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APPLICATION OF TEXAS WATER UTILITIES, L.P. AND CS WATER CORPORATION FOR SALE, TRANSFER OR MERGER OF FACILITIES AND CERTIFICATE RIGHTS IN BOSQUE COUNTY	§ § § § § §	PUBLIC UTILITY COMMISSION OF TEXAS
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TEXAS WATER UTILITIES L.P.’S OBJECTION TO COMMISSION STAFF’S SECOND REQUEST FOR INFORMATION QUESTION NOS. STAFF 2-2 THROUGH 2-5

Texas Water Utilities L.P. (TWU) objects to Request for Information (RFI) Nos. Staff 2-2, 2-3, 2-4, and 2-5 because they seek information that is not relevant to this proceeding and not required under applicable Commission rules.¹ TWU has negotiated diligently and in good faith with the Staff of the Public Utility Commission of Texas (Staff) as required by 16 Texas Administrative Code (TAC) § 22.144(d), but negotiations have been unsuccessful. The discovery requests were received on December 1, 2022. Therefore, this objection is timely filed on or before December 12, 2022, under 16 TAC § 22.144(d).²

I. APPLICABLE LAW

A. Relevance

The Commission’s procedural rules permit parties to obtain discovery regarding any matter that is relevant to the subject matter of a proceeding and is not privileged or exempted under the rules of evidence or civil procedure.³ Under Texas Rule of Evidence 401, “evidence is relevant if: (a) it has any tendency to make a fact more or less probable than it would be without the evidence; and (b) the fact is of consequence in determining the action.” As detailed below, the question of whether the transferee in a sale, transfer, merger application under Texas Water Code (TWC) § 13.301 meets the leverage and operations test is only of consequence in

¹ 16 TAC § 22.144(a); Tex. R. Evid. § 401.

² Objections are due within ten calendar days of receipt of the discovery request. The tenth calendar day after December 1, 2022 is Sunday, December 11, 2022. Because the Commission is not open for business on Sunday, the deadline moves to Monday, December 12, 2022 pursuant to 16 TAC § 22.4(a).

³ 16 TAC § 22.141(a).

approving the application *after* the Commission finds that the transferee cannot demonstrate adequate financial capability and directs the transferee to provide financial assurance.⁴ As a result, discovery requests for information that make it more or less probable that the transferee can satisfy the leverage and operations test are not yet relevant in this proceeding because no finding has been made regarding TWU's financial capability. If such a finding is made, and TWU is ordered to provide financial assurance, RFI Nos. Staff 2-2 through 2-5 remain irrelevant because they are based on an impermissibly broad reading of the reference to "projected operations and maintenance shortages" in 16 TAC § 2.411(e)(3), and therefore, do not make it more or less probable that TWU or an affiliate can satisfy the operations test.

B. 16 TAC § 24.239—Financial Capability

TWU objects to RFI Nos. Staff 2-2, 2-3, 2-4, and 2-5, which all seek information related to TWU's financial capability. The application that is the subject of this proceeding was filed under TWC § 13.301. The Commission rule corresponding to this statute is 16 TAC § 24.239. Under 16 TAC § 24.239(e), the transferee in a proposed transaction "must demonstrate adequate financial, managerial, and technical capability for providing continuous and adequate service to the requested area and the transferee's certificated service area as required by § 24.227(a)" The Commission may hold a hearing on the application if the transferee cannot demonstrate adequate financial, managerial, and technical capability to provide continuous and adequate service⁵ or the financial ability to provide the necessary capital investment.⁶ The Commission may also hold a hearing if, there are concerns that the transaction does not meet the public interest after a weighing of factors that include "the financial stability of the transferee, including, if applicable, the adequacy of the debt-equity ratio of the transferee if the transaction is approved,"⁷ If the transferee cannot demonstrate adequate financial capability, the Commission may require the transferee to provide "financial assurance" to ensure continuous

⁴ See 16 TAC § 24.239(f).

⁵ 16 TAC § 24.239(h)(2).

⁶ 16 TAC § 24.239(h)(4).

