices located at the delivery points, and (b) that amount shall be multiplied by a factor of 1.10 so as to take into account transportation losses occurring prior to delivery of water at the delivery points. CITY agrees to install and maintain such meters or measuring devices at its expense, subject to DISTRICT's approval as to the type of meter and construction and maintenance methods utilized. DISTRICT shall read the meters monthly on the fourth Friday of each month and promptly certify in writing to CITY the amount of water measured at the meter(s) point and the date the meter was read each month. Access to the meter(s) for reading and examination shall be free to all parties hereto.*
3. It is agreed that all other terms and conditions of the Contract shall remain in full force and effect and applicable to waters covered by the Contract delivered by the **DISTRICT** to **CITY** whether delivered at the new additional delivery point or at the existing diversion point at the corner of 18th Street and Expressway 83.

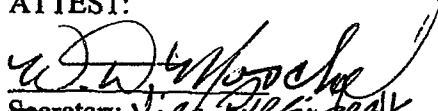
This Amendment is executed by the parties through their authorized representatives on the dates indicated below.

HIDALGO COUNTY WATER
IMPROVEMENT DISTRICT NO. 3

Date: May 16, 2011

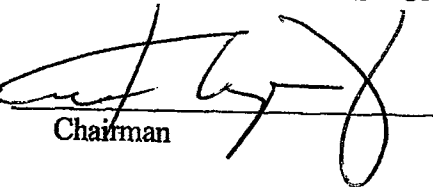
By: 
President, Board of Directors

ATTEST:



Secretary *Vice President*

MCALLEN PUBLIC UTILITIES BOARD

Date: 4/19/11

By: 
Chairman

ATTEST:


Secretary

STATE OF TEXAS §

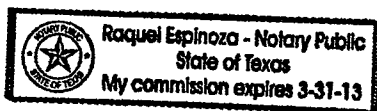
COUNTY OF HIDALGO §

This instrument was acknowledged before me on this the 16th day of May, 2011 by Ofelia E. Brand Jr., President of HIDALGO COUNTY WATER IMPROVEMENT DISTRICT NO. 3, a water district operating under the laws of the State of Texas, on behalf of said District.

Raquel Espinoza
Notary Public in and for The State of Texas

Notary's Printed Name:

Raquel Espinoza



STATE OF TEXAS §

COUNTY OF HIDALGO §

This instrument was acknowledged before me on this the 19th day of April, 2011, by Tony Aguirre Jr., Chairman of McALLEN PUBLIC UTILITIES BOARD, an agency of the City of McAllen, State of Texas, on behalf of said agency.

Nyla L. Flatau
Notary Public in and for The State of Texas

Notary's Printed Name:

Nyla L. Flatau

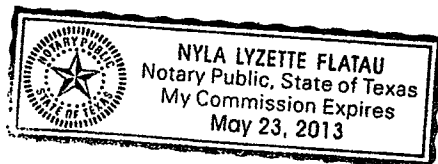


Exhibit B

Letter from HCWID 3 to MPU re: Rate Increase Notification

HIDALGO COUNTY WATER IMPROVEMENT DISTRICT NUMBER THREE

Board of Directors
President-Othal Brand, Jr.
Vice President-Chris Burns
Secretary-Mark Freeland
Member-W.D. Moschel
Member- Lance Neuhaus

1325 Pecan Blvd
McAllen, Texas 78501
(956) 686-8303
Fax (956) 686-1022

Chairman
cc: Charles
Amos

July 29, 2021

Mr. Mark Vega
Utility Manager
McAllen Public Utilities
P.O. Box 220
McAllen, Texas 78505-0220

RE: Rate Increase Notification

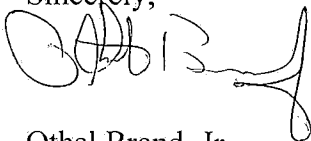
Dear Mr. Vega:

According to the Permanent Water Supply and Delivery Contract dated May 12, 1999 Between Hidalgo County Water Improvement District No. 3 and the City of McAllen, All water for Fiscal year 2021-22 under Adjudication Numbers 0848.000, 0848.0001, And 0353-002, will be charged a water delivery rate at \$0.34975 cents per 1,000 gallons translated the charge to \$113.96 per acre-foot.

Per contract the 550 acre feet will charge at a water delivery rate at \$0.121 cents per 1000 gallons which is \$39.43 per acre-foot. All outside contract water will be charged a water delivery rate at \$0.11 cents per 1,000 gallons which is \$35.84 per acre-foot. These rate increase will be effective September 1, 2021.

If you have any further questions concerning these rates, please feel free to call me.

Sincerely,



Othal Brand, Jr.
President of the Board

Exhibit C

Raw Water Service Contracts between MPU and
Hidalgo County Irrigation District No. 1
Hidalgo County Irrigation District No. 2
United Irrigation District

ORIGINAL

PERMANENT WATER SUPPLY AND DELIVERY CONTRACT

STATE OF TEXAS §
 §
COUNTY OF HIDALGO §

This Permanent Water Supply and Delivery Contract (this "**Contract**") is entered into effective the 10th day of October, 2013, to be performed as provided for herein, by and between **HIDALGO COUNTY IRRIGATION DISTRICT NO. ONE** (the "**District**"), a political subdivision of the State of Texas, and **THE CITY OF MCALLEN, TEXAS** (the "**City**"), a municipality under the laws of the State of Texas, to set forth their agreement pertaining to the supply and delivery of untreated water from the Rio Grande River by the District to the City. The District and the City are sometimes referred to herein individually as a "Party" and collectively as the 'Parties.'

In consideration of the mutual benefits to be received by both Parties and other good and valuable consideration, the receipt and sufficiency of which being acknowledged by both Parties, the District agrees to divert and deliver to the City certain raw, untreated and non-potable water and the City agrees to pay the District, all pursuant to the terms and provisions of this Contract.

1. **THE DISTRICT.**

The District owns rights to divert and use water from the Rio Grande River for irrigation and for domestic, municipal and industrial uses. These water rights are currently administered by the Rio Grande Watermaster of the Texas Commission on Environmental Quality (the "**Commission**"), or its successor, which makes allocations of available Rio Grande River water to the District in accordance with its water rights. The District has an established water diversion system upon the Rio Grande River and delivery facilities within its boundaries. The District was created and operates primarily for the purpose of providing delivery of raw, untreated and non-potable water from the Rio Grande River for irrigation purposes to agricultural lands within its boundaries and as an incidental activity delivers Rio Grande River water through contracts with other water users for the delivery of water from the Rio Grande River for their use for domestic, municipal and industrial purposes.

2. **THE CITY.**

The City constructed a water treatment plant (the "**Plant**") on Lots 428, 438 and 448, John H. Shary Subdivision, Hidalgo County, Texas to provide treated water service to its citizens. The City is in need of an additional raw water supply and raw water delivery service for the Plant.

THIS CONTRACT COUNTAINS PROVISIONS FOR BINDING ARBITRATION

3. DELIVERY POINT.

The City agrees to construct and install a metered water conveyance pipeline (the "**Pipeline**") from the Plant to a location to be mutually agreed upon at the District's canal in Lots 184 and 185, Block 46, Pride O' Texas Subdivision, Hidalgo County, Texas (the "**Delivery Point**"). The District shall furnish the City with a permit to connect the Pipeline with the District's canal at the Delivery Point. The City shall, at its own expense, acquire any right of way from the Plant to the Delivery Point for the construction of the Pipeline. The City shall be responsible for the construction and maintenance of the Pipeline. The City shall obtain plans and specifications (the "**Plans**") for the connection of the Pipeline to the District's canal at the Delivery Point (the "**Diversion Facility**"). The City shall present the Plans for the Diversion Facility to the District for review and approval. Following the approval of the Plans by the District, the City shall give the District at least thirty (30) days prior written notice before the commencement of construction of the Diversion Facility. The City shall give the District's representatives access to the construction activity to verify the City's compliance with the Plans. Following the completion of construction, the City shall provide the District with an as-built set of construction documents for the Diversion Facility. In constructing the Pipeline, the City shall comply with the provisions of Paragraph 9 herein.

4. WATER SUPPLY AND McALLEN WATER SUPPLY PAYMENT.

(a) The water to be supplied hereunder to the City by the District shall be referred to herein as the McAllen Water Supply.

The "**McAllen Water Supply**" is 4,000 acre-feet of domestic, municipal and industrial use raw, untreated, non-potable water made available to the City, for consideration exchanged as set forth in this Contract. The City agrees to order and pay for at least 1,000 acre-feet of such water within 3 years from the effective date of this Contract. The City further agrees to order and pay for the balance of the McAllen Water Supply in quantity of no less than 1,000 acre-feet at no more than 2 year increments after the initial purchase. During the first three (3) years of this Contract, the price to be paid by the City to the District for that portion of the McAllen Water Supply purchased within such time period shall be Two Thousand One Hundred and No/100ths Dollars (\$2,100.00) per acre-foot ("**Initial Water Rate**"). After the first three (3) years of this Contract, the price to be paid by the City to the District for that portion of the McAllen Water Supply purchased within such time period shall be \$2,300.00.

(b) Each time the City elects to purchase all or any portion of the McAllen Water Supply, the City shall notify the District of such election in writing. The City shall pay the District the product of the number of acre-feet purchased times the applicable Water Rate (the "**Water Rights Payment**") within thirty (30) days from the date the City notifies the District of such purchase.

(c) After the City orders and pays the District in full for the 4,000 acre-feet provided in this Contract, the Parties may agree upon future sales by the District and purchases by the City of additional water. Any additional water to be added to the McAllen Water Supply shall be endorsed on an addendum hereto and executed by both Parties to acknowledge consent showing the additional amount of water to be supplied by the District to the City as part of the McAllen Water Supply, and the price for such additional water. Any such additional water to be supplied by the District to the City shall be delivered by the District to the City pursuant to the terms of this Contract.

(d) The McAllen Water Supply shall always be delivered by the District pursuant to the terms of this Contract.

(e) Within fifteen (15) days after the City orders and pays for all or any portion of the McAllen Water Supply, the District shall prepare and file (at the District's expense) an application with the Commission for conversion of a sufficient number of the District's Class A irrigation water rights to satisfy the District's obligation to supply the City with that portion of the McAllen Water Supply ordered and paid for by the City as domestic, municipal and industrial use water. Once the Commission has approved the conversion by the District of all or a portion of the McAllen Water Supply from irrigation use water to domestic, municipal and industrial use water, the District shall establish an account with the Commission that allocates that portion of the McAllen Water Supply that has been purchased by the City, as water allocated to the City to be pumped by the District.

5. **WATER DELIVERY CHARGES.**

(a) Following payment by the City for all or any portion of the McAllen Water Supply, during each calendar year thereafter the City may order delivery of that applicable portion of the McAllen Water Supply from the District. Upon receipt of the City's request for water delivery, the District shall contact the Commission and request an appropriate release of a sufficient volume of water from the Falcon International Reservoir. Once the released water reaches the District's facilities on the Rio Grande River at Penitas, Texas, the District shall divert the water from the river and pump it through the District's canals and pipelines until it reaches the Delivery Point.

(b) The charge for the diversion and delivery of the water by the District to the City is referred to herein as the "**McAllen Water Delivery Charge**". The McAllen Water

Delivery Charge shall be computed as the sum of the "**McAllen Water Base Charge**" and the "**Energy Charge**" as such terms are defined herein.

(c) The initial McAllen Water Base Charge shall be Forty Seven and No/100th Dollars (\$47.00) per acre-foot for that portion of the McAllen Water Supply delivered by the District to the Delivery Point.

(d) The McAllen Water Base Charge shall be adjusted annually proportional to increases in the Consumer Price Index as provided herein.

(e) In addition to the McAllen Water Base Charge, the City shall pay to the District an estimated energy pass-through charge which is derived from the actual cost of energy to the District during the prior calendar year for diesel, natural gas, electricity and/or any other source of energy used for the operation of the District's pumping plant in Penitas, Texas ("**Energy Charge**"). For example, the Energy Charge for water delivered by the district to the City in 2013 will be estimated at the District's actual cost of energy in 2012.

(f) Beginning with the effective date of this Contract, the Energy Charge for each year during the term of this Contract shall be estimated based upon the actual energy cost of the District per thousand gallons of total water diverted for the prior calendar year. For example, the District's actual Energy Charge for the calendar year 2011 was \$0.0137 per thousand gallons of total water diverted by the District for all purposes. As soon as possible after the end of a calendar year, but no later than January 20th of the next year, the actual energy costs for total water diverted during the previous calendar year will be calculated by the District as set out above and the District shall notify the City of such actual energy costs and the method of calculation.

