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APPLICATION OF TEXAS WATER	§	PUBLIC UTILITY COMMISSION
UTILITIES, L.P. AND SOUTHERN	§	
HORIZONS DEVELOPMENT, INC.	§	OF TEXAS
FOR SALE, TRANSFER, OR MERGER	§	
OF FACILITIES AND CERTIFICATE	§	
RIGHTS IN LIBERTY AND	§	
MONTGOMERY COUNTIES	§	

TEXAS WATER UTILITIES, L.P.'S REPLY BRIEF ON THRESHOLD ISSUES

Texas Water Utilities, L.P. (TWU) files this Reply Brief on Threshold Issues. Pursuant to the Order Requesting Briefing on Threshold Issues filed by the Commission Counsel for the Public Utility Commission of Texas (Commission) on November 3, 2023, this reply brief is timely filed.¹

I. EXECUTIVE SUMMARY

The briefing of both Commission Staff and the Office of Public Utility Counsel (OPUC) fails to acknowledge Texas Water Code (TWC) § 13.3011(b) and instead places emphasis on other provisions of the Water Code. By its plain language, this statute prohibits the Commission from requiring a rate proceeding to establish initial rates for customers acquired via a sale, transfer, or merger (STM). Reading TWC § 13.3011 to *allow*, rather than *require*, the Commission to approve a request for initial rates and to require a review using the just and reasonable standard contravenes TWC § 13.3011 in two significant ways. First, in the event a request for an initial rate is denied, it leaves a base rate case as the only way for the acquiring utility to charge its approved rates to the acquired customers. Second, it necessitates a process for reviewing an initial rate that is potentially just as time and resource intensive as a base rate case, which defeats the purpose of the prohibition. Both of these outcomes render TWC § 13.3011 moot and negate the legislative intent underlying the passage of this statute. To give meaning and weight to the entirety of TWC § 13.3011, it must be interpreted to require the Commission to approve a request for initial rates.

¹ Order Requesting Briefing on Threshold Issues at 2 (Oct. 13, 2023) (establishing 3:00 p.m. on November 3, 2023, as the deadline for all parties to file their reply briefs).

II. THRESHOLD ISSUE NOS. 1 AND 2

Neither of the initial briefs filed by Commission Staff and OPUC acknowledged the clear legislative intent behind TWC § 13.3011 or its connection to filed rate doctrine. Instead, both conclude that the Commission has discretion to approve or deny a request for an initial rate. However, neither party opined as to how the Commission can exercise this discretion while also abiding by TWC § 13.3011(b), which prohibits a regulatory authority from requiring a new rate proceeding to establish an initial rate. “In interpreting a statute, a court shall diligently attempt to ascertain legislative intent and shall consider at all times the old law, the evil, and the remedy,”² and, in addition to the statutory construction aids already discussed in TWU’s Initial Brief on Threshold Issues (TWU’s Initial Brief), a court may consider the consequences of a particular construction.³

Under the “old law,” as interpreted by the Commission Staff, the only way for a utility that acquired customers via an STM to change the rates charged to those customers was to file a base rate case. Commission Staff’s “old law” would necessitate disregarding the Third Court of Appeals decision in *Entex v. R.R. Comm’n of Tex.*, 18 S.W.3d 858 (Tex. App—Austin 2000, pet. denied) and the language in TWC § 13.190. The requirement to file a base rate case, i.e., the inability to change the rates charged to the acquired customer as part of the STM proceeding, is also the issue (or “evil” to use the term from the statute) TWC § 13.3011 was passed to address.⁴ The “remedy” chosen by the Legislature was to authorize the acquiring utility to use its previously approved rates immediately after acquisition.⁵

The consequence of an interpretation of TWC § 13.3011 that authorizes the Commission to approve or deny a request for initial rates is to subvert the Legislature’s intent. All of the ratemaking standards and criteria used to set and evaluate the rates charged by a utility are found in TWC Chapter 13, subchapter F, which also includes the procedures to be used in a base rate case. Yet, none of the provisions referenced by Staff and OPUC are referenced in TWC § 13.3011, and the Legislature did not add TWC § 13.3011 to subchapter F. Moreover,

² Tex. Gov’t Code § 312.055.

³ Tex. Gov’t Code § 311.023(5).

⁴ Senate Research Center Bill Analysis, Tex. H.B. 1484, 88th Leg., R.S. (2023) at 1 (HB 1484 Bill Analysis).

⁵ *Id.*

neither the proposed new rule, 16 Texas Administrative Code (TAC) § 24.240, nor OPUC's briefing make it clear that it is possible to review an initial rate using the standards in subchapter F without running afoul of TWC § 13.3011(b) because the standards in subchapter F are tailored to a rate proceeding.

The plain language of TWC § 13.3011(b) should be respected. An interpretation of TWC § 13.3011 that fails to give due weight to subsection (b) eviscerates the remedy chosen by the Legislature. The interpretations of Commission Staff and OPUC give this language no deference at all. Accordingly, these interpretations must be rejected.

A. Reply to Commission Staff

Commission Staff relies heavily on the *unadopted* 16 TAC § 24.240, which has been proposed to implement TWC § 13.3011,⁶ to support its interpretation that the Commission is not required to grant a request for initial rates.⁷ When adopting a proposal for publication, the Commission is not required to state the legal arguments supporting the interpretation of the statutory provisions the rule implements, so the statutory construction underlying the rule is not known and not directed by the Commissioners. The legal argument provided by Commission Staff opines on the use of “may” in TWC § 13.3011(a). This subsection addresses the right and responsibilities of the acquiring utility. In contrast, subsection (b) addresses the rights and responsibilities of the Commission and expressly states that the Commission cannot require a rate case to establish an initial rate. Commission Staff has explained neither how the discretion granted to an acquiring utility in TWC § 13.3011(a) can be construed to grant similar discretion for the Commission nor how the process for reviewing an initial rate proposed in 16 TAC § 24.240 is in accordance with TWC § 13.3011(b).

⁶ *Water and Sewer Utility Rates After Acquisition*, Project No. 53924, Proposal for Publication of New 16 TAC § 24.240 as Approved at the September 14, 2023, Open Meeting (Sept. 14, 2023) (PFP).

⁷ Commission Staff's Brief on Threshold Issues at 1 (Oct. 27, 2023) (Staff's Initial Brief).

B. Reply to OPUC

1. OPUC improperly relies on TWC § 13.182 to the exclusion of all other aspects of TWC Chapter 13.

Despite OPUC's reference to the rule of statutory construction requiring the consideration of the entirety of the Water Code when interpreting TWC § 13.3011,⁸ OPUC's arguments that the Commission is not required to grant a request for initial rates do not conform to this rule. OPUC claims that its interpretation preserves the Commission's jurisdiction over ratemaking found in TWC §§ 13.181 and 13.182.⁹ The specific authority granted in TWC § 13.181(b) permits the Commission to "fix and regulate rates of utilities, including rules and regulations for determining the classification of customers and services and for determining the applicability of rates." The act of fixing rates takes place in a base rate case, which TWC § 13.3011(b) plainly states is not required to establish an initial rate. The regulation of rates through the adoption of rules is informed by the relevant statutes.

Here, OPUC has cited only to TWC § 13.182 despite other wholly relevant statutes such as TWC §§ 13.183, 13.184, 13.190, and 13.3011. In citing to TWC § 13.182, OPUC does not explain how a rate that was not approved for the acquiring utility and is not charged to any other customers of the acquiring utility is not a preferential rate and is equitable and consistent in application. Nor does OPUC address how a rate that was derived from a revenue requirement reflecting the selling utility's cost of service will allow the acquiring utility to recover overall revenues at a level that satisfies TWC § 13.183(a)(1) and (2). OPUC's arguments also fail to take into consideration any characteristics of the selling utility's rate, such as how long ago it was approved. A rate that was set ten or fifteen years ago will no longer reflect the selling utility's cost of providing service, yet OPUC's arguments suggest it is somehow just and reasonable for the acquiring utility to continue to charge this rate even though it has requested an initial rate that was more recently reviewed and approved by a regulatory authority.

Finally, OPUC argues that its interpretation of TWC § 13.3011 prevents favoring private interests over the public interest.¹⁰ While this presumption is enumerated in the Code

⁸ Office of Public Utility Counsel's Response to Order Requesting Briefing on Threshold Issues, at 4 (Oct. 27, 2023) (OPUC's Initial Brief).