⁷ 16 TAC § 24.239(h)(5)(F).

and adequate service in an amount set by the Commission and in a form that meets the requirements of 16 TAC § 24.11.⁸

C. 16 TAC § 24.11—Financial Assurance

By its own terms, 16 TAC § 24.11 states that it is applicable to “new and existing owners or operators of retail public utilities *that are required* to provide financial assurance under this chapter.”⁹ The types of financial assurance the Commission may require are: (1) an irrevocable standby letter of credit;¹⁰ or (2) documentation sufficient to determine that the transferee meets both a leverage test and an operations test.¹¹ The leverage test requires a showing that the transferee possesses one or more financial attributes ranging from a debt-to-equity ratio of less than one to an investment-grade credit rating from one of the three major credit rating agencies.¹² The operations test requires a showing that “sufficient cash is available to cover any projected operations and maintenance shortages in the first five years of operations.”¹³

The transferee may rely on an affiliate to satisfy the operations test, if the affiliate provides a written guarantee that it will cover temporary cash shortages.¹⁴ The transferee must also demonstrate that the affiliate is capable, available, and willing to cover temporary cash shortages and that the affiliate satisfies one of the leverage tests under 16 TAC § 24.11(e)(2)(A)-(D).¹⁵ The types of documents that may be relied on to show compliance with the leverage and operations tests are described in 16 TAC § 24.11(e)(4)(B).

If the proposed transaction would constitute a substantial addition to the transferee’s existing service area that requires capital improvements in excess of \$100,000, then there is an additional element of financial assurance required in a proceeding under TWC § 13.301.

⁸ 16 TAC § 24.239(f).

⁹ 16 TAC § 24.11(b) (emphasis added).

¹⁰ 16 TAC § 24.11(d).

¹¹ 16 TAC § 24.11(e)(1).

¹² 16 TAC 24.11(e)(2)(A)-(D).

¹³ 16 TAC § 24.11(e)(3).

¹⁴ *Id.*

¹⁵ 16 TAC § 24.11(e)(2)(E).

Specifically, the transferee must submit “loan approval documents indicating funds are available for the purchase of an existing system plus any improvements necessary to provide continuous and adequate service to the existing customers.”¹⁶ This is the only provision in 16 TAC § 24.11 that references the purchase price or capital expenditures.

II. OBJECTIONS

A. The Commission has not required TWU to provide financial assurance.

As a threshold matter, the RFIs promulgated by Staff are premature. Under 16 TAC § 24.239(f), the Commission is permitted to require TWU to provide financial assurance pursuant to 16 TAC § 24.11 only after a finding that TWU has failed to demonstrate adequate financial capability. This differs from 16 TAC § 24.227(f), which reads in relevant part:

The commission may require an applicant seeking to obtain a new CCN or a CCN amendment to provide a bond or other form of financial assurance to ensure that continuous and adequate retail water or sewer utility service is provided. The commission will set the amount of financial assurance. The form of the financial assurance will be as specified in §24.11 of this title (relating to Financial Assurance).

Accordingly, a finding that the applicant has failed to demonstrate adequate financial capability is not a prerequisite to the Commission requiring an applicant to provide financial assurance in an application to obtain or amend a certificate of convenience and necessity (CCN). Although the proposed transaction will result in an amendment to TWU’s CCN, 16 TAC § 24.239(f) should take precedence over 16 TAC § 24.227(f) because it is specifically tailored to apply to a sale, transfer, merger application, which is the type of application at hand.

TWU has the financial capability to provide continuous and adequate service to the requested area and its existing CCN area. TWU is a well-established Class A utility that has operated in Texas for many years. In the numerous applications TWU has submitted seeking approval for CCN amendments and acquisitions, TWU has always been found to possess adequate financial capability. Less than a month ago, TWU received approval to amend its CCN, which included findings that TWU satisfies the leverage and operations tests.¹⁷ TWU also

¹⁶ 16 TAC § 24.11(e)(5)(A).