For example, for illustrative purposes only, if during the prior calendar year a total of 70,000 acre-feet (22,809,570 thousand gallons) were diverted by the District from the Rio Grande River at an annual pumping (diversion) energy cost of \$180,000.00, then the annual pumping energy costs per acre-foot of water diverted is \$2.57 (\$180,000/70,000) or \$0.0079 per thousand gallons.

(g) Each year, an Energy Charge adjustment will be determined for the prior year taking into account the total water diverted for the City that year, the total amount of energy pass through charges actually paid to the District that year, and the actual energy costs per acre-foot (in terms of thousand gallons) of water diverted, calculated as provided above. In the event of an overpayment of the Energy Charge by the City during the previous calendar year, the District shall pay the City the amount of the overpayment on or before January 20th of the following year. In the event of an underpayment by the City, the City shall pay the District the amount of the underpayment within thirty (30) days of receipt of a written accounting from the District.

(h) The Parties agree and stipulate that the Water Delivery Charge is just and fair and arrived at after giving due consideration to all relevant matters in determining that such charge is at this time in the best interest of each of the Parties.

(i) The City may, by giving written notice to the District within sixty (60) days of the date the District notifies the City of the new Energy Charge, have the District's records of actual energy costs for total water diverted during the calendar year in question inspected at the District's offices by a certified public accountant of the City's choice. If such audit reveals an error of two percent (2%) or more in the District's calculation of the new Energy Charge, the District shall bear the cost of the audit. The City's failure to notify the District in writing within the sixty (60) days provided for herein shall constitute a waiver of its rights to audit the Energy Charge for that calendar year.

(j) On an annual basis, the McAllen Water Base Charge shall be adjusted annually proportional to any increase in the *Consumer Price Index - All Urban Consumers (not seasonally adjusted)*, U.S. *All Items Less Food and Energy Series CUUR0000SAOL1E*, as published by the Bureau of Labor Statistics, hereafter referred to as "CPI". In January of each year, the McAllen Water Base Charge for the current year shall equal the McAllen Water Base Charge of the previous year multiplied by the product $[1 + (CPI_2 - CPI_1) / CPI_1]$ where CPI_1 is the index for the month of November prior to the beginning of the twelve (12) month period, and CPI_2 is the index for the next to last month (November) of such twelve (12) month period.

(k) In addition to the McAllen Water Delivery Charge, the City shall pay the District the product of twenty-five percent (25%) of the McAllen Water Supply delivered by the District to the Delivery Point times the then current District rate for delivery of agricultural irrigation water to compensate the District for its conveyance losses. As of the effective date of this Contract, the District's rate for delivery of agricultural irrigation water is fifteen and No/100th Dollars (\$15.00) per acre-foot. The District shall supply its own agricultural irrigation water to deliver the McAllen Water Supply to the City. In the event the rules and regulations of the Commission change so that use of the District's agricultural irrigation water for this purpose is not permitted, the City shall either supply its own agricultural irrigation water for such purposes or purchase an additional supply of water from the District for such purposes. In the event: (i) the Commission prohibits the delivery of agricultural irrigation water; or (ii) the Commission limits the delivery of agricultural irrigation water for the District's agricultural customers to less than two and one half (2.5) acre feet of irrigations per year, then in either such event the City shall either furnish its own municipal water for such purposes or the District shall deliver seventy five percent (75%) of the amount of McAllen Water Supply ordered and paid for by the City and the City shall, in addition to the McAllen Water Delivery Charge, pay the District the percent of twenty five (25%) of the volume of water ordered by the City times the then current District rate for delivery of agricultural irrigation water. For illustrative purposes only, if as of the effective date of the Contract, the City requests

delivery of 100 acre-feet of municipal water, the City shall pay the District the applicable McAllen Water Delivery Charge together with the product of 25% of the 100 acre-feet, 25 acre-feet, times \$15.00 per acre-foot or three hundred seventy five and No/100ths Dollars (\$375.00).

6. **ACCOUNTING FOR "NO CHARGE PUMPING WATER".**

(a) During a reporting period if the Commission's Rio Grande Watermaster has declared no-charge pumping at the District's diversion point, the amount of water reported by the District to the Rio Grande Watermaster as diverted from Rio Grande River for the City as **"No-Charge Pumping Water"** during such reporting period shall be equal to the total amount of water delivered for the City during the reporting period, multiplied by the ratio of the total volume of water pumped by the District during the reporting period allowing for no-charge pumping divided by the total volume of water pumped by the District in the reporting period. As an example, if the total volume of water pumped by the District in the reporting period is 720 acre-feet and the District pumps 72 acre-feet during the time periods the Rio Grande Watermaster declares no-charge pumping, then ten percent (10%) of the water delivered to the City during that reporting period would be reported as No-Charge Pumping Water.

(b) No reduction shall be made against the McAllen Water Supply for No-Charge Pumping Water.

(c) The City shall pay the McAllen Water Delivery Charge for No-Charge Pumping Water as calculated pursuant to this Contract.

7. **WATER USE REPORTS AND ASSESSMENTS.**

The District will make the necessary Rio Grande River water diversion reports to the Commission's Rio Grande Watermaster or its successor, relating to the total amount of water diverted from the Rio Grande River by the District for the City.

8. **WATER DELIVERY PROVISIONS.**

(a) Water shall be delivered to City at the Delivery Point. Notwithstanding any other provision of this Contract, the maximum delivery rate shall not be required to exceed 22 cfs. or an amount mutually approved by the Parties in writing.

(b) The City shall give the District sufficient notice of the need for water deliveries so that the District has sufficient time to order the water under applicable Rio Grande River Administrative Rules and operational procedures so that the water will arrive at the District's diversion point within sufficient time to transport the water to the Delivery

Point within the capability of the District's delivery system and the requirements of this Contract and in accordance with the District's normal operations. The District agrees to utilize its facilities and the knowledge and experience of its management, employees and directors to timely deliver the water to the best of its ability.

(c) The District agrees to promptly notify the City when there will be a known or expected interruption of water delivery service to the City. To the extent known by the District, the District agrees to timely advise the City of the existence of, or the likelihood of interruption of water deliveries due to reasons beyond the control of the District.

(d) The District disclaims any other warranties, representations, or inferences of quantity, quality, or time for delivery of water delivered.

9. MEASUREMENT OF WATER.

(a) The City agrees to pay for the necessary metering, gate equipment and required devices acceptable to the District to measure and control the quantity of water delivered by the District to the City at the Delivery Point. Such metering and gate equipment shall be SCADA enabled and shall be compatible with the District's system. Such metering and gate equipment shall be located at the Delivery Point. The District shall be responsible for the maintenance and operation of the meter and gate and may calibrate such metering equipment as deemed necessary by its manager, or whenever requested by City. A meter registering more than two percent (2%) above or below the correct quantity as determined by the test results shall be deemed inaccurate and shall be calibrated. If the meter is deemed accurate, the requesting Party is responsible for the cost of the calibration; otherwise, City shall be responsible for the cost. The previous readings of any meter disclosed by test to be inaccurate shall be corrected for the 90 days previous to such test, or if the date of the last calibration is less than 90 days prior, back to the last calibration in accordance with the percentage of inaccuracy found by such tests. If any meter fails to register for any period of time, the amount of water furnished shall be deemed to be the amount of water delivered in the last preceding comparable period of time known to have been accurately metered, unless the District and the City agree upon a different amount. The metering equipment shall be read by the District on a day each month as mutually agreed to by the Parties. Each Party shall have access to read the meter and meter readings made by either Party. Such readings shall be made available to the other Party.

(b) The McAllen Water Delivery Charge made by the District to the City shall be based upon the amount measured by such meter at the Delivery Point, converted and rounded to the nearest acre-foot.

(c) Each Party shall have free access to the meters.

10. **FAILURE OF DELIVERY.**

Neither Party shall be liable to the other for failure of delivery of water or the failure to comply with other conditions hereof, except for payment for water and/or for water delivered, in the event of acts of God, wars, acts of terrorism, insurrections, riots, epidemics, landslides, drought, lightning, earthquakes, fires, storms, floods, hazardous spills, explosions, and unforeseeable failure of machinery, structures, or water delivery facilities, or other occurrences beyond a Party's control. (collectively "**Force Majeure**") nor shall either Party be liable to the other Party in any event, so long as the Party is taking reasonable and continuous steps to continue and maintain delivery of water to the City.

11. **PERIODIC OPERATION OF DISTRICT PUMPING PLANT AND MAIN CANAL.**

Notwithstanding any other provisions of this Contract, the District may elect to operate its water delivery and diversion facilities in such a manner so as to limit deliveries of water to the City to a single day per week to reduce the amount of water lost to seepage, evaporation, or other losses and other drought management circumstances.

12. **WATER RIGHTS NOT AFFECTED.**

Nothing in this Contract shall be construed to affect the water rights of either Party.

13. **TERM OF CONTRACT.**

This Contract shall become effective on the date subscribed below, and shall remain in effect unless amended or terminated by mutual agreement. In the event either Party fails to comply with any of the provisions hereof, the other Party, after giving the non-complying Party thirty (30) days advance written notice of the provision so violated, may suspend the operation of this Contract pending the curing of said default. All amendments hereto shall be in writing and mutually agreed upon by both Parties.

14. **CAPITAL IMPROVEMENT CHARGES.**

"**Capital Improvement**" means the capital assets including land, improvements to land, easements, buildings, infrastructures, and other tangible and intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period as more particularly described in the Governmental Accounting & Financial Reporting Standards as applicable to the District.

(a) If the District engages in a Capital Improvement project for improvements to that portion of its irrigation system which is used and useful to the delivery of water to the City, the City agrees to pay its pro rata share of the costs of the Capital Improvements paid by the District.

(1) If the District pays for such Capital Improvement project in cash, the City shall reimburse the District its pro rata share of such cash payments incurred by the District within thirty (30) days of being billed for such pro rate share by the District.

(2) If the District finances such Capital Improvement project, the City shall pay its pro rata share of each payment, including interest, by the District on the financed improvement costs within thirty (30) days of being billed for such pro rata share by the District.

(3) City's Pro Rata Share.

(i) The City's pro rate share of a Capital Improvement project paid in cash by District shall be the ratio that the total amount of water diverted by the District for the City in the preceding five (5) year period bears to the total water diverted by the District in the preceding five (5) year period.

1. As to any Capital Improvement project financed by the District for less than five (5) years, the City's pro rata share for any financed Capital Improvement costs paid by the District in a year shall be calculated by the ratio that the total amount of water diverted by the District for the City in the preceding five (5) year period bears to the total water diverted by the District in the preceding five (5) year period

2. As to any Capital Improvement project financed by the District for five (5) years or more, the City's pro rata share for any financed Capital Improvement costs paid by the District in a year shall be calculated by the ratio that the amount of water diverted by the District for the City bears to the total water diverted by the District in the preceding calendar year

(b) The pro rata amount payable by the City shall be based upon the pro rata amount of the cost of improvements made in the Capital Improvement project involving any existing District facilities along the route of delivery from and including its Rio Grande River diversion facilities to the City's Delivery Point. This pro rata amount shall be referred to herein as that portion of the Capital Improvement project cost to which the City shares with others receiving service from the District (referred to herein as "**shared cost**").

15. **INTEREST ON DELINQUENT AMOUNTS.**

Any amount owed due to a breach of this Contract including but not limited to any payment provided for herein which remains unpaid for at least ten (10) days following the date for payment provided herein shall bear interest at Prime Rate. As used herein "**Prime Rate**" means the annual rate of interest announced from time to time by *The Wall Street Journal* as the Prime Rate, changing as and when such rate changes, unless a lesser rate shall then be the maximum rate permissible by law with respect to the matter for which interest is being computed, in which case such lesser rate shall be charged, or in the event *The Wall Street Journal* no longer publishes a Prime Rate, such other similar rate of interest published or announced from time to time by a similar publication or major bank with offices in McAllen, Texas, chosen by the District.

16. **SUCCESSORS.**

In the event any other person or entity succeeds to any part or all of the business, operations or facilities of either Party, whether by purchase, assignment, contract, operation of law, court order, or by any other means or for any reason, this Contract shall be binding upon such person or entity in all of their terms and conditions and any such purchase, assignment, contract, operation of law, court order or other means shall be subject to this Contract.