⁹ OPUC's Initial Brief at 4.

¹⁰ *Id.* at 4-5.

Construction Act,¹¹ it does not trump the legislative policy and purpose of TWC Chapter 13, which identifies the public interest Chapter 13 was adopted to protect as “the public interest inherent in the rates and services of retail public utilities.”¹² The Legislature went on to acknowledge that retail public utilities are monopolies and that regulation of utility rates, operations, and services is needed as a substitute for competition.¹³ However, it also stated that the regulatory structure enacted in Chapter 13 should “assure rates, operations, and services that are just and reasonable to the consumers and to the retail public utilities.”¹⁴ OPUC’s interpretation of TWC § 13.3011 does not support this holistic view of the public interest.

2. Taken together, OPUC’s responses to Threshold Issue Nos. 1 and 2 subvert the benefits of TWC § 13.3011 to the point of rendering it useless.

As stated above, OPUC’s arguments rely heavily on the just and reasonable standard in TWC § 13.182, but this standard does not exist in a vacuum, and OPUC’s interpretation of TWC § 13.3011 ignores this reality. The actual rates a utility may charge are derived from the utility’s revenue requirement. The just and reasonable standard does not consider how high or low a utility’s revenue requirement and resulting rates are. Instead, it focuses on the components of the revenue requirement such as the reasonable and necessary costs incurred during a historic test year adjusted for known and measurable changes; the original cost of the utility assets and the service life or depreciation rate used to calculate depreciation expense; the prudently incurred amount of invested capital; and the rate of return.¹⁵ The Commission’s review of these facts must result in a level of overall revenues that preserve the financial integrity of a utility and permits it “a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses.”¹⁶

¹¹ Tex. Gov’t Code § 311.021(5).

¹² TWC § 13.001(a).

¹³ TWC § 13.001(b).

¹⁴ TWC § 13.001(c).

¹⁵ TWC §§ 13.184 and 13.185; 16 TAC §§ 24.41 and 24.43; *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm’n of W. Va.*, 262 U.S. 679 (1923) and *Fed. Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

¹⁶ TWC § 13.183.

The evidence underlying the inquiries attendant to a determination of just and reasonableness are facts presented during a general rate case. Therefore, and as recognized by the filed rate doctrine, the just and reasonableness of a requested initial rate has already been determined by the Commission or another regulatory authority at the time it approves the rates in a utility's tariff. If the Commission is not required to approve a request for an initial rate, and instead must review the requested rate for compliance with TWC § 13.182(a) and (b), it is not clear how such a review can be accomplished without a rate case. This is evident through review of some of the categories of information required by proposed 16 TAC § 24.240, including unspecified types and unlimited amounts of documentation from the rate case in which the requested initial rates were approved and any other information necessary to demonstrate that the requested initial rates are just and reasonable.¹⁷

The practical effect of OPUC's construction of TWC § 13.3011 is a process whereby a request for an initial rate is reviewed using the standards in TWC Chapter 13, subchapter F that are designed to accompany a full base rate proceeding; yet the review is somehow completed in a manner that complies with the prohibition against requiring a base rate proceeding in TWC § 13.3011(b). There is no timeframe in which the Commission must complete the review, and once the review is completed, the Commission may or may not approve the requested initial rate. This outcome in no way can be supported by the language contained in TWC § 13.3011 or the stated legislative intent.

A process such as proposed by OPUC effectively negates the passage of TWC § 13.3011. Under the Code Construction Act, the consequences of a particular construction may be used to aid interpretation,¹⁸ and a consequence so severe cannot be ignored. The Legislature adopted TWC § 13.3011 to encourage and facilitate consolidation of water and wastewater utilities through acquisitions. The result of OPUC's construction of TWC § 13.3011 is to inject such a high degree of regulatory uncertainty into the process for reviewing an initial rate that it eliminates any benefits the statute might provide to an acquiring utility and undermines the public interest benefit of encouraging consolidation.

¹⁷ Project No. 53924, PFP at 8.

¹⁸ Tex. Gov't Code § 311.023(5).