¹⁷ *Application of Monarch Utilities I LP to Amend Its Certificate of Convenience and Necessity and to Decertify Portions of Johnson County Special Utility District and Mountain Peak Special Utility District in Johnson County*, Docket No. 53472, Notice of Approval at Findings of Fact Nos. 28 and 29 (Nov. 17, 2022).

received Commission approval of a base rate increase in February of this year.¹⁸ On November 30, 2022, the Commission appointed TWU as the Temporary Manager for Curtis D. Logan dba L and T Waterworks LLC.¹⁹

All these facts support a finding that TWU has adequate financial capability. Consequently, a finding to the contrary would be unfounded. Without such a finding, Staff has no basis for requesting information related to financial assurance at this time.

B. The discovery requests for financial assurance misconstrue the operations test.

Staff's RFIs are based on a reading of the operations test that is beyond the scope of the provisions of 16 TAC § 24.11(e) that are relevant to this proceeding. If TWU were required to provide financial assurance, the leverage and operations tests are the standards to be used to evaluate TWU's financial capability, and the three types of supporting documentation enumerated in 16 TAC § 24.11(e)(4) constitute the relevant documentation. The requirement in subsection (e)(5) is not relevant to the review of this application because capital improvements are not needed to ensure continuous and adequate service to the requested area in addition to TWU's certificated service area.²⁰

While RFI No. Staff 2-5 appears to be designed to obtain a copy of the financials for TWU's parent company, it also appears to request these documents based on an interpretation of the operations test that views the purchase price for the proposed transaction and capital expenditures as elements to be used to calculate projected temporary cash shortages. The operations test evaluates whether the transferee has sufficient cash available to cover any projected *operations and maintenance (O&M)* shortages in the first five years of operations.²¹ Therefore, the references to temporary cash shortages in 16 TAC § 24.11 are specific to O&M shortages.

¹⁸ *Application of Monarch Utilities I L.P. for Authority to Change Rates*, Docket No. 50944, Order (Feb. 23, 2022).

¹⁹ *Petition to Appoint a Temporary Manager for L and T Waterworks LLC*, Docket No. 54272, Order (Nov. 30, 2022).

²⁰ Application for Sale, Transfer, Merger of a Retail Public Utility at Part D, Question No. 12 (Sept. 30, 2022).

²¹ 16 TAC § 24.11(e)(3) (emphasis added).

Under general ratemaking principles, capital expenditures are not recorded as an O&M expense; they are recorded as components of rate base.²² The price TWU pays to purchase CS Water Corporation (CS Water) is also not an O&M expense—it is a one-time expense for a very specific purpose, rather than an ongoing expense to furnish normal utility service and maintain utility plant. Thus, any review of O&M shortages pursuant to the operations test should not consider capital expenditures or the purchase price for the proposed transaction.

1. RFI Nos. Staff 2-3 and Staff 2-5

Read together, RFI Nos. Staff 2-3 and Staff 2-5 seek the disclosure of the audited financial statements for TWU's parent company in the event TWU cannot show that it currently has unrestricted cash available in an amount that will cover the purchase price of CS Water. The specific questions are worded as follows:

- Staff 2-3 If Texas Water's current unrestricted cash is not sufficient to cover the purchase price of CS Water Corporation, then provide the information requested in Staff 2- 5.
- Staff 2-5 Please provide Texas Water's parent company's most recent audited financial statements indicating funds are available to cover the purchase price and capital improvements as well as an affidavit containing a written guarantee from the parent company indicating the parent company is capable, available, and willing to cover temporary cash shortages of Texas Water and the purchase price of CS Water Corporation.

Financial assurance specific to the purchase price of the proposed transaction is only required if the proposed transaction exceeds the capital expenditure threshold in 16 TAC § 24.11(e)(5). As stated previously, subsection (e)(5) is not applicable to this proceeding. If it were applicable, TWU would be required to provide loan documents covering the purchase price and necessary capital improvements, rather than the financials of an affiliate.²³ Further, Staff is seeking parent company financials in the event of a temporary cash shortage that does not fall within the scope

²² Compare 16 TAC § 24.41(b)(1)(A) (stating that allowable expenses include "operations and maintenance expenses incurred in furnishing normal utility service and in maintaining utility plant used by and useful to the utility in providing such service"), with, 16 TAC § 24.41(c)(2) (stating that rate base includes "[o]riginal cost, less accumulated depreciation, of utility plant, property, and equipment used by and useful to the utility in providing service.").