17. **INTERPRETATION.**

This Contract and all the terms and conditions hereof shall be liberally construed to effectuate the purpose set forth herein and to sustain the validity of this Contract. The Parties agree that this Contract shall not be construed in favor of or against either Party on the basis that the Party did or did not author the Contract.

18. **PARTIES IN INTEREST.**

This Contract shall be for the sole and exclusive benefit of the Parties hereto and their successors and assigns hereof, and this Contract shall not inure to the benefit of any other persons or entities, and is the result of negotiations between the Parties and is not to be considered a precedent with respect to either Party in any other like situation or with respect to any other party in any other like situation.

19. **ENFORCEMENT.**

Subject to the provisions of Paragraph 25, it is understood and agreed that either Party hereto may demand specific performance of this Contract.

20. **INVALIDITY OF PROVISION.**

In the event any provision hereof is declared invalid by an arbitrator, such invalidation shall not invalidate the remaining portions of this Contract unless the provision(s) so invalidated renders this Contract non-performable by either Party and/or frustrates the purpose of the Contract.

21. **NOTICE.**

All notices, demands, requests or communications required or permitted hereunder shall be in writing and shall either be (i) personally delivered, against a written receipt, (ii) sent by certified mail, return receipt requested, postage prepaid or (iii) delivered by a nationally recognized courier service (costs prepaid) and addressed to the Parties at the addresses set forth below, or at such other addresses as may be hereafter specified by written notice delivered in accordance herewith:

If to District: HIDALGO COUNTY IRRIGATION DISTRICT NO. ONE
 Attention: Manager
 P.O. Box 870
 Edinburg, Texas 78540

If to City: CITY OF MCALLEN, TEXAS
 Attn: City Manager
 1300 Houston Ave.
 McAllen, Texas 78501

22. **AUTHORIZATION.**

The representatives of the Parties executing this Contract represent unto the other that they are authorized by action of the governing bodies of each Party to execute this Contract.

23. **AMENDMENTS AND SUPPLEMENTS.**

All amendments and supplements to this Contract shall be in writing in suitable form for recordation in the Official Records of Hidalgo County and be mutually agreed upon by both Parties.

24. **CONTRACT NOT INTENDED AS A WHOLESALE WATER SUPPLY CONTRACT.**

The Parties agree that this Contract is not intended to be a wholesale water supply contract.

25. ARBITRATION.

Except to the extent prohibited by law, upon the request of any Party hereto, whether made before or after the institution of any legal proceeding, any action, dispute, claim or controversy of any kind (e.g. whether in contract or in tort, statutory or common law, legal or equitable, or otherwise), now existing or hereafter arising between the Parties, shall be resolved by binding arbitration in accordance with the terms of this Contract. The foregoing matters shall be collectively referred to as "Disputes." Any Party hereto may bring an action in court to compel arbitration of any Dispute. All Disputes shall be resolved by binding arbitration and, unless otherwise agreed upon by the Parties hereto, any arbitration hereunder shall be administered by the American Arbitration Association (the "AAA"). Any arbitration hereunder shall be administered in accordance with the terms of this Contract, the Arbitration Rules for the AAA, and, to the maximum extent applicable, the Federal Arbitration Act (Title 9 of the United States Code). Arbitration proceedings hereunder shall be conducted at a location in Hidalgo County, Texas, agreed to in writing by the Parties, or, in the absence of such an agreement, selected by the arbitrator. The provisions of this Paragraph 25 shall survive any termination, amendment or expiration of this contract, unless the Parties otherwise expressly agree in writing. This Paragraph 25 may be amended, changed or modified only by the express provisions of a writing which specifically refers to this Paragraph 25 and which is signed by all of the Parties hereto.

[The remainder of this page intentionally left blank.]

IN WITNESS WHEREOF AND EXECUTED by the Parties through their authorized representatives on this Oct 10 day of 2013.

THIS CONTRACT COUNTAINS PROVISIONS FOR BINDING ARBITRATION

HIDALGO COUNTY IRRIGATION DISTRICT No. ONE

By: Robert L. Bell, Jr.
Robert L. Bell, Jr., President



CITY OF MCALLEN, TEXAS

By: James Darling
James Darling, Mayor

Annette Villarreal
Annette Villarreal, TRMC
City Secretary

MCALLEN PUBLIC UTILITY

By: Charles Amos

Charles Amos, Chairman of the Board of Trustees

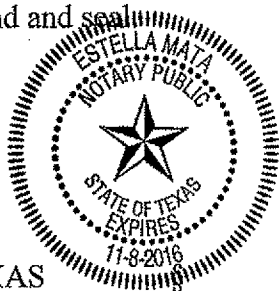
ATTEST:

Nyla L. Flatau
Nyla L. Flatau, TRMC
Utility Board Secretary

ACKNOWLEDGMENT

STATE OF TEXAS §
 §
 COUNTY OF HIDALGO §

This instrument was acknowledged before me on this the 10th day of Oct, 2013, by Robed L. Bell, Jr., President of HIDALGO COUNTY IRRIGATION DISTRICT No. ONE, a political subdivision of the State of Texas, on behalf of said political subdivision, to certify which I witness my hand and seal.



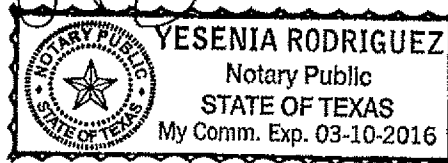
Estella Mata
 Notary Public in and for the State of Texas

STATE OF TEXAS §
 §
 COUNTY OF HIDALGO §

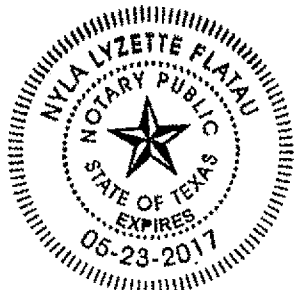
This instrument was acknowledged before me on the 16th day of Sept., 2013, by James Darling, Mayor of the CITY OF MCALLEN, TEXAS on behalf of said municipality and in the capacity stated, to certify which witness my hand and seal.

James Darling
 Notary Public in and for the State of Texas

STATE OF TEXAS §
 §
 COUNTY OF HIDALGO §



This instrument was acknowledged before me on the 10th day of Sept, 2013, by Charles Amos, Chairman of Board of Trustees of the MCALLEN PUBLIC UTILITIES, on behalf of said Board and in the capacity stated, to certify which witness my hand and seal.



Nyia L. Flatau
 Notary Public in and for the State of Texas

STATE OF TEXAS

§

PERMANENT WATER
SUPPLY CONTRACT

COUNTY OF HIDALGO

§

This Permanent Water Supply Contract is entered into by and between **HIDALGO COUNTY IRRIGATION DISTRICT NO. 2**, a water irrigation district operating under the laws of the State of Texas and a political subdivision of the State of Texas, hereinafter referred to as "**DISTRICT**"; and the **CITY OF McALLEN**, a municipality under the laws of the State of Texas, hereinafter referred to as "**CITY**"; wherein **DISTRICT** agrees to provide to **CITY** untreated water from the Rio Grande River, and **CITY** agrees to receive such waters in accordance with the following terms and conditions:

I.

WATER SUPPLY

1.1 Water Allocation:

a. **DISTRICT** is the holder of various water rights to the Rio Grande River to divert and use waters of the Rio Grande for irrigation, municipal, industrial, domestic, and livestock uses as adjudicated to the **DISTRICT** in the Final Judgment in the Valley Water Suit, with reference to Court No. 531 and as further evidenced by Certificate of Adjudication No. 23-808 issued by the Texas Water Rights Commission (now Texas Natural Resources Conservation Commission, hereinafter referred to as "**COMMISSION**") and of record in the Water Rights Adjudication records of Hidalgo County, Texas, to which reference is hereby made. Under the terms of a Stipulation in the *Valley Water Suit*

Judgment and Certificate of Adjudication No. 23-808 the District is authorized to divert from the Rio Grande and deliver to the City 6,140 acre feet of municipal use water.

b. **CITY** and **DISTRICT** agree that upon completion of the construction of the pipeline and facilities described in paragraph 1.3 below, District will deliver to City at the Delivery Point described herein and subject to all the terms hereof 1,500 acre feet of municipal use water from the Rio Grande per annum, such water herein referred to as "DISTRICT WATER." This 1,500 acre feet is in addition to the 6,140 acre feet per annum referred to in paragraph 1.1.a

1.2 Future Water Supply

a. Under this Contract, **DISTRICT** and **CITY** are providing for the supply of additional water, hereinafter referred to as **CONVERTED WATER**, upon the subdivision of land (as that term is defined in Chapter 212 Local Government Code) within the city limits of **CITY** and within the boundaries of **DISTRICT** and the exclusion of same from the boundaries of **DISTRICT**, all as provided for hereinbelow.

b. The **CONVERTED WATER** to be furnished and delivered hereunder to **CITY** are those untreated waters of the Rio Grande which the **DISTRICT** will allocate or has allocated or diverted to **CITY** from **DISTRICT**'s municipal, industrial and domestic uses allotment or allocation as currently allocated or as may hereafter be allocated to **DISTRICT** by the Commission's Rio Grande Watermaster, or its successor, pursuant to **DISTRICT**'s water rights, as such allotment or allocations are presently administered or as hereafter administered pursuant to the rules and regulations of the Commission, as they presently exist or as hereafter amended. The amount of such **CONVERTED WATER**

which **DISTRICT** agrees to supply and divert to **CITY** under this paragraph, is the equivalent of 1.25 acre feet per annum per net irrigable acre on the **DISTRICT** flat rate rolls contained in lands within the City limits of **CITY** and excluded from the **DISTRICT** boundaries in the future as provided for herein, and measured at the **DISTRICT**'s point of diversion on the Rio Grande. It is agreed that the amount of 1.25 acre feet per annum per acre contained in this paragraph is based upon the current Rules of the Commission relating to the conversion of irrigation water rights to municipal water rights and, in the event such conversion Rules are changed in the future, then this amount will be changed accordingly.

c. **CITY** agrees to adopt the Procedure for Concurrent Subdivision Plat Review and Exclusion attached to this agreement as Exhibit "A" and incorporated herein by reference and to follow said Procedure as to all subdivision plats, where such land is located within the boundaries of the **DISTRICT**, and which is submitted to **CITY** for approval more than sixty (60) days after the execution of this Agreement.

d. When **DISTRICT** has excluded lands from its boundaries containing at least 500 acres of previously irrigable land on the flat rate rolls of the **DISTRICT** so as to provide, upon conversion of such irrigation use rights to municipal use rights, a minimum of at least 625 acre feet (after conversion from irrigation to municipal use) per annum of municipal use rights, **CITY** may serve written notice on **DISTRICT** that it is in need of such water to meet existing needs of the **CITY** and the receipt of which notice shall be acknowledged in writing by the **DISTRICT**.

Upon the occurrence of 1.2.c and 1.2.d above, the **DISTRICT** will proceed with appropriate administrative proceedings to convert said irrigation use rights to municipal use rights; provided, however, **CITY** shall cause to be deposited with **DISTRICT** an amount which **DISTRICT** estimates will be its reasonable expenses and attorneys' fees which will be incurred in such administrative proceedings before **DISTRICT** shall be obligated to initiate such administrative proceedings. **CITY** agrees to cause to be paid any fees and expenses in excess of that amount deposited with **DISTRICT**, within fourteen (14) days of receipt of invoice therefore, and **DISTRICT** agrees to refund to **CITY**, or any applicable party, any amount so deposited which is not used once the administrative proceedings are completed.

DISTRICT agrees to exercise all reasonable diligence to accomplish these proceedings before the Commission, or its successor, and it is contemplated that such proceedings should be completed within one hundred and fifty (150) calendar days from the date of initiation of such proceedings; however, any delay in such proceedings beyond such one hundred and fifty (150) calendar day period shall not be grounds for termination of this Agreement.

e. **DISTRICT** agrees upon receipt from the Commission of an amended Certificate of Adjudication or other appropriate order authorizing the change of purpose of use of said 500 acres of its Class "A" irrigation rights, to 625 acre feet per annum of municipal use water rights, to promptly notify **CITY** in writing, and such water rights will then be considered and be designated **CONVERTED WATER** under this Agreement.

f. **DISTRICT** agrees should an emergency develop where **CITY** is in need of additional raw water prior to the completion of the necessary proceedings to convert irrigation use rights to municipal use rights as provided above, that **DISTRICT** will, if allowed by existing rules and regulations and applicable law, deliver up to the amount of acre feet involved in said conversion proceedings pending the completion of such proceedings.

g. It is understood and agreed that **DISTRICT** shall not be obligated to supply and deliver any amount of water that it cannot furnish because of the refusal of the Commission to allow conversion of irrigation use water rights previously used to serve subdivided properties within the city limits of **CITY** and boundaries of **DISTRICT** which are excluded from **DISTRICT** pursuant to this paragraph to municipal use water rights.

h. It is further agreed that **DISTRICT** will not convey, transfer or enter into permanent water supply contracts covering irrigation use rights of **DISTRICT** that can be converted to municipal use which could become available for conversion hereunder due to the exclusion of property subdivided into urban subdivisions lying within the city limits of **CITY** other than with **CITY**. Such irrigation use rights of **DISTRICT** will be held and retained by **DISTRICT** for conversion to municipal use rights upon demand by **CITY** as herein provided.

1.3 Water Delivery and Storage Facilities:

CITY shall use such water at its Water Treatment Plant Number 1 using existing water delivery systems and/or at Water Treatment Plant Number 2 using a delivery point at a location at approximately Rowe Street (2nd Street) and Wichita Avenue in the City

where a new minimum thirty (30") pipeline will be installed from such delivery point to Water Treatment Plant Number 2. This new pipeline shall be constructed at CITY's cost and subject to plans and specifications approved by the District. The exact location of delivery point(s) and specifications therefor shall be located and installed in accordance with mutually agreeable locations and specifications therefor. CITY agrees to maintain its existing water storage facilities at CITY's Water Plant Number 1, so long as such plant remains operational and to keep such facilities filled as much as possible so as to insure an uninterrupted supply of water in the event that DISTRICT temporarily ceases to supply water to CITY due to maintenance of DISTRICT's system, mechanical failure, strikes, acts of God, or other causes beyond DISTRICT's control and CITY agrees that DISTRICT may, in DISTRICT's discretion, supply water to Water Treatment Plants Numbers 1 and 2 on other than a daily basis so long as CITY has adequate water from its storage facilities and other deliveries of water by DISTRICT or other districts.

1.4 Special Conditions

It is agreed that the DISTRICT's obligations under the foregoing paragraphs are conditional upon the existence of the water delivery and storage facilities described above or replacement facilities of the CITY having at least the minimum treatment capacity of the CITY facilities described in paragraph 1.3 above. In the event the CITY no longer operates facilities to which water may be delivered by the DISTRICT, then the DISTRICT may terminate this Contract upon thirty (30) days' advance written notice to CITY.

II.

WATER DELIVERY

2.1 Water Delivery Charge:

The **DISTRICT** shall charge 8.5 cents per 1,000 gallons actually diverted and delivered by **DISTRICT** to **CITY** as a pumping charge. **CITY** shall pay to **DISTRICT** monthly, at its office in San Juan, Texas, an amount equal to the sum of the pumping charge for all water actually diverted and delivered by **DISTRICT** to **CITY** for such monthly period measured as provided herein. **CITY** agrees to pay **DISTRICT**, on or before twenty-five (25) days following the date of **DISTRICT**'s monthly statement to **CITY**, the amount due hereunder for the prior month's water deliveries. All past due amounts due hereunder to **DISTRICT** shall bear interest at an effective rate of fifteen percent (15%) per annum compounded monthly.

The charge provided herein shall be adjusted if applicable, annually by **DISTRICT** in the same proportion that the **DISTRICT** adjusts its water delivery charge and flat rate for water delivery to land within the **DISTRICT**. The calculation shall be based on the combination of both the flat rate and water delivery charge.

The current flat rate assessment in the **DISTRICT** is \$8.25 per acre and the current irrigation water delivery charge is \$7.50 per acre irrigated. For purposes of this Agreement, it is assumed that the average use is two (2) irrigations per acre and the application of one (1) acre foot per acre. Based upon these assumptions, the current acre-foot cost for irrigation is the flat-rate of \$8.25 and two (2) irrigations at \$7.50 each for a total of \$23.25.

In the event the **DISTRICT** changes the flat rate and water delivery charge, then the percentage of change in irrigation acre-foot cost using the above assumptions will be applied in the same percentage ratio to the rate above for the **CITY** and it shall be effective at the same time changes are effective to irrigators in the **DISTRICT**.

2.2 Delivery Point: **DISTRICT** shall deliver water to **CITY** from the main irrigation canal currently owned by **DISTRICT** at **CITY**'s diversion points as provided in paragraph 1.3 hereof.

2.3 Measurement of Water: The water delivered by **DISTRICT** hereunder to **CITY**'s Water Treatment Plant Number 1 shall be measured by metering at the Delivery point at the Reservoir located at Business Highway 83 and 2nd Street, at such Plant in the City of McAllen . Should the **CITY** commence diversion from the Rowe and Wichita location, the metering equipment utilized and the cost in maintaining such metering equipment shall be borne by **CITY**, and both the type of metering equipment and the method of construction and maintenance utilized shall be subject to **DISTRICT**'s approval, which shall not be unreasonably withheld. Both parties shall have free access to such meter for reading and examination. All measuring equipment shall be installed and maintained at the **CITY**'s cost.

2.4 Water Diversion Reports: **DISTRICT** will make the necessary Rio Grande diversion reports to the Commission's Rio Grande Watermaster, of the amount of water diverted from the Rio Grande for **CITY** based upon the amount of water delivered measured as provided in paragraph 2.3 above, multiplied by a factor of 1.2 so as to take into account canal transportation losses occurring prior to such measurement. **DISTRICT**

will also pay all assessments due to the Commission, or its successor, on account of such diversion.

2.5 Failure of Delivery: DISTRICT shall not be liable to CITY for failure of delivery in the event of mechanical failure, strikes, acts of God or other occurrences beyond DISTRICT's control nor shall DISTRICT be liable to CITY in any event, so long as DISTRICT is taking reasonable steps to continue and maintain service to CITY. In the event drought conditions result in a limited amount of water available for allocation by the Commission, or its successor, and there is implemented a proration of available water supply, then in such event, the amount of water covered by this Contract will be prorated according to the rules and regulations of the Commission and state law so that CITY will be treated on the same basis as other similar users upon the Lower Rio Grande River.

2.6 Minimum Delivery

The CITY agrees that it will order from and take delivery of at least fifty (50%) percent of the water to which CITY is entitled from the DISTRICT under this Contract. In the event CITY fails to order and take delivery of such amount by December 31 of each year, then the CITY agrees to pay to the DISTRICT the delivery charge on the amount of water representing the difference in the amount actually received from the CITY and fifty (50%) percent of its entitlement under this Contract.

III.

GENERAL PROVISIONS

3.1 Transfer of Contract: This Contract may not be transferred or assigned by CITY without the express written approval of DISTRICT.

3.2 Term of Contract: This Contract shall become effective on the date below written, and shall remain effective thereafter unless amended or terminated by either of the parties under the provisions hereof, but not otherwise.

3.3 Default: In the event CITY fails to comply or fails to cause compliance with any of the payment provisions hereof, DISTRICT shall give CITY sixty (60) days written notice of the payment provision so violated. If CITY has not cured such default within the sixty-day period, this Contract shall terminate, as it relates to the future obligations of DISTRICT under Article I Section 1.2 hereof. If the payment in default is for City Water Rights, then CITY shall forfeit any and all rights to such water on a prorated basis based on payments made to date of default and CITY shall continue to be liable for any administrative expense incurred in relationship to the conversion of such water right, which such liability shall be enforceable in a court of competent jurisdiction. Should this Contract be terminated upon default of CITY as provided herein, then CITY shall remain entitled to receive the amount of water to which it is entitled at that time, but no further CONVERTED WATER.

3.4 Amendments: All amendments hereto shall be in writing and mutually agreed upon by both parties.

3.5 Enforcement: It is understood and agreed that unless another remedy is provided herein for a specific breach of this Contract, that either party hereto may demand specific performance of this Contract.

3.6 Laws and Regulations: This Contract shall be subject to the Rules and Regulations of the Commission or its successor, as they presently exist or as they are hereafter amended, to the extent such Rules and Regulations pertain to the operations of the parties hereunder. This Contract shall be subject to all valid applicable State, Federal and local laws, rules and regulations; provided that either party hereto shall be entitled to regard all laws, rules and regulations issued by any Federal or State regulatory body as valid and may act in accordance therewith until such time as the same may be held invalid by final judgment in a court of competent jurisdiction.

3.7 Water Use Reports and Assessments The DISTRICT will make the necessary Rio Grande water diversion reports to the Rio Grande Watermaster of the Commission, or its successor, relating to the amount of water diverted from the Rio Grande for the CITY based upon the amount of water metered as provided for above, plus the amount of transportation losses incurred in transporting the water from the Rio Grande to the CITY's delivery point(s) calculated as provided in this Contract. It is agreed that the DISTRICT will report water delivered to the CITY first on the DISTRICT's industrial, municipal and domestic allotment before reporting use under the 6,140 acre foot allotment included within Certificate of Adjudication No. 23-808 referred to above. The CITY shall pay all assessments made by the Commission, or its successors, with respect to the water to which the CITY is entitled to receive delivery under this Contract.

3.8 Limitation of Liability DISTRICT shall have no liability to CITY or its citizens or treated water customers for any pollution or contamination of water delivered to CITY unless caused by the deliberate act of the DISTRICT's Board of Directors or Manager. The CITY agrees to hold DISTRICT harmless for any claim or demand which may be made against DISTRICT growing out of pollution or contamination of water delivered under this Contract unless caused by the deliberate act of the DISTRICT's Board of Directors or Manager.

3.9 Water Supply Shortage

In the event DISTRICT is unable to deliver all of the water to which CITY is entitled under this Contract because of low water supply in the Rio Grande and Falcon and Amistad Reservoirs, the supply to the CITY will be reduced in the same proportion as other municipal users in the Lower Rio Grande (that area lying downstream on the Rio Grande below Falcon Reservoir) under the administration of the Commission's Rio Grande Watermaster, or his successor; provided, however, this provision shall not control if the reason for the DISTRICT's inability to serve is due to the CITY having insufficient water allocation rights to the Rio Grande under this Contract, so as to allow DISTRICT to divert and deliver water to CITY, in which case DISTRICT shall not be responsible for making water deliveries to CITY.

3.10 Parties in Interest This Contract shall be for the sole and exclusive benefit of the parties hereto and their successors and it shall not inure to the benefit of any other persons, entities or third parties.

3.11 Merger This Contract constitutes the entire agreement between the parties relative to the subject matter hereof.

3.12 Authorization: Those representatives of the parties executing this Contract on behalf of the parties, represent one to the other that they are authorized by action of the governing bodies of each party to execute this Contract.


3.13 Arbitration: In case any dispute arises between the parties, including the rates charged by the **DISTRICT**, such disputes shall be subject to binding arbitration under the Texas General Arbitration Act (Tex. Rev. Civ. Stat. Ann. Art. 224, et seq.) and the parties specifically agree that no dispute shall be appealed or filed with the Commission or any successor agency and should either party violate this specific provision, then such party so appealing or filing any such matter with the Commission, other than the conversion of water rights and ancillary proceedings as specifically provided herein, shall pay all costs and expenses of the other party, including attorney's and expert fees, providing such other party is ready, willing and able to abide by the arbitration provisions herein.

EXECUTED THIS _____ day of October, 1993.

