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Item Number - 67

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Governor

Connie Corona
Interim Executive Director

Public Utility Commission of Texas

TO: Chairman Thomas J. Gleeson
Commissioner Lori Cobos
Commissioner Jimmy Glotfelty
Commissioner Kathleen Jackson

All Parties of Record

FROM: Commission Advising

RE: *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*, Docket No. 54617, Draft Preliminary Order, March 7, 2024 Open Meeting, Item No. 6.

DATE: February 29, 2024

Please find enclosed the draft preliminary order filed by Commission Advising in the above-referenced docket. The Commission will consider this draft preliminary order at the March 7, 2024 open meeting. Parties shall not file responses or comments addressing this draft preliminary order.

Any modifications to the draft preliminary order that are proposed by one or more Commissioners will be filed simultaneously prior to the consideration of the matter at the March 7, 2024 open meeting.

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DOCKET NO. 54617

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

DRAFT PRELIMINARY ORDER

On February 2, 2023, Texas Water Utilities, L.P. and Southern Horizons Development, Inc. filed an application for approval of the sale, transfer, or merger of facilities and certificate rights in Liberty and Montgomery counties. This preliminary order identifies the issues that must be addressed.

Texas Water Utilities seeks approval to acquire facilities, decertify certificated acreage, add uncertificated acreage, and transfer water service area from Southern Horizons in Liberty and Montgomery counties under water certificate of convenience and necessity (CCN) number 12863. The requested area includes 452 water connections. Texas Water Utilities seeks to transfer 527 acres from Southern Horizons' CCN into its CCN, decertify 99 acres, and add 102 uncertificated acres to its CCN. Texas Water Utilities provides water service under CCN number 12983.

The applicants filed the application on February 2, 2023. The applicants filed supplements to the application on February 16, March 15, and June 23, 2023. On March 27, 2023, a motion to intervene filed by the Office of Public Utility Counsel (OPUC) was granted.¹ On April 5, 2023, the Commission administrative law judge (ALJ) found the application administratively complete. On May 16 and May 30, 2023, the Commission ALJ granted motions to intervene filed by Gerald Stover, Collin Jones, Cecil Fairfax, Jeffrey Berry, and Anna Miller.² On June 22, 2023, the Commission ALJ found notice sufficient.³

¹ Order No. 3 at 1 (Mar. 27, 2023).

² Order No. 6 at 1 (May 16, 2023); Order No. 8 at 1 (May 30, 2023).

³ Order No. 9 at 1 (June 22, 2023).

On August 23, 2023, Anna Miller, Gerald and Constance Stover, and Cecil V. Fairfax each filed a request for a hearing. Timeliness concerns were raised concerning the requests filed by Gerald and Constance Stover and Cecil V. Fairfax. The Commission does not address the issue of timeliness because only one request for a hearing is needed, and it not disputed that Anna Miller's request for a hearing was timely. Anna Miller requested a hearing regarding the initial rates Texas Water Utilities proposes to charge under Texas Water Code (TWC) § 13.3011. The Commission construes the hearing request "so as to do substantial justice" under 16 TAC § 22.75(a) as a request for a hearing to determine whether the sale, transfer, or merger (STM) transaction, including the request for initial rates under TWC § 13.3011, is in the public interest in accordance with Threshold Issue 4 below.

The applicants were directed, and Commission Staff and other interested persons were allowed, to file by October 3, 2023 a list of issues to be addressed in the docket and also identify any issues not to be addressed and any threshold legal or policy issues that should be addressed. Texas Water Utilities, Commission Staff, and Anna Miller timely filed lists of issues.

Upon approval of its application for the sale and transfer, Texas Water Utilities seeks to charge its tariffed and in-force rates to the customers to be acquired from Southern Horizons under TWC § 13.3011. Specifically, Texas Water Utilities seeks to charge the following rates compared to Southern Horizon's current rates:⁴

Rate	Southern Horizons' Current Rate	Proposed Texas Water Utilities' Rate
5/8" base rate	\$32.20	\$48.37
Usage rate (0–2,000 gal.)	\$0.00	\$6.48
Usage rate (2,000–10,000 gal.)	\$3.18	\$7.98
Usage rate (10,000–20,000 gal.)	\$3.18	\$9.05
Usage rate (>20,000 gal.)	\$3.18	\$9.64

On October 13, 2023, the Commission requested briefing from the parties addressing issues related to the implementation of existing tariffed rates and whether a hearing is permitted

⁴ Application, Attachment 1 (Transaction Summary – Redacted) at 2.

under Texas Water Code (TWC) § 13.3011.⁵ Commission Staff, OPUC, Anna Miller, and Texas Water Utilities each filed an initial brief and a reply brief on the threshold issues.

I. Threshold Legal and Policy Determinations

Parties filed briefs addressing the following legal and policy questions. The following statements of position were reached in consideration of the arguments of the parties. Accordingly, as required by section 2001.058(c) of the Administrative Procedure Act,⁶ the Commission states its position on the following threshold issues:

1. Under Texas Water Code (TWC) § 13.3011, is the Commission required to grant an acquiring utility's request to charge its existing filed rates for another water or sewer system owned by the acquiring utility to customers in the acquired utility's service area?

No, the Commission is not required to grant a utility's request to charge its existing rates in a newly acquired utility's service area. TWC § 13.3011 states that an acquiring utility "may request" that the Commission authorize it to charge its existing filed rates to the customers of a newly acquired water or sewer system. The language used in TWC § 13.3011 is discretionary and is distinguishable from nondiscretionary language in other statutes that require the Commission to grant a utility's requested relief if certain criteria are met.

2. If the Commission is not required to grant a request under TWC § 13.3011(a), what criteria, if any, should the Commission use to determine whether to grant such a request?

TWC § 13.3011 does not specify the criteria for determining whether to grant a request under TWC § 13.3011. The Commission declines to answer this question at this time and will address this issue on a case-by-case basis.

3. If the Commission is not required to grant a request under TWC § 13.30311(a) and does not do so, what rates may the Commission authorize the acquiring utility to charge the customers of the acquired system in light of the prohibition in TWC § 13.3011(b)?

The Commission declines to answer this question at this time and will address this issue on a case-by-case basis.

⁵ Order Requesting Briefing on Threshold Issues (Oct. 13, 2023).

⁶ Administrative Procedure Act, Tex. Gov't Code §§ 2001.001–.902 (APA).

4. Does a request for a hearing to contest approval of rates under TWC § