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APPLICATION OF TEXAS WATER UTILITIES, L.P. AND SOUTHERN HORIZONS DEVELOPMENT, INC. FOR SALE, TRANSFER, OR MERGER OF FACILITIES AND CERTIFICATE RIGHTS IN LIBERTY AND MONTGOMERY COUNTIES	§ § § § § § §	BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS
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TEXAS WATER UTILITIES, L.P.’S REPLY BRIEF

Texas Water Utilities, L.P. (TWU), on behalf of itself and Southern Horizons Development, Inc. (Southern Horizons) (collectively, Applicants), files this Reply Brief. Pursuant to the briefing schedule agreed to at the conclusion of the hearing on the merits, this Reply Brief is timely filed on or before August 23, 2024.

I. EXECUTIVE SUMMARY

- As has been continuously confirmed by the Staff (Staff) of the Public Utility Commission of Texas (Commission), the proposed transaction between TWU and Southern Horizons, including TWU’s request for initial rates under Texas Water Code (TWC) § 13.3011, satisfies the requirements in 16 Texas Administrative Code (TAC) § 24.239 including 16 TAC § 24.239(h)(5)(H), is in the public interest, and should be approved.
- Southern Horizons’ customers will benefit from a probable improvement of service in joining the TWU system.
- TWU has provided estimates of planned capital improvements as part of a prudent capital plan to facilitate the long-term health of the Southern Horizons’ public water systems and/or improve system reliability.

- TWU’s proposed initial rates were found just and reasonable by the Commission in TWU’s last rate proceeding, which was resolved via a unanimous settlement that included the Office of Public Utility Counsel (OPUC).¹
- The record does not support Commission Staff’s “alternative solution” to approve the phase four Villas of Willowbrook rates as the initial rates to be charged to the Southern Horizons customers.
- OPUC’s last minute proposal to adopt the rates charged to TWU customers served by the Dal-High Water System as initial rates for the proposed transaction is in no way supported by the record.
- Consolidation of rates helps alleviate rate shock by allowing for mitigation of effects of large capital expenditures due to the larger customer base.
- Direct customer assistance programs are more effective in mitigating bill impacts than phased-in rates.

II. INTRODUCTION

TWU responds to the initial briefs of Commission Staff, OPUC, and the Intervenors. TWU agrees with Commission Staff that the proposed transaction, including the requested initial rates, is in the public interest.² Therefore, the proposed transaction, as filed, should be approved by the Commission. While Commission Staff does propose an “alternative solution” to use the Villas of Willowbrook rates as initial rates for Southern Horizons customers, which is supported by OPUC,³ this proposed solution is misguided.

Once the proposed sale and transfer is complete, the Southern Horizons customers will receive the same level of service as all other TWU customers. The requested initial rates are the just and reasonable rates that the Commission approved based on a full review of TWU’s cost of service for the calendar year ending 2019. The rate schedules phasing in those rates for a small subset of TWU’s customers were negotiated as part of a comprehensive settlement

¹ Redacted Direct Testimony of Brian D. Bahr, Ex. TWU-1, Attachment BDB-7 (Apr. 18, 2024).

² Redacted Rebuttal Testimony of Brian D. Bahr, Ex. TWU-5, Attachment BDB-R-1 at bates p. 20 (Jun. 20, 2024).

³ Office of Public Utility Counsel’s Post-Hearing Initial Brief at 8 (Aug. 9, 2024) (OPUC’s Initial Brief).

agreement. Commission Staff's alternative proposal, as well as the arguments raised by OPUC and the other intervenors, fail to acknowledge these facts about the rates themselves and instead focus, to the exclusion of all else, on the increase in the rates that will be charged to the Southern Horizons customers.