Attest

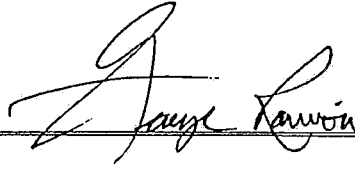
CITY OF McALLEN

Leticia M. Vacek
Leticia M. Vacek *by up*
City Secretary

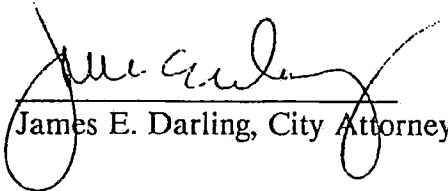
By: 
Othal E. Brand, Sr.
Mayor

McALLEN PUBLIC UTILITY
BOARD OF TRUSTEES

Leticia M. Vacek
Leticia M. Vacek *by ip*
City Secretary

By: 
Chairman

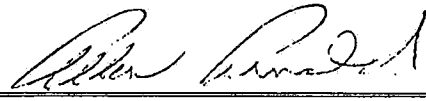
APPROVED AS TO FORM:


James E. Darling, City Attorney

ATTEST:

HIDALGO COUNTY IRRIGATION
DISTRICT NO. 2

Bert Forthuber
Bert Forthuber
Secretary, Board of Directors

By: 
Allen Arnold
President, Board of Directors

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PROCEDURE FOR CONCURRENT
SUBDIVISION PLAT REVIEW AND EXCLUSION

1. City agrees to require all subdivisions, which do not desire a raw water supply from District, which are located within the city limits of City and the boundaries of the District and which will require municipal water service from the City, to be excluded from the boundaries of the District.
2. When the City receives a preliminary Plat of a proposed subdivision, a copy will be forwarded to District for preliminary inspection for any conflicts with District right of ways, easements, facilities, etc. City will inform developers that exclusion of the property from the District's boundaries will be necessary.
3. After the Plat is reviewed by District for the purposes set out in paragraph 2 above, it will be returned to City approved as submitted, or with stated requirements which are necessary for approval. The city will review preliminary Plats under its regular subdivision procedure and will incorporate the requirements identified by District, if any. If there are changes, Plats will be returned to District for inspection for the purposes set out in paragraph 2 above, and final approval. City shall compel the developer to comply with all of District's requirements.
4. At the time the final Plat approval is requested from the City by the developer, the City will require proof that the developer has waived irrigation service from

EXHIBIT "A"
Page 1 of 3 Pages
To Permanent Water Supply Contract Between
HIDALGO COUNTY IRRIGATION DISTRICT NO. 2 and CITY OF McALLEN

the District, consented to the exclusion of the subdivision property from the District, and placed funds with the District sufficient for the payment of necessary reasonable expenses for the proceedings required to obtain exclusion fees and expenses with the District. All current and delinquent taxes and flat rates must be paid. The District will place this deposit in a special escrow account to be applied toward payment of such costs when the subdivision property is formally excluded. The developer will further agree to pay any excess that may be needed should that be necessary, and the District will agree to reimburse to the developer, any overage in the escrow deposit once the exclusion is finalized.

The required proof will be the form of Waiver of Irrigation Service and Consent to Exclusion on a form approved by the District. Upon execution thereof by the developer/landowner and the exclusion escrow money deposited with the District, the District will retain the original copy of the Waiver and give the landowner/developer a copy and transmit a copy to City, of the Waiver evidencing that the landowner/developer has consented to exclusion and deposited the necessary exclusion escrow funds.

5. The developer will file final Plats for record with the County and will notify the City and the District of the Volume and page number in which the Plat is recorded. Upon receipt of this information, the District will commence the necessary exclusion proceedings to exclude the subdivision property from the District's boundaries.

EXHIBIT "A"
Page 2 of 3 Pages
To Permanent Water Supply Contract Between
HIDALGO COUNTY IRRIGATION DISTRICT NO. 2 and CITY OF McALLEN

6. When the exclusion proceeding is completed, the District will have prepared and recorded a final Resolution of Exclusion and Release of the property from further taxation from the District. After recording, copies of the Resolution and Release will be forwarded to the landowner and the City.

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EXHIBIT "A"
Page 3 of 3 Pages
To Permanent Water Supply Contract Between
HIDALGO COUNTY IRRIGATION DISTRICT NO. 2 and CITY OF McALLEN

THE STATE OF TEXAS

COUNTY OF HIDALGO

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PERMANENT WATER SUPPLY AND
DELIVERY CONTRACT

This Permanent Water Supply and Delivery Contract is entered into by and between UNITED IRRIGATION DISTRICT, of Mission, Hidalgo County, Texas, an irrigation district operating under the laws of the State of Texas and a political subdivision of the State of Texas, hereinafter referred to as "District," and the CITY OF MCALLEN, TEXAS, a municipality under the laws of the State of Texas, hereinafter referred to as "City," wherein District agrees to furnish and deliver to City untreated water from the Rio Grande, and City agrees to receive such waters in accordance with the following terms and conditions:

Background Recitals

1. City is in the process of acquiring or has acquired property in Lots 428, 438 and 448, John H. Shary Subdivision, Hidalgo County, Texas, as a location for Water Treatment Facilities to provide additional treated water service to its citizens, and is in need of a raw water supply and raw water delivery service for such facilities.

2. The Water Treatment Facilities described above lie within the boundaries of District and are accessible to the District's existing raw water delivery system and District is able and desires to provide the raw water supply and delivery service needs of the City at these Facilities inasmuch as some of the current and future water service needs of City will be in the boundaries or former boundaries of the District.

3. In consideration of the mutual benefits to be received, the parties desire to enter into this Contract whereby the City is granted a permanent allocation of municipal water rights by District and District agrees to deliver such water in accordance with the terms of this Contract.

Construction of Facilities

4. The City agrees to construct the said Water Treatment Facilities and shall give District ninety (90) days advance written notice of its need for water deliveries at the

Facilities. This Contract shall become effective as provided below regardless of when the City completes construction of said Facilities and is in need of water supply and deliveries. District shall furnish necessary right-of-way and shall be responsible for the maintenance of its water delivery facilities up to the northwest corner of Lot 448, John H. Shary Subdivision, Hidalgo County, Texas. City shall be responsible for required right-of-way and the construction and maintenance of its necessary facilities beginning at the northwest corner of said Lot 448.

City hereby reserves the right to designate any different delivery point from the designated delivery point as specified above. Provided, however, that District shall only be responsible for maintenance of its present water delivery facilities and should such delivery point be located at a point other than on the District's present water delivery facilities, City shall be responsible for the required right-of-way and the construction and maintenance cost of the necessary facilities from the City's ultimate destination to the point of delivery at the District's present water delivery facilities.

City's Water Entitlement and Allocation

5. The water to be furnished and delivered hereunder to City are those untreated waters of the Rio Grande which the District will allocate and deliver to City from the District's municipal allotment or allocation as currently allocated or as hereafter allocated to District by the Texas Water Commission, Rio Grande Watermaster, or its successor, pursuant to District's water rights, as such allotment or allocation is presently administered or as hereafter administered pursuant to the rules and regulations of the Texas Water Commission, or its successor, as they presently exist or as hereafter amended.

6. The amount of municipal use water which District agrees to supply to City hereunder, is up to a maximum of 11,250 acre-feet of water, on a calendar year basis, measured at the

District's point of diversion on the Rio Grande in accordance with the terms of this Contract.

7. While it is agreed that District will furnish and deliver to City a maximum of up to 11,250 acre-feet of water annually, the maximum amount of water to be furnished and delivered in any one calendar year shall be the Amount of Designated Water established by the City on the most recent Date of Designation in a previous year. The initial Amount of Designated Water is 5,000 acre-feet per annum. On or before September 1, 1989 and on or before each September 1 thereafter, City may increase the Amount of Designated Water in increments of 1,250 acre-feet until the Amount of Designated Water equals the maximum of 11,250 acre-feet. It is agreed that City may not decrease the Amount of Designated Water and that City may not increase the Amount of Designated Water in any increment(s) other than 1,250 acre-feet or multiples thereof and only on an annual basis as set out above. The Date of Designation is September 1 of the year City increases the Amount of Designated Water, and such Designation shall be in writing and delivered to District on or before September 1. The City shall be entitled to the increased Amount of Designated Water effective January 1 of the year following the Date of Designation.

Delivery of Water

8. Water hereunder shall be delivered to City at the northwest corner of Lot 448, John Shary Subdivision ("the Delivery Point"). The Delivery Point may be changed in accordance with the provisions of Paragraph 4 above.

In requesting deliveries of water, the City shall give District sufficient notice, as determined by District, so as to allow District sufficient time to order the water under applicable Rio Grande Governmental Administrative Rules to arrive at its Rio Grande diversion point and sufficient time to transport the water to the delivery point within the capability of the District's delivery system. The District agrees to deliver water at the Delivery Point at a volume not to exceed six

(6) cubic feet per second (cfs) at natural ground elevation. If a greater than 6 cfs delivery rate is required, then it is agreed that District shall provide the necessary right-of-way for the construction and maintenance of necessary pipeline and appurtenant facilities required for a greater than 6 cfs delivery rate and the City will pay for the cost of construction of such facilities. The District agrees to construct or have constructed such additional facilities at the City's cost according to plans and specifications mutually agreed upon. After the construction of such facilities, the District shall own and thereafter maintain such additional facilities.

Measurement of Water

9. (a) City agrees to furnish, install, operate and maintain at the Delivery Point, necessary metering equipment and required devices of standard type to measure the quantity of water delivered by District in gallons and to calibrate such metering equipment whenever requested by District but not more frequently than once every six (6) months. A meter registering not more than two (2%) percent above or below the test result shall be deemed accurate. The previous readings of any meter disclosed by test to be inaccurate shall be corrected for the 90 days previous to such test in accordance with the percentage of inaccuracy found by such tests. If any meter fails to register for any period, the amount of water furnished during such period shall be deemed to be the amount of water delivered in a corresponding period prior to the failure with similar rate of flow conditions unless District and City shall agree upon a different amount. The metering equipment shall be read by the District on the same date each month as determined by the District after advice and consultation with the City. The City shall have access to read the meter.

(b) The amount measured by such meter or measuring device shall be the amount, rounded to the nearest 1,000 gallons, upon which billings by District to City provided for herein shall be based.

Contract and Water Delivery Charges

10. In consideration of District's agreement to furnish, supply and deliver or have delivered the water covered by this Contract to City for use in serving its citizens, it is agreed that City shall pay to District an Initial Fee, a Dedication Fee, an Annual Fee and Water Delivery Charges as follows:

(a) The Initial Fee is ONE MILLION, FIVE HUNDRED THOUSAND AND NO/100THS (\$1,500,000.00) DOLLARS, one-half of which is to be paid in cash upon the execution of this Contract by City and District, and the balance six (6) months later.

(b) The Dedication Fee shall be THREE HUNDRED AND NO/100THS (\$300.00) DOLLARS per acre-foot of the increase in the Amount of Designated Water, to be paid in cash when the written Designation, provided for in Paragraph 7 above, is made.

(c) The Annual Fee is for the amount of Designated Water not requested or delivered to the City at the delivery point each calendar year and shall be paid on an annual basis, in cash, in an amount equivalent to the flat rate assessment per irrigable acre assessed by the District against irrigators in the District, in effect at the end of the year involved for each 1.25 acre-foot of Designated Water not requested or delivered as calculated pursuant to Paragraph 13 below, unless such failure to deliver is due to Rio Grande water shortages and proration of Rio Grande water supply or other occurrences as provided for in Paragraph 16 below. The Annual Fee includes the amount assessed for water delivered to other locations as provided in Paragraph 15 below. District shall advise the City in writing, the amount of Annual Fee owed following the end of the calendar year and City shall pay District said amount due within thirty (30) days following receipt thereof.

Except as provided in Paragraph 15, City will not be assessed the Annual Fee until after May 1, 1991 or until after the completion of the construction of the Water Treatment Facilities described in Paragraphs 1 and 2 above, whichever event occurs sooner. In the event the Annual Fee becomes effective

during the course of a calendar year, the Annual Fee due for that partial year shall be a pro rata amount, prorated on a monthly basis rounded to the nearest month.

(d) City agrees to pay a Water Delivery Charge of \$ 0.12 per 1,000 gallons of water delivered to City at the Delivery Point, and measured as provided in Paragraph 9 above. City agrees to pay District on or before the 15th day of each month the amount due for water delivered the prior month. The amount of the Water Delivery Charge shall be adjusted from time to time as provided in Paragraph 11 below. It is understood that the cost of diversion and transportation of water lost due to conveyance losses incurred in transporting the water from the Rio Grande to City's delivery point is included in the Delivery Charge.

(e) In the event the City fails to pay any amounts due the District hereunder, the District may cease deliveries of water under this Contract after thirty (30) days written notice to City. In such event, the District will be damaged in an amount impractical or which is extremely difficult to determine, and therefore it is agreed that liquidated damages in an amount of \$100.00 per month or 12% calculated on a per annum basis (1% per month) on the amount owed, whichever is greater, shall be paid by City to District until the amount due is paid. Such liquidated damages shall be considered a part of the charge or fee which is due.

Adjustments to Delivery Charges

11. The Water Delivery Charge provided for in Paragraph 10 above of \$0.12 per 1,000 gallons shall remain in effect until January 1, 1990, at which time the Water Delivery Charge will be adjusted in accordance with the terms of this Paragraph.