²³ 16 TAC § 24.11(e)(5)(A).

of O&M. For these reasons, RFI Nos. Staff 2-3 and Staff 2-5 do not seek information that makes it more or less likely that TWU or an affiliate can satisfy the operations test.

2. RFI Nos. Staff 2-2 and 2-4

Whether a response to RFI No. Staff 2-5 is necessary also depends on a comparison of the information provided in response to RFI No. Staff 2-2 to the information provided in response to RFI No. Staff 1-1. The text of each of these questions is as follows:

- Staff 1-1 File a table summarizing the 5-year projected net incomes, planned capital expenditures, and purchase prices (if applicable) for all dockets filed since the ending date of your financial statements until the filing date of this docket, including docket numbers 53215, 53472, 53920, and 54171.
- Staff 2-2 Please provide Texas Water's projected balance sheets, income statements, and cash flow statements for the next five years that includes net income and unrestricted cash available.²⁴
- Staff 2-4 If Texas Water's projected net income and cash amounts provided in response to Staff 2-2 are not sufficient to cover the confidential projected net effect amounts provided in response to Staff 1-1, then provide the information requested in Staff 2-5.

Staff is basing its request for TWU's parent company financials on a comparison of financial projections to net amounts that were calculated using the purchase price for both CS Water and Creek Water Utility LLC (Creek Water)²⁵ as well as projected capital expenditures for Creek Water and two recently-approved certificate of convenience and necessity amendments.²⁶ Because both the financial information requested in RFI No. Staff 2-2 and previously provided in response to RFI No. Staff 1-1, encompasses more than just O&M, the comparison described in RFI No. Staff 2-4 does not make it more or less probable that TWU can meet the operations test

²⁴ It is worth noting that this RFI requests financial information that is only partially required to demonstrate compliance with the leverage and operations tests. Two of the three accepted forms of documentation require only historical financial information for the most recent fiscal year, while the third requires only three years of projections and two years of historical information. 16 TAC § 24.11(e)(4)(B)(i)-(iii). The rule does not indicate how to reconcile historical documentation with a test that evaluates projected temporary cash shortages.

²⁵ *Application of Texas Water Utilities LP and Creek Water Utility LLC for Sale, Transfer, Merger of Facilities and Certificate Rights in Marion County*, Docket No. 53920 (pending).

²⁶ *Application of Texas Water Utilities LP and Creek Water Utility LLC for Sale, Transfer, Merger of Facilities and Certificate Rights in Marion County*, Docket No. 53920 (pending); Docket No. 53472, Notice of Approval (Nov. 17, 2022); *Application of Monarch Utilities I LP to Amend Its Certificate of Convenience and Necessity in Harris, Liberty, and Montgomery Counties*, Docket No. 53215, Notice of Approval (Oct. 24, 2022).

because it does not speak specifically to temporary O&M shortages. In the event the Commission requires TWU to provide financial assurance, the projected temporary shortages (if any) subject to evaluation must be restricted to O&M to be relevant to the operations test.

III. CONCLUSION

TWU respectfully requests the entry of an Order sustaining its objections to RFI Nos. Staff 2-2 through Staff 2-5 because they address “financial assurance” under 16 TAC § 24.11 even though the Commission has not made a finding that TWU does not possess adequate financial capability, which is a prerequisite for requiring TWU to provide financial assurance. If financial assurance was required, the objections should be sustained because Staff’s RFIs incorporate information related to capital expenditures and purchase prices, which is not information relevant to the leverage or operations test under 16 TAC § 24.11(e)(2) and (3). Additionally, TWU requests any further relief to which it has shown itself entitled.

Respectfully submitted,

/s/ William A. Faulk, III

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**ATTORNEYS FOR TEXAS WATER
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CERTIFICATE OF SERVICE

I hereby certify that notice of the filing of this document was provided to all parties of record via electronic mail on December 12, 2022 in accordance with the Order Suspending Rules, issued in Project No. 50664.

/s/ William A. Faulk, III

William A. Faulk, III