Commission Staff's alternative also fails to recognize that Southern Horizons' customers will receive a probable improvement in service because of joining the TWU system.⁴ The application included estimated costs for planned capital projects that will improve the reliability of the Southern Horizons system.⁵ Consolidated rates like TWU's requested rates will help the Southern Horizons customers shoulder less of the burden of these planned capital expenditures. This is preferable to the current rates, which have not always generated revenue sufficient to cover the entire cost of needed capital improvements.⁶ The record does not support the conclusion that TWU and its current customers should subsidize the Southern Horizons' customers, yet that would be the result if anything other than the initial rates requested by TWU are approved. Therefore, based on the record evidence as a whole, and an evaluation of all of the factors in TWC §§ 13.305(e) and 13.246(c), and 16 TAC § 24.239, the proposed transaction, including the requested initial rates, is in the public interest.

III. REPLY TO COMMISSION STAFF

TWU agrees with Commission Staff that the proposed transaction, including the requested initial rates, is in the public interest.⁷ This is what the totality of admitted evidence in this proceeding demonstrates. The sum of the evidence does not support Commission Staff's alternative recommendation to apply the phase 4 rates currently in effect for TWU customers served by the Villas of Willowbrook water system as initial rates.

Commission Staff's alternative suggestion on initial rates was made for the sole purpose of moderating impacts to customer bills.⁸ In other words, Commission Staff is proposing to phase in the initial rates requested by TWU. In its discussion of this suggestion, Commission

⁴ Ex. TWU-1 at 22.

⁵ *Id.*

⁶ Direct Testimony of Steve Sullivan, Ex. TWU-3 at 7 (Apr. 18, 2024).

⁷ Commission Staff's Initial Brief at 4 (Aug. 9, 2024) (Staff's Initial Brief).

⁸ Staff's Initial Brief at 4–5.

Staff does not mention the other phased-in rate schedules included in TWU’s tariff or provide any analysis whatsoever as to why Villas of Willowbrook rates were selected as opposed to one of the other phased-in schedules. In fact, the testimony that Commission Staff witness James Harville provided on cross examination did not mention any rates but the Villas of Willowbrook rates.⁹ Commission Staff also does not address why it is appropriate to adopt a set of phased-in rates that were negotiated as part of a comprehensive settlement that included a rate design based on a specific revenue requirement that TWU would not fully recover until all sixteen systems with phased-in rates reached the final phase.¹⁰

Commission Staff also does not present any argument or framework to be used to weigh the overwhelming evidence supporting a finding that TWU’s requested initial rates are just and reasonable against claims of “rate shock”—a term that is not defined in statute or rule.¹¹ For example, Commission Staff’s Initial Brief did not challenge the calculations presented by Brian Bahr using an operations and maintenance cost per customer derived from TWU’s 2022 Annual Report and a capital cost per customer using the ratemaking rate base for Southern Horizons. For a customer using 5,000 gallons, this calculation results in a monthly bill that is higher than the bill resulting from TWU’s requested initial rates.¹² Evidence such as this is particularly salient because the Commission has stated that the criteria used to evaluate a request for initial rates under TWC § 13.3011 will be determined on a case-by-case basis.¹³ Here, Commission Staff has presented a possible “solution” with almost no explanation as to how it arrived at this solution or why it is appropriate in light of the evidence to the contrary. Commission Staff’s proposal to use the Villas of Willowbrook rates should not be adopted.

In addition to the lack of supporting analysis, Commission Staff’s alternative should be rejected because it improperly construes the criterion addressing the probable improvement of

⁹ See Tr. at 69:3–7 and 13–17 (Harville Cross) (Jul. 23, 2024) (“Q. [By Mr. Faulk] Okay. Can you describe for me what you reviewed to evaluate the rates proposed by TWU that would be applied to Southern Horizons in this application? A. Sure . . . But as a direct comparison, I did take the initial rates proposed by TWU, and I compared them to the rates with SHDL. I also did a comparison to support my testimony and what was in there for the comparison between those of TWU and those of Willowbrook as a suggestion.”).

¹⁰ Ex. TWU-1 at 14:18–15:8.

¹¹ Ex. TWU-9 at 3—Commission Staff’s Response to TWU’s First Request for Information, RFI No. TWU 1-10.

¹² Confidential Ex. TWU-6 at 4:15–5:5 and Attachment BDB-R-2.