(a) During the period January 1, 1990 until December 31, 1996, or during the period January 1, 1990 until January 1 of the year following five (5) years after the first deliveries of water by District to City under this Contract, whichever event occurs sooner, the Water Delivery Charge shall be annually

adjusted based upon the increase in total annual expenditures of the District for fuel and labor expenses as shown by the District's Annual Audit Report in accordance with the following provisions:

(1) For these purposes the term "fuel" shall mean all expenditures for gas, oil, diesel, natural gas and electricity. The term "labor" shall include all direct and indirect employment expenses, including cost of fringe benefits.

(2) The base fuel and labor costs for the District's fiscal year ending September 30, 1988, which shall be the base year amount for comparison purposes for adjustments beginning January 1, 1990 and during the period defined in subparagraph (a) above are as follows:

Base Fuel Costs: \$259,605.24
 = \$0.0190/1000 gallons
 42,030 acre feet

Base Labor Costs: \$577,731.83
 = \$0.0422/1000 gallons
 42,030 acre feet

where: \$259,605.24 and \$577,731.83 are the total annual expenditures of the District for fuel and labor respectively during its fiscal year ending September 30, 1988, and 42,030 acre feet is the amount of water diverted by the District at the Rio Grande during the fiscal year ending September 30, 1988.

(3) Beginning January 1, 1990, and January 1 of each following year until the end of the period defined in subparagraph (a) above, the Water Delivery Charge ("DC") shall be adjusted based upon the difference between the Base Fuel Cost of \$0.0190 per 1000 gallons of water diverted by the District at the Rio Grande ("BFC") and the fuel costs incurred by the District for each 1000 gallons of water diverted by the District at the Rio Grande during each subsequent year ("FC"),

calculated as in Paragraph 11(a)(2) above, plus the difference between the Base Labor Cost of \$0.0422 per 1000 gallons of water diverted by the District at the Rio Grande ("BLC") and the labor costs incurred by the District for each 1000 gallons of water diverted by the District at the Rio Grande during each subsequent year ("LC"), calculated as in Paragraph 11(a)(2) above, according to the following formula:

$$DC = [\$0.12/1000 \text{ gallons} + (FC-BFC) + (LC-BLC)]$$

(b) After the expiration of the period defined in subparagraph (a) above, the Water Delivery Charge ("DC") shall be adjusted annually based upon the change in the flat rate assessment and irrigation delivery charge assessed by the District for irrigators in the District's boundaries in effect on January 1 of the year involved from the prior year and in the same ratio as the Water Delivery Charge of \$0.12/1000 gallons bears to the fiscal year 1988 irrigators' water delivery cost. Adjustments in the DC shall be made annually in accordance with the following provisions:

(1) The flat rate assessment ("FR") to irrigators is the annual assessment made on irrigable land in the District's boundaries regardless of value or use, and the irrigation charge ("IC") is the rate charged to irrigators per hour of irrigation. For these purposes the irrigators' water delivery cost per 1000 gallons ("IDC") is to be calculated by use of the following formula:

$$IDC = \frac{FR + (4IC)}{325.851}$$

(2) Effective January 1 of the year following the period defined in subparagraph (a) above, the Water Delivery Charge (DC) shall be adjusted by use of the following formula:

$$\text{New DC} = 1.3033 \times IDC$$

(3) Each January 1 following the year involved in subparagraph 11(b)(2) above the Water Delivery Charge shall be adjusted in accordance with the same formulas depending upon the flat rate assessment (FR) and irrigation delivery charge (IC) in effect on January 1 of the year involved.

Capital Improvement Charges

12. (a) Effective January 1 of the year following the period defined in Paragraph 11(a) above, it is agreed that in the event District engages in a capital improvement project for improvements to its irrigation system which is financed by indebtedness incurred by the District, City agrees to pay annually its pro rata share of the annual amount required to service such capital indebtedness in accordance with the provisions of this Paragraph.

(b) The pro rata amount payable by the City as an annual Capital Charge ("CC") shall be based upon the pro rata amount of the indebtedness attributable to the cost of improvements made in the capital improvement project involving any existing District facilities in the area from and including its Rio Grande diversion facilities to the City's delivery point except for the Third (3rd) Lift Mission Main Canal which is located on the western side of the District's boundaries north of the Two(2) Mile Road. This pro rata amount shall be referred to herein as that portion of the capital improvement project indebtedness to which the City shares with others receiving service from the District (referred to herein as "shared cost").

(c) The amount payable each year by City shall be based upon (1) the percentage that the Shared Cost bears to the total cost of improvements multiplied by the annual debt service requirement and (2) the average amount of water diverted at the Rio Grande for the City compared to the total diversions by the District over the previous five (5) year period, expressed as a percentage and referred to herein as "City's Percentage Share."

(d) The amount of annual CC payable by City to District shall be equal to the District' annual debt service requirement ("DS") multiplied by the City's Share ("CS") and the City's Percentage Share ("CPS") or:

$$\text{Annual CC} = [\text{DS} \times \text{CS}] \times \text{CPS}$$

Water Use Reports and Assessments

13. The District will make the necessary Rio Grande water diversion reports to the Rio Grande Watermaster of the TWC or its successor, relating to the amount of water diverted from the Rio Grande for City and to be charged against City's Amount of Designated Water , based upon the amount of water metered (measured) as provided above, plus the amount of transportation and conveyance losses incurred in transporting the water from the Rio Grande to the City's delivery point. It is agreed for the purposes of this Paragraph that the amount of such losses to be charged against City's Amount of Designated Water is fifteen (15%) percent of the amount of water delivered to City and measured at the delivery point (or, the amount delivered multiplied by 1.1764).

In the event the Rio Grande Watermaster of the Texas Water Commission or its successor allows Rio Grande diverters to divert water from the Rio Grande without charging such diversions against the diverters' water rights allotment or allocation, currently referred to as "No Charge Pumping", then water delivered to City which was pumped and diverted by the District from the Rio Grande while No Charge Pumping was in effect and not charged against the District's municipal use allocation will not be charged against the City's annual water entitlement and allocation under this Contract (Amount of Designated Water), but will be considered as water requested and delivered to City for purposes of the Annual Fee provided for in Paragraph 10c.

The City shall pay all assessments made by the TWC with respect to water to which the City is entitled under this Contract.

Deliveries of Other Water

14. To the extent that District is capable of doing so with its then-existing facility and upon City's request, District agrees to divert and deliver water from the Rio Grande to which City is entitled to have diverted under rights separate and apart from this Contract. For such deliveries, City agrees to pay District the same Water Delivery Charges as are provided for water delivered under this Contract and under the same terms as provided in Paragraph 10(d) and 10(e) above and measured and reported as provided in Paragraphs 9 and 13 above. Deliveries of such water shall not be considered as water requested and delivered under this Contract for purposes of Paragraph 10c above.

Use of Water Elsewhere

15. District agrees that City may transfer its Designated Water to third parties or use amounts of its Designated Water at other City Water Treatment Plants. This Paragraph is effective upon the effective date of this Contract, provided, however, District shall have a period of ninety (90) calendar days following the City's initial request to transfer such water or such period as is necessary to complete any necessary Texas Water Commission (or its successor agency) or other applicable legal proceedings required for District to have available all of the Designated Water for transfer under the terms of this Paragraph. City agrees to pay District the Annual Fee provided for in Paragraph 10c above for the amounts of water City elects to transfer and use under this Paragraph. City does hereby assume the risk of loss of the right to the Designated Water through applicable legal proceedings due to its exercise of its rights under this Paragraph, including the loss of such rights arising from cancellation of water rights proceedings or other legal proceedings affecting such rights.

Failure of Delivery

16. District shall not be liable to City for failure of delivery in the event of mechanical failure, strikes, acts of God or other occurrences beyond the District's control, nor shall District be liable to City in any event, so long as District is taking reasonable steps to continue and maintain service to City. In the event drought conditions result in a limited amount of water available for allocation by the Texas Water Commission, or its successor, and there is implemented a proration of available water supply, then in such event, the amount of water covered by this Contract will be prorated so that City will be treated on the same basis as other similar users upon the Lower Rio Grande.

Limitation of Liability

17. District shall have no liability to City or its citizens or treated water customers for any pollution or contamination of water delivered to City unless caused by the deliberate act of District's Board of Directors, Manager or employees. The City agrees to hold District harmless from any claim or demand which may be made against District growing out of pollution or contamination of water delivered under this Contract unless caused by the deliberate act of the District's Board of Directors, Manager, or employees.

Successors

18. It is agreed that in the event of any occurrence rendering a party incapable of performing under this Contract, any successor of the party succeeding to the statutory functions of such party, whether the result of legal process, assignment, or otherwise, shall succeed to the rights of such party hereunder. This Contract shall be binding upon and inure to the benefit of such successor(s) to the parties; provided, however, except as provided in Paragraph 15 above, City may not transfer or assign its water allocation rights or water delivery rights under this Contract to any other party without the prior written consent of the District.

Laws and Regulations

19. It is agreed that this Contract is subject to such rules, regulations, or laws as may be applicable to similar contracts in the State of Texas, and the District and City will collaborate in obtaining such permits, certificates, or the like as may be required to comply therewith. This Contract shall also be subject to the Rules and Regulations of the Texas Water Commission, or its successor(s), as they presently exist or as they are hereafter amended, to the extent such Rules and Regulations pertain to the operations of the parties hereunder. This Contract shall be subject to all valid applicable state, federal and local laws, rules and regulations; provided, that either party hereto shall be entitled to regard all laws, rules and regulations issued by any federal or state regulatory body as valid and may act in accordance therewith until such time as the same may be held in invalid by final judgment in a court of competent jurisdiction.

Interpretation

20. This Contract and all the terms and conditions hereof shall be liberally construed to effectuate the purposes set forth herein and to sustain the validity of this Contract. The parties agree that this Contract shall not be construed in favor of or against either party on the basis that the party did or did not author the Contract.

Approvals

21. Whenever this Contract requires or permits approvals or consents to be given or mutual agreements to be reached, the parties agree that such approval or consent shall not be unreasonably withheld and each party will reasonable exert effort to reach mutual agreements. Such approval or consent or mutual agreements shall be evidenced in writing and be authorized by the governing body of each party.

Parties in Interest

22. This Contract shall be for the sole and exclusive benefit of the parties hereto and their successors and assigns hereof, and it shall not inure to the benefit of any other persons or entities, and is the result of negotiations between the parties and is not to be considered a precedent with respect to either party in any other like situation or with respect to any other party in any other like situation.

Term of Contract

23. This Contract shall become effective on January 1, 1989, and shall remain effective thereafter unless amended or terminated by mutual agreement of the parties. In the event City fails to comply with any of the provisions hereof, District, after giving City thirty (30) days advance written notice, of the provision so violated, may terminate the operation of this Contract pending the curing by City of its said default.

Enforcement

24. It is understood and agreed that either party hereto may demand specific performance of this Contract.

Invalidity of Provisions

25. In the event any provision hereof is declared invalid by a final judgment of a court of competent jurisdiction, after all applicable court appeals have been exhausted, such invalidation shall not invalidate this Contract unless the provision(s) so invalidated renders this Contract unperformable by either party and/or frustrates the purpose of the Contract.

Authorization

26. Those representatives of the parties executing this Contract on behalf of the parties, represent unto the other that they are authorized by action of the governing bodies of each party to execute this Contract.

Amendments and Supplements

27. All amendments and supplements to this Contract shall be in writing in suitable form for recordation in the Official Records of Hidalgo County and be mutually agreed upon by both parties.

EXECUTED by the parties through their authorized representatives on the dates indicated below.

UNITED IRRIGATION DISTRICT

By: G.T. Wells
President
Board of Directors

ATTEST:

R. D. P.
Secretary

Date: 5/11/89

CITY OF MCALLEN, TEXAS

By: Charles Paul
Mayor

ATTEST:

Elba Herrera
City Secretary

Date: 5/10/89

MCALLEN PUBLIC UTILITIES

By: Jan M. Kunder
Its: _____

ATTEST: Elba Herrera

Date: 5/10/89

STATE OF TEXAS §

COUNTY OF HIDALGO §

This instrument was acknowledged before me on the day of MAY, 1989, by G.T. WELLS, the President of the Board of Directors of UNITED IRRIGATION DISTRICT, a political subdivision of the State of Texas, on behalf of said political subdivision.

Vince Borin
Notary Public in and for the
State of Texas

My Commission expires:

10-10-89

Notary's Printed Name:

VINCE BORIN

STATE OF TEXAS §

COUNTY OF HIDALGO §

This instrument was acknowledged before me on the 10th day of May, 1989, by Othal E. Mayor, Sr., the Mayor of the CITY OF McALLEN, TEXAS, a municipality under the laws of the State of Texas, on behalf of said municipality.