The filing of an STM application and request for an initial rate occurs after the selling and acquiring utility have negotiated and agreed upon the purchase price and other details of the proposed transaction. The ability to request rate X that is currently in force for system Y may be one of the principal factors in the decision to pursue the transaction—especially in a situation where the seller is a small utility with a system in need of capital improvements and existing rates that have not been adjusted regularly (or ever) to keep pace with the cost of service. In addition, the initial rate selected may be the direct result of an agreement regarding other terms of the transaction.

If the Commission is not required to approve a request for initial rates under TWC § 13.3011, and the just and reasonable standard controls, the time and expense added to the processing of an STM combined with the uncertainty over whether the requested initial rates will be approved, will likely have the unintended consequence of discouraging the acquisition of the utilities that are most in need of new management or undermining the viability of a transaction by restricting the freedom to contract for a complete set of interdependent terms. And all this assumes, that the Commission can find a way to perform the review in a manner that complies in substance (and not just form) with the prohibition in TWC § 13.3011(b).

III. THRESHOLD ISSUE NO. 3

Both Commission Staff and OPUC state that if the Commission is not required to approve a request for initial rates under TWC § 13.3011, and does not approve the requested initial rates, the acquiring utility may continue to charge the rates approved for the selling utility.¹⁹ While there is no other option if Commission approval of a request under TWC § 13.3011(a) is not required, the fact that the selling utility's rates are the only option continues to highlight why this interpretation is flawed. Specifically, if the Commission denies a request for an initial rate, then the utility has no choice but to file a rate case if it wants to change the rates charged to the customers acquired via an STM. This is counter to TWC § 13.3011(b) and the Legislature's stated intent to authorize acquiring utilities to use previously approved rates immediately after acquisition.²⁰

¹⁹ Staff's Initial Brief at 2; OPUC's Initial Brief at 6.

²⁰ H.B. 1484 Bill Analysis at 1.

IV. THRESHOLD ISSUE NO. 4

Both Commission Staff and OPUC failed to consider the specific purpose of TWC § 13.301(e), which is to set forth the reasons the Commission may hold a public hearing to determine if the *transaction* will serve the public interest. Accordingly, this is the only aspect of the STM application to which the criteria in TWC § 13.301(e) are applicable. A request for an initial rate is distinct from the sale, acquisition, lease, or rental of facilities. Consequently, the review of a request for an initial rate is beyond the scope of TWC § 13.301(e).

OPUC and Staff also do not address the timing of the initial adoption of what is now TWC § 13.301(e)(5). The language referencing TWC § 13.246(c) was first added to TWC § 13.301 in 1995.²¹ The criteria currently listed in TWC § 13.246(c) have been in statute even longer. Given the 26-year gap between the addition of the reference to TWC 13.246(c) to TWC § 13.301, and the passage of TWC § 13.3011, it is obvious that these criteria were not crafted to apply to a request for initial rates. The quarter of a century long gap also makes it hard to believe that the Legislature intended these criteria to apply to a request for initial rates absent some specific indication.

The Legislature enumerated the criteria a requested initial rate must satisfy in TWC § 13.3011(a)(1) and (2) and did so without referencing TWC § 13.301(e). And, TWC § 13.301(e) applies only to the acquisition of a water or sewer system. Therefore, a request for a hearing to contest approval of rates under TWC § 13.3011(a) does not constitute proper grounds for a hearing under 13.301(e) regardless of the reference to TWC § 13.246(c).

V. CONCLUSION

TWU respectfully requests that the Commission adopt an order construing TWC § 13.3011 to require the approval of an acquiring utility's request for an initial rate. In the alternative, TWU requests the adoption of an order finding that a hearing request made for the purpose of contesting the approval of rates under TWC § 13.3011(a) does not constitute proper grounds for a hearing under TWC § 13.301(e), declining to adopt a preliminary order in this proceeding, and directing the administrative law judge to proceed with the continued processing of this docket.

²¹ Act of 1995, 74th Leg., R.S., ch. 400 § 7 1995 Tex. Gen. Laws 2954, 2957.

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 November 3, 2023, in accordance with the Order Suspending Rules, issued in Project No. 50664.



Eleanor D'Ambrosio