¹³ Preliminary Order at 3 (Mar. 7, 2024).

service or lowering of cost to consumers.¹⁴ Commission Staff concludes that the lack of a need for any improvements, construction, or capital investment to meet the minimum requirements of the Texas Commission on Environmental Quality (TCEQ) or Commission rules casts doubt on whether the requested initial rates are in the public interest.¹⁵ This conclusion ignores the distinction between capital investment necessary to meet all applicable regulatory standards—i.e., to provide continuous and adequate service, and any estimated capital improvements made as part of a prudent capital plan to facilitate the long-term health of the Southern Horizons' public water systems and/or improve system reliability.¹⁶

In the application, TWU listed improvements identified during due diligence that are based on preliminary cost and timing estimates that are subject to change once TWU closes the transaction, and—as the legal owner of the systems—can perform a more thorough evaluation.¹⁷ When asked why the application in this proceeding included only estimated capital improvements, TWU witness Brian Bahr testified as follows:

It's estimated because it's based on initial due diligence performed at the time that we're looking at the system. However, the close of the transaction doesn't happen for a year or several years after that due diligence is done. And there is no way of – for us to know at this time if that's what's actually going to be needed after we take over the system and become more familiar with the details of the operations¹⁸

Commission Staff does not assert that if these estimated capital improvements are completed, they will not result in a probable improvement of service to the Southern Horizons customers. Yet, their briefing appears to suggest that if there is no capital investment needed to comply with TCEQ standards or Commission rules, then there are no projects whatsoever that will result in a probable improvement of service to customers.¹⁹ Such a narrow view is not supported by the plain language of TWC § 13.246(c) or 16 TAC § 24.239(h)(5).

¹⁴ TWC § 13.246(c)(8); 16 TAC § 24.239(h)(5)(H).

¹⁵ Staff's Initial Brief at 7.

¹⁶ Ex. TWU-1 at 20:1–16.

¹⁷ Confidential Ex. TWU-2, Confidential Direct Testimony of Brian D. Bahr, Attachment BDB-2a at 94–95; Ex. TWU-1 at 20:14–16.

¹⁸ Confidential Tr. 44:9–20 (Bahr Re-Direct) (Jul. 23, 2024).

¹⁹ Staff's Initial Brief at 6–7.

In its recommendation filed on July 17, 2023, Commission Staff concluded that “Reliability and quality of water service is expected to improve under Texas Water’s management.”²⁰ At the hearing on the merits, Mr. Harville stressed that this recommendation has not changed.²¹ In briefing, Commission Staff appears to back away from this conclusion even though it is supported by the direct testimony of Mr. Bahr, which describes TWU’s mission and approach to operations and customer service as well as its superior access to capital.²² Taken as a whole, the evidence supports the conclusion that the proposed transaction will result in a probable improvement of service to customers, and therefore, Commission Staff’s alternative suggestion regarding initial rates should not be approved.

Finally, Commission Staff’s alternative suggestion is improper because it appears to rely only on whether the proposed transaction will result in a probable improvement of service or lowering of cost to customers. Neither TWC chapter 13 nor Commission rules indicate that any one factor used to evaluate a sale, transfer, or merger holds more weight than any other. These factors are found in TWC §§ 13.301(e) and 13.246(c) and the corresponding Commission rule, 16 TAC § 24.239(h). Based on the initial briefing submitted by the parties, the only contested issue in this proceeding is the request for initial rates, and the only factor used by any party to argue against the requested initial rate is the factor that addresses improvement of service or lowering of cost.²³ Accordingly, all other factors support a finding that the proposed transaction, including TWU’s request for initial rates, is in the public interest. One factor alone is not enough to overcome the rest. And for the reasons already stated, the record supports a finding that the proposed transaction will result in the probable improvement of service to the Southern Horizons’ customers. Consequently, the entirety of the evidence in the record supports approving the transaction and TWU’s requested initial rates.

IV. REPLY TO OPUC

Despite OPUC’s unsupported claims, the proposed transaction, including TWU’s request for initial rates, is in the public interest. OPUC contends that this transaction should

²⁰ Ex. TWU-5, Attachment BDB-R-1 at bates p. 20.

²¹ Tr. at 84:11–13 (Harville Cross) (Jul. 23, 2024).

²² Ex. TWU-1 at 15:9–17:2.

²³ Staff’s Initial Brief at 6–7; OPUC’s Initial Brief at 4.

not be approved because implementing the initial rates proposed by TWU “would result in the transaction failing to be in the public interest.”²⁴ However, as supported by the record evidence, and as repeatedly affirmed by Commission Staff, the proposed transaction, inclusive of TWU’s request for initial rates, is within the public interest. First, Commission Staff stated in its Recommendation on the Approval of the Transaction that it “recommend[s] that the Commission find the transaction will serve the public interest and that the Applicants be allowed to proceed with the proposed transaction.”²⁵ In its recommendation, Commission Staff notes that “[a]s allowed by statute, Texas Water has requested that the customers’ rates be changed to match Texas Water’s currently effective approved rates.”²⁶ Commission Staff never changed this recommendation as it reiterated during the hearing on the merits when Mr. Harville stated “if you look back to the prior sale [] memo and my testimony, that information will be the same, as my recommendation has not changed.”²⁷ Mr. Harville was clear that his recommendation was that the transaction with TWU’s proposed initial rates met the public interest requirements of 16 TAC § 24.239, and that using the Villas of Willowbrook rates as initial rates was only proposed as an “alternative solution.”

In its initial brief, OPUC focuses on the public interest factor noted in 16 TAC § 24.239(h)(5)(H): “the probable improvement of service or lowering of cost to consumers in the requested area resulting from approving the transaction[.]”²⁸ Specifically, OPUC focuses on the lowering of costs to consumers and ignores that the factor states “probable improvement of service *or* lowering of cost to consumers.”²⁹ Unlike OPUC, Commission Staff acknowledges that Southern Horizons’ customers will receive a probable improvement of service as part of TWU. Commission Staff states in its memorandum attached to the Recommendation on the Approval of the Transaction that “[r]eliability and quality of water service is expected to improve under Texas Water’s management.” In his direct testimony, TWU witness Mr. Brian

²⁴ OPUC’s Initial Brief at 3.

²⁵ Ex. TWU-5, Attachment BDB-R-1 at bates p. 20.

²⁶ *Id.*

²⁷ Tr. at 101:19–24 (Harville Cross) (Jul. 23, 2024).

²⁸ 16 TAC § 24.239(h)(5)(H).

²⁹ *Id.* (emphasis added).

Bahr discusses the probable improvement of service for Southern Horizons' customers.³⁰ TWU has access to substantial resources that benefit customers including a dedicated customer call center, access to capital through capital markets, an engineering team, and the ability to draw on affiliate resources during times of natural disasters.³¹ Additionally, Mr. Bahr discusses how being part of a large customer base will allow Southern Horizons customers to have mitigated effects from large, single capital expenditures.³² Overall, the Southern Horizons customers will receive a probable improvement of service from becoming part of TWU.

Additionally, OPUC states that it supports Commission Staff's proposed alternative solution of implementing the Villas of Willowbrook rates because no capital improvements are initially needed to bring Southern Horizons' public water systems into compliance with TCEQ minimum standards.³³ However, TWU did include in its application initial estimates of capital improvements that TWU intends to make post-acquisition to improve the long-term health of the system.³⁴ Furthermore, Mr. Steve Sullivan, the current owner of the Southern Horizons, notes in his direct testimony that "[i]n years when we have had to make substantial repairs or improvements to our facilities, our rates have not always generated enough revenue to cover the full cost of these capital expenditures."³⁵ Mr. Sullivan also testified that costs to run the utility have increased due to inflation and that neither himself nor his partner are compensated for their work in managing the utility.³⁶ OPUC acknowledges that "customers of Southern Horizons have not had regular rate adjustments in the past fourteen years[.]"³⁷ which suggests that Southern Horizons' current rates may not generate enough revenue to cover its cost of service. TWU witness Mr. Bahr acknowledged that currently TWU is not charging rates that collect the full revenue requirement approved in Docket No. 50944, and simply adding additional customers does not increase revenue without an analysis of the cost to serve those

³⁰ Ex. TWU-1 at 22.

³¹ *Id.*

³² *Id.*

³³ OPUC's Initial Brief at 8.

³⁴ Ex. TWU-1 at 20.

³⁵ Ex. TWU-3 at 7.

³⁶ *Id.*

³⁷ OPUC's Initial Brief at 6.

customers.³⁸ Importantly, as Mr. Bahr noted, “adding revenues and expenses from Southern Horizons customers would not result in TWU earning greater than its authorized return.”³⁹ One of the principles in setting water rates is that the regulatory authority should fix revenues in a manner that allows a utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over its reasonable and necessary operating expenses.⁴⁰ TWU and its current customers should not be forced to subsidize the rates of Southern Horizons’ customers simply because those customers have not had a rate increase in fourteen years.

Furthermore, OPUC argues that the rates requested by TWU as initial rates cannot be held to be just and reasonable under TWC § 13.182(a).⁴¹ TWU § 13.182(a) states that “[t]he regulatory authority shall ensure that every rate made, demanded, or received by any utility or by any two or more utilities jointly shall be just and reasonable.” TWU’s requested initial rates have already been found just and reasonable by the Commission in Docket No. 50944.⁴² In fact, even OPUC agreed that these rates were just and reasonable and “in accordance with the public interest.”⁴³ As explained above, rates are not tailored to each specific group of customers. To that end, in Docket No. 50944, the Commission acknowledged that TWU has only one comprehensive customer class and has developed a comprehensive cost of service and revenue requirement for providing water and sewer service for all its customers.⁴⁴ While TWU’s proposed initial rates have been found just and reasonable recently in 2022, the rates currently charged by Southern Horizons to its customers were last approved by the Commission on October 24, 2020.⁴⁵ While OPUC contends that the initial rates proposed by TWU are exorbitant using a price comparison to Southern Horizons’ current rates,⁴⁶ OPUC fails to

³⁸ Ex. TWU-1 at 15.

³⁹ *Id.* at 14.

⁴⁰ TWC § 13.183.

⁴¹ OPUC’s Initial Brief at 5.

⁴² *Application of Monarch Utilities I, L.P. for Authority to Change Rates*, Docket No. 50944, Order at Conclusion of Law No. 8 (Feb. 23, 2022).

⁴³ *Id.*, Order at Finding of Fact No. 74.

⁴⁴ *Id.*, Order at Finding of Fact No. 59.

⁴⁵ Ex. TWU-3 at 6.

⁴⁶ OPUC’s Initial Brief at 5.

acknowledge that Southern Horizons' customers currently pay no gallonage fee for up to 2,000 gallons of water, and all consumption above 2,000 gallons is charged the same gallonage fee of \$3.18 per 1,000 gallons.⁴⁷ This rate structure does not encourage conservation of water.⁴⁸ Lastly, for customers that have not seen a rate increase for several years, a rate increase can be large, and the rates to be charged still just and reasonable. The size of an increase is not determinative of the rate's just and reasonableness.

OPUC argues that the Villas of Willowbrook or Dal-High rates should be adopted as initial rates for Southern Horizons customers to mitigate the exorbitant rate shock.⁴⁹ As noted in TWU's initial brief, the Commission found that although OPUC proposed phased-in rates in CSWR-Texas Utility Operating Company's most recent rate proceeding, the consolidation of systems sufficiently mitigated rate shock while ensuring that customers were paying their actual cost of service.⁵⁰ Furthermore, the Villas of Willowbrook and Dal-High rates have also not been tailored to Southern Horizons customers. While OPUC notes that phased-in rates were included in the Commission's final order in TWU's last proceeding, these phased-in rates were part of a settlement agreement and agreed to by all parties including TWU and OPUC.⁵¹ Lastly, use of the Dal-High rates as initial rates for TWU customers was not proposed at any point in this proceeding until OPUC's initial brief, all without any evidentiary record support. The use of those rates is not supported by the record in this proceeding and were not part of any party's testimony or discussed at the hearing on the merits.

OPUC quotes the testimony of intervenor ratepayers in its initial brief.⁵² While TWU acknowledges that the increase in rates may pose difficulties for some Southern Horizons ratepayers, it should be noted that the intervenor testimony focuses solely on the rate increase and not on the rates themselves and that the intervenor testimony and protests in this proceeding only represents 1.5% of Southern Horizons customer base.⁵³ Furthermore, as addressed in

⁴⁷ *Id.*

⁴⁸ Ex. TWU-5 at Attachment BDB-R-4.

⁴⁹ *Id.* at 10–11.

⁵⁰ Texas Water Utilities, L.P.'s Initial Brief of at 18–19 (Aug. 9, 2024) (TWU Initial Brief).

⁵¹ Docket No. 50944, Order at Findings of Fact Nos. 68–69.

⁵² OPUC's Initial Brief at 6–7.

⁵³ Tr. at 98:3–8 (Harville Cross) (Jul. 23, 2024).

TWU's initial brief, TWU offers direct-to-customer assistance programs that are more effective at mitigating bill impacts than using phased-in rates including the Low-Income Household Water Assistance Program, Elderly Assist Rates, and alternate payment arrangements.⁵⁴

V. REPLY TO INTERVENORS

TWU also will summarily respond to the initial briefs of intervenors Cecil Fairfax, Constance Stover, and Anna Miller.⁵⁵ TWU notes that all three initial briefs do not cite to the record evidence in this proceeding and are akin to statements of position or testimony rather than briefs.⁵⁶ As a result, TWU believes that the initial briefs of the intervenors should not be given any weight in this proceeding.

Furthermore, the initial briefs of Constance Stover and Anna Miller focus on affordability of the water rates for Southern Horizons customers.⁵⁷ As noted above, direct-to-customer assistance programs—which have been determined to be more effective for mitigating bill impact than using phased-in rates—include the Low-Income Household Water Assistance Program, Elderly Assist Rates, and alternate payment arrangements.⁵⁸ These programs offer assistance directly to the customer and are more effective and efficient because they result in the provision of payment assistance to those who need it most instead of artificially depressing rates for a large group of customers, which can result in inappropriate subsidization of rates and assistance going to customers who may not need it or who use large amounts of water.⁵⁹ Furthermore, the customer assistance programs balance the needs of the utility and the customers it serves because it avoids putting rates below the level needed to recover a utility's approved cost of service.⁶⁰ TWU firmly believes that the concerns around affordability raised by the intervenors will be better addressed for all its ratepayers via the programs addressed by Mr. Bahr in his testimony.

⁵⁴ TWU's Initial Brief at 13–14.

⁵⁵ Cecil Fairfax Intervenor Initial Brief (Aug. 18, 2024); Constance Stover Intervenor Initial Brief (Aug. 18, 2024) (Stover Initial Brief); Anna Miller Intervenor Initial Brief (Aug. 18, 2024) (Miller Initial Brief).

⁵⁶ *Id.*

⁵⁷ Stover Initial Brief at 2; Miller Initial Brief at 2–3.

⁵⁸ Ex. TWU-5 at 8–9.

⁵⁹ *Id.*

⁶⁰ *Id.*

VI. CONCLUSION

For the reasons stated in this Reply Brief, TWU has established that the proposed transaction between TWU and Southern Horizons, including TWU's request for initial rates under TWC § 13.3011, is in the public interest. Accordingly, TWU respectfully requests that the Commission approve the sale, transfer, and merger as requested in the application and grant other such relief to which TWU has shown itself justly entitled.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that, unless otherwise ordered by the presiding officer, notice of the filing of this document was provided to all parties of record via electronic mail on August 23, 2024, in accordance with the Second Order Suspending Rules, issued in Project No. 50664.

/s/ William A. Faulk, III
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