ELBA HERRERA
My Commission expires:
10/31/92

Elba Herrera
Notary Public in and for the
State of Texas

Notary's Printed Name:
Elba Herrera

STATE OF TEXAS §

COUNTY OF HIDALGO §

This instrument was acknowledged before me on the 10th day of May, 1989, by Jan M. Klinck, the Chairman of McALLEN PUBLIC UTILITIES, CITY OF McALLEN, TEXAS on behalf of said municipality.



ELBA HERRERA
My Commission expires:
10/31/92

Elba Herrera
Notary Public in and for the
State of Texas

Notary's Printed Name:
Elba Herrera

Exhibit D

Affidavit of Marco A. Vega, P.E.

PUC DOCKET NO. _____

PETITION OF McALLEN PUBLIC
UTILITY APPEALING WHOLESALE
WATER RATES CHARGED BY
HIDALGO COUNTY WATER
IMPROVEMENT DISTRICT NO. 3 IN
HIDALGO COUNTY, TEXAS

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BEFORE THE

PUBLIC UTILITY COMMISSION

OF TEXAS

AFFIDAVIT OF MARCO A. VEGA, P.E.

On this day, appeared before me, the undersigned notary public, Marco A. Vega, P.E., General Manager of McAllen Public Utility, a municipally owned utility operating in Hidalgo County, Texas, and after I administered an oath to him, upon his oath, he said:

“My name is Marco A. Vega. I am the Manager of McAllen Public Utility (“MPU”). I am more than twenty-one (21) years of age and capable of making this affidavit. I have personal knowledge of the facts stated herein, which are true and correct.

1. MPU is the municipally owned water and sewer utility for the City of McAllen, Texas. I have been employed by MPU for 18 years, and I have served as its General Manager since June of 2014. I am a licensed professional engineer in the State of Texas, and my license is in good standing with Texas Board of Professional Engineers.
2. I have prepared this affidavit in support of the Original Petition MPU filed with the Public Utility Commission of Texas on October 27, 2021 (the “Petition”) appealing wholesale water service rates charged to MPU by Hidalgo County Water Improvement District No. 3 (“HCWID 3”). The Petition represents the first time MPU has filed any action before the Public Utility Commission of Texas with respect to HCWID 3.
3. MPU purchases the vast majority of water it uses for municipal water supply to its more than 150,000 customers under contracts with four districts: Hidalgo County Irrigation District No. 1 (“HCID 1”), Hidalgo County Irrigation District No. 2 (“HCID 2”), HCWID 3, and United Irrigation District (“United”). All water delivered to MPU by these districts is raw water diverted under permits authorizing water use from the Rio Grande. MPU does not purchase treated water from any of the districts. None of the districts possess treatment capabilities sufficient to meet federal and state drinking water quality standards. Based on my experience as the general manager for the largest customer of each of these districts, HCID 1, ID 2, and United have all historically

charged MPU rates that are reasonable and consistent with fair market values of raw water in the Lower Rio Grande Valley. I consider the rates that HCWID 3 has charged MPU for the last 10 years for essentially the same service to be unreasonable, unjustifiable, and harmful to the public interest—including and especially to the retail ratepayers served by MPU.

4. HCWID 3 was originally created to serve both as the supplier of water to McAllen for municipal purposes and as a raw water supplier to irrigation users. However, since HCWID 3's creation, the area within its boundaries has urbanized significantly. Today, over 90 percent of HCWID 3's area is within McAllen's corporate limits, and HCWID 3 serves only a nominal amount of irrigation customers to irrigate a maximum of 1,278 acres in total based on MPU's calculations. Most of the time, however, HCWID 3 provides irrigation water to far less area than it is authorized to under its water rights. HCWID 3 charges its irrigation customers a rate of \$13.40 per acre-foot of water. As far as I am aware, there really is no functional difference between the service that HCWID 3 provides to its irrigation customers and that provided to MPU for municipal use. HCWID 3 uses the same diversion pump station and system of canals and pipes to deliver water by gravity flow to all of its customers. The distance from HCWID 3's permitted diversion point to the contracted points of delivery, is the shortest transmission distance among all districts that currently supply raw water to MPU.
5. MPU purchases all of its raw water from HCWID 3 under the terms of a Permanent Water Supply and Delivery Contract between MPU and HCWID 3 (the "Contract"). The Contract requires MPU to purchase, on a "take-or-pay" basis, water from HCWID 3 plus a loss factor of 1.10 or 10 percent. The Contract does not prescribe a methodology for HCWID 3's adjustments to delivery charges.
6. MPU is HCWID 3's only municipal supply customer. MPU understands that it annually purchases a substantial majority of water delivered by HCWID 3 to all of its customers collectively. I am unaware of any other significant sources of revenue available to HCWID 3 than its charges to its customers. I am unaware of any outstanding bonded indebtedness of HCWID 3 or any plans by HCWID 3 to issue bonds, and to the best of my knowledge, HCWID 3 has not significant source of revenue other than that collected

through customer charges. These facts are not known to me because HCWID 3 lacks any effective policies that allow for transparency of its financial and managerial records.

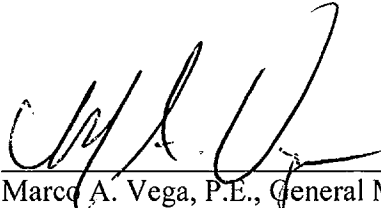
7. As a result of MPU being the only municipal customer paying HCWID 3 a rate that is 8.5 times that charged by HCWID 3 for its relatively small irrigation use obligations, and HCWID 3 having no other sources of revenues, MPU effectively pays nearly all of HCWID 3's annual operating budget and revenue requirement. MPU calculates that the Contract with HCWID 3 will require MPU to pay HCWID 3 a total of \$1,752,476.88 for 13,980 acre-feet of raw water from September 1, 2021 through August 31, 2022 and continuing every year thereafter. That will create an annual increase of \$249,124 of revenue paid by MPU to HCWID 3, which is approximately 16.6 percent. HCWID 3 is also contractually obligated to deliver water that MPU owns directly under its own water rights permit. That is in excess of the 13,980 acre-feet. In years when HCWID 3 delivers MPU's water under that water right permit, MPU would end up paying even more.
8. MPU's unique relationship with HCWID 3 effectively means that MPU is contractually obligated to pass through nearly all of HCWID 3's costs and expenses—no matter how unreasonable or publicly undisclosed—to the retail water customers of the City of McAllen. In 2012, the Texas State Auditor's Office determined that HCWID 3 had spent more than \$450,000 in professional, legal, and consulting fees resulting from legal disputes with the City of McAllen and HCWID 3's lobbying efforts. The City of McAllen's retail water service ratepayers ultimately were responsible for paying those expenses. This is true despite the fact that the State Auditor also found, with respect to HCWID 3, "significant deficiencies in its controls over accounting and financial reporting that could negatively affect its operations."
9. As used in the Contract, "outside contract water" is water that HCWID 3 delivers to MPU to which MPU is entitled to receive under water rights owned by and contracts with United Irrigation District. United currently lacks its own infrastructure capable of delivering its contract water to MPU at MPU's South Water Treatment Plant.
10. The Texas Legislature passed S.B. 2185 during the 2021 Regular Session, which enacted several specific requirements for HCWID 3 to improve its transparency and financial management practices. Among the requirements is a prohibition against the same person

serving as both HCWID 3's board president and general manager. S.B. 2185 also requires HCWID 3 to create an online searchable database of District expenditures.

11. As the General Manager of HCWID 3's largest customer, I have not been provided any information that indicates HCWID 3 has implemented any of the requirements of S.B. 2185 since it took effect on September 1, 2021. In fact, based on my understanding of HCWID 3's actions, it has taken steps to circumvent the Legislature's directives. For example, rather than hiring a different individual as general manager, HCWID 3 simply eliminated that position. It is my understanding that the board president continues to effectively serve as the chief executive of HCWID 3. Also, HCWID 3 does not post public notices of meetings of its board of directors and does not publicly disclose the location of board meetings. Therefore, MPU is incapable of appearing before HCWID 3's governing body to formally address concerns about the rates charged to MPU for raw water service, obtain information that might justify its revenue requirement and rate increases, or engage in any process to resolve rate disputes. Despite these management deficiencies, as of September 1, 2021, HCWID 3 charges MPU a rate that is 56 to 122 percent higher than rate charged by similar districts for essentially the identical service to MPU and other municipal retail utilities in the Lower Rio Grande Valley. I understand that to be the case based on a recent Comparative Rate Study conducted by NewGen Strategies and Solutions at MPU's request. An affidavit from NewGen's CFO and rate analyst, Chris Ekrut, is included as an exhibit to the Petition.
12. Because HCWID 3 charges by far the highest rate among MPU's water suppliers, and because MPU's contract with HCWID 3 requires MPU to annually pay for the full volume allotted under the water rights permits, MPU annually uses, to the extent possible, HCWID 3 water first before relying on water supplied by the other districts. On average, HCWID 3 supplies over 50 percent of all of MPU's municipal water demand.
13. On July 29, 2021, HCWID 3 sent notice to MPU of an increase in the water delivery charge to MPU from \$97.67 per acre-foot of water to \$113.96 per acre-foot. MPU calculates that will result in MPU paying approximately \$227,000 of additional revenue to HCWID 3 every year. Because HCWID 3 has and continues to charge by far the highest rates of any of MPU's water suppliers, and because the Contract requires MPU to annually pay for all of the water to which MPU is entitled regardless of whether MPU

actually takes delivery of such water, MPU prioritizes use of water delivered by HCWID 3 to avoid additional excessive cost burdens for MPU's retail customers. MPU annually uses, to the greatest extent possible, HCWID 3 water before relying on water supplied by the other districts.

FURTHER AFFIANT SAYETH NOT.



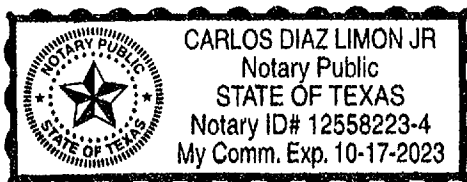
Marco A. Vega, P.E., General Manager
McAllen Public Utility

STATE OF TEXAS

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§
§

COUNTY OF HIDALGO

Sworn to and subscribed before me the undersigned authority on this the 26th day
of October, 2021.



Notary Public, State of Texas

Exhibit E

State Auditor's Office, An Audit Report on
The Hidalgo County Water Improvement District No. 3, Report No. 12-034



John Keel, CPA
State Auditor

An Audit Report on

The Hidalgo County Water Improvement District No. 3

May 2012

Report No. 12-034

The Hidalgo County Water Improvement District No. 3

Overall Conclusion

The Hidalgo County Water Improvement District No. 3 (District) has significant weaknesses in the management of its finances and operations. Those weaknesses exist largely because the District has not established a framework to provide for effective governance, oversight, and planning. Examples of specific weaknesses identified include a lack of financial controls; the absence of a formal, comprehensive, long-term master plan; noncompliance with procurement requirements; and noncompliance with certain requirements of the Texas Water Code.

Key Points

The District should implement significant financial controls.

Auditors did not find evidence of misappropriation of funds during testing at the District. However, the District's lack of financial controls over many of its financial transactions could affect its ability to operate within its means and could create opportunities for misappropriation to occur without detection.

From fiscal year 2008 through fiscal year 2011, the District's expenditures exceeded its revenue from customers (see text box). The District offset losses through the sale of assets; however, it cannot continue to sustain itself through the sale of assets. The District offset losses through the sale of nearly \$5.8 million of its assets in fiscal years 2009 through 2011.

Auditors also identified a lack of approval and supporting documentation for District financial transactions. For example, the District did not have supporting

Background Information

The Hidalgo County Water Improvement District No. 3 (District) was created in 1921. It is a political subdivision of the State of Texas and a public body with statutory duties to provide water for irrigation and other purposes (see Appendix 3 for additional details).

Senate Bill 978 (82nd Legislature, Regular Session) was introduced to dissolve the District and allow the transfer of all of the District's obligations, liabilities, and assets to the City of McAllen. The bill passed both houses of the Legislature, but the Governor subsequently vetoed it (see Appendix 3 for additional details).

The Governor requested that the State Auditor conduct an audit of the District's finances and practices (see Appendix 2 for additional details). The District is subject to Texas Water Code, Chapter 49, which authorizes the State Auditor to conduct audits of the financial transactions of water districts.

District Operating Revenues and Expenditures

<u>Fiscal Year</u>	<u>Revenues</u>	<u>Expenditures</u>
2008	\$1,346,481	\$1,375,478
2009	\$1,134,616	\$1,399,325
2010	\$1,310,266	\$1,408,647
2011	\$ 867,510	\$1,337,217

Source: The District's audited annual financial statements for fiscal years 2008 through 2011 (see Appendix 4 for additional information).

documentation for 6 (20 percent) of 30 expenditures tested; therefore, the appropriateness of those expenditures could not be determined.

In addition, the District spent more than \$6.0 million for capital improvement projects from fiscal year 2008 through fiscal year 2011. However, it has not developed a formal, comprehensive, long-term master plan that aligns its capital improvement projects with its mission and goals. Examples of capital improvement projects include the \$1.7 million reservoir that the District completed in 2011 and a boat ramp that was under construction during this audit at the District's pumping station on the Rio Grande River.

The District should implement a process to mitigate the risks associated with related-party transactions.

The District did not have a process to ensure compliance with requirements in Texas Local Government Code, Chapter 171 (regarding conflicts of interest) and Chapter 176 (regarding disclosure of relationships with certain government officers). From fiscal year 2008 through fiscal year 2011, the District spent \$106,000 for services provided by businesses that were owned by or controlled by the individual who is both the District's general manager and the president of the District's board. While the District may have received services from those businesses, auditors were unable to determine the appropriateness of the transactions associated with those services due to the District's lack of policies and inconsistent handling of issues regarding potential conflicts of interest.

The District should improve its management of professional services contracts.

The District substantially complied with most competitive bidding requirements for major construction and renovation contracts. However, it did not comply with the requirements of Texas Water Code, Section 49.199(a)(4), related to procuring professional services. The District did not comply with statutory requirements to have written policies and procedures for selection, monitoring, or review and evaluation of professional services; it procured more than \$500,000 in professional services in fiscal year 2008 through fiscal year 2011. The District also could not provide documentation demonstrating compliance with Texas Government Code, Chapter 2254, which requires the District to undertake a selection process for professional services.

Additionally, the majority of the professional and consulting services agreements, letters, and contracts that auditors reviewed did not contain adequate provisions to protect the District's financial interests and help ensure that the contractor delivered the expected services.

The District should comply with specific requirements of the Texas Water Code.

The District's board did not comply with certain requirements of the Texas Water Code. For example, as discussed above, the board has not developed written policies and procedures as required by Texas Water Code, Section 49.199. In

addition, neither the board nor District employees who handled cash were bonded as required by Texas Water Code, Sections 49.055 and 49.057.

Summary of Management's Responses

District management generally agreed with many of the issues and most of the recommendations in this report; it also disagreed with certain issues and recommendations in this report. When District management responded to this report, it provided additional documentation to auditors. After reviewing that documentation, auditors made modifications to certain portions of this report but made no modifications to other portions of this report.

The District's summary of its management's responses is presented in Appendix 13. The attachments that District management provided with its responses are not included in this report due to the confidential nature of some of the information in those attachments. The District informed auditors that it intends to post the attachments to its management's responses on the following Web site:
<http://www.waterlookout.org/fluid/>.

Summary of Information Technology Review

This audit did not include a review of information technology. The District contracts with outside firms to process its payroll and prepare its monthly financial information.

Summary of Objectives, Scope, and Methodology

The objectives of the audit were to:

- Determine whether the District has controls that are designed and operating to help ensure that financial transactions comply with applicable law, policies and procedures, and contract terms.
- Provide information on rates and fees the District charges.
- Provide information related to water use by the District.

The audit scope included a review of the District's financial processes, procurement of goods and services, governance processes, and rates and fees for fiscal years 2008 through 2011. The scope covered fiscal years 2007 through 2011 for water usage information.

The audit methodology consisted of conducting interviews; collecting and reviewing information; and performing tests, procedures, and analyses against predetermined criteria.

Auditors determined that the District's computer-generated data was reasonably accurate, complete, and consistent. The City of McAllen is the source of more than 90 percent of revenue for the District, which allowed auditors to trace the majority of the District's revenue to its primary customer.

Auditors assessed the reliability of the District's data by interviewing District staff and accountants knowledgeable about the data and systems and conducting testing to determine whether the information from the District's system reconciles to the information maintained by the accounting firm that prepares the District's monthly financial information. Auditors determined that the data was sufficiently reliable for the purposes of this audit.

Auditors communicated other, less significant issues to District management separately in writing.

Contents

Detailed Results

Chapter 1	
The District Should Strengthen Its Financial and Operational Controls	1
Chapter 2	
The District Should Establish a More Effective Governance Framework	13
Chapter 3	
Information on District Real Property Ownership, Rates and Fees, and Irrigable Acres Served	16
Chapter 4	
Information on District Water Usage	19

Appendices

Appendix 1	
Objectives, Scope, and Methodology	20
Appendix 2	
Governor's Request for This Audit	24
Appendix 3	
District Background Information	26
Appendix 4	
District Revenue	28
Appendix 5	
District Rates and Fees for 2011	29
Appendix 6	
District Water Rights and Acres Served	30
Appendix 7	
District Raw Water Diversion	31
Appendix 8	
Commission on Environmental Quality Investigation	32

Appendix 9	
City of McAllen’s Current and Projected Water Need.....	33
Appendix 10	
District and County Maps	35
Appendix 11	
District Watermaster Area	37
Appendix 12	
Comparison of District Contract Provisions for Professional and Consulting Services and Excerpts from State of Texas Contract Management Guide	39
Appendix 13	
Management’s Responses	42

Detailed Results

Chapter 1

The District Should Strengthen Its Financial and Operational Controls

The Hidalgo County Water Improvement District No. 3 (District) has significant weaknesses in the management of its finances and operations. The District has not established a framework to provide for effective governance, oversight, and planning. Examples of specific weaknesses identified include a lack of financial controls; the absence of a formal, comprehensive, long-term master plan; noncompliance with procurement requirements; and noncompliance with certain requirements of the Texas Water Code.

Chapter 1-A

The District Should Implement Significant Improvements to Financial Controls

In testing, auditors did not find evidence of misappropriation of funds at the District. However, the District's lack of financial controls—including budgeting and internal controls—could create opportunities for misappropriation to occur without detection. In addition, continued losses in its operations could affect the District's long-term sustainability.

The District has significant deficiencies in its controls over accounting and financial reporting that could negatively affect its operations.

The District's independent auditor has repeatedly identified overall accounting control weaknesses and lack of oversight and review of the District's accounting processes. Those weaknesses include failure to properly record capital improvements, variances between budgeted expenses and actual expenses, and noncompliance with various provisions of the Texas Water Code.

District Operating Revenues and Expenditures

<u>Fiscal Year</u>	<u>Revenues</u>	<u>Expenditures</u>
2008	\$1,346,481	\$1,375,478
2009	\$1,134,616	\$1,399,325
2010	\$1,310,266	\$1,408,647
2011	\$ 867,510	\$1,337,217

Source: The District's audited annual financial statements for fiscal years 2008 through 2011 (see Appendix 4 for additional information).

The District's operating expenditures have exceeded its operating revenues.

From fiscal year 2008 through fiscal year 2011, the District's expenditures exceeded its revenue from customers (see text box). The District offset losses through the sale of assets; however, it cannot continue to sustain itself through the sale of assets. The District offset losses through the sale of nearly \$5.8 million of its assets in fiscal year 2009 through fiscal year 2011.

The District earns operating revenue by providing raw water from the Rio Grande River to customers. Although the District serves

farmers and other customers, its primary customer is the City of McAllen. The District relied on the City of McAllen for 91 percent of its operating revenue in fiscal year 2008 through fiscal year 2011.

Legal disputes and associated expenditures have negatively affected the District's financial condition.

Professional, legal, and consulting fees resulting from legal disputes with the City of McAllen and the District's efforts against legislation to dissolve the District have negatively affected its financial condition. In fiscal year 2011, those fees totaled more than \$450,000, an increase of 537 percent from fiscal year 2010. The District's operating revenues totaled \$867,510 in fiscal year 2011, a decrease of 34 percent from fiscal year 2010.

As discussed above, the District's operating revenue was insufficient to cover operating expenses. Although operating revenue was insufficient to cover operating expenditures, the District covered those expenditures through non-operating revenue, such as revenue from the sale of District assets. Specifically, the District sold nearly \$5.8 million in assets, including real property and water rights, from fiscal year 2009 through fiscal year 2011 (see Table 1).

Table 1

Assets the District Sold Fiscal Years 2008 - 2011		
Fiscal Year	Amount	Assets Sold
2008	\$ 0	
2009	2,827,117	Land
2010	20,200	Easement
2011	1,371,895	Land
	1,569,200	Water rights
Total	\$5,788,412	

Sources: District financial records and audited financial statements.

The District does not have a formal, comprehensive, long-term master plan that aligns its capital improvement projects with its mission and goals.

The District spent more than \$6.0 million for capital improvement projects from fiscal year 2008 through fiscal year 2011 (see Table 2). However, the District has not developed a formal, comprehensive, long-term master plan that includes all planned capital projects and aligns its capital improvement projects with its mission and goals. One example of a capital improvement project is the \$1,733,275.16 reservoir that the District completed in 2011. Auditors also observed the construction of a boat ramp during this audit in early fiscal year 2012 at the District's pumping station on the Rio Grande River.

Table 2

District Capital Improvement Projects Fiscal Years 2008 - 2011		
Capital Project (as listed in the District's Records)	Date in Service	Cost
Road Improvements	March 1, 2009	\$ 41,503.00
Improvement to Borrow Ditch	April 1, 2009	119,569.00
Levee Improvement	March 1, 2009	68,733.00
Embankment Improvement	November 1, 2008	40,210.00
Land Improvement - River Bank	November 1, 2008	3,250.00
New Reservoir	August 31, 2011	1,733,275.16
Buoy Reservoir Overflow	August 31, 2011	28,426.00
Canal Improvements	August 31, 2011	702,564.60
U.S. Fish and Wildlife Irrigation Line	August 31, 2011	70,003.23
Hackney Floodway Siphon Project	February 22, 2008	488,803.00
Major Pump Improvements - 2008	February 28, 2008	422,364.00
New Pump Station	June 1, 2009	825,853.90
Major Pump Improvements - 2009	June 10, 2009	132,443.52
Waterline to River Pump Station	February 11, 2009	20,499.00
200 HP Pump and Motor	January 10, 2010	107,291.00
Border Wall Gates	August 31, 2010	538,380.00
Pump Station Renovation	August 31, 2011	880,779.75
Total		\$6,223,948.16

Source: The District's accounting records.

To improve financial reporting and controls, the District has contracted with payroll and accounting firms.

In fiscal year 2009, the District began efforts to improve the accuracy of its financial reporting and to strengthen financial controls by contracting with a payroll firm to process its payroll and with an accounting firm to perform its

monthly accounting and balance sheet reporting. As a result, certain financial controls over revenues and expenditures were strengthened.

The District does not consistently maintain supporting documentation for its expenditures and document its review and approval of expenditures.

The expenditures auditors tested for which the District had supporting documentation were allowable and reasonable. However, the District should improve controls over maintaining supporting documentation and approval of payments. Auditors identified the following during testing of expenditures:

- The District did not have supporting documentation for 6 (20 percent) of 30 non-related-party expenditures tested and 2 (3 percent) of 64 related-party expenditures tested. While the District may have received services associated with those expenditures, auditors could not determine whether the District received best value for the funds expended (see additional discussion related to this issue below).
- For 5 (8 percent) of 62 related-party expenditures tested, the District recorded the expenditures in the incorrect general ledger accounts. (In this case, the sample size was 62 instead of 64 because 2 invoices could not be located and auditors could not determine whether those invoices were recorded correctly.)
- For 24 (38 percent) of 64 related-party expenditures tested and 6 (21 percent) of 29 non-related-party expenditures tested, there was no evidence of District review or approval of the invoice.

The District's compensation and reimbursements to board members did not comply with Texas Water Code, Section 49.060.

Texas Water Code, Section 49.060, limits compensation payments made to board members to \$150.00 per day and \$7,200.00 per year. For the time period that auditors tested (fiscal years 2008 through 2011 and the first two months of fiscal year 2012), annual compensation for board members did not exceed the annual \$7,200.00 limit. However, the District paid board members \$227.12 per day for duties they performed, which exceeded the \$150.00 daily statutory limit by \$77.12 per day. For the time period that auditors tested, the overpayments totaled \$24,275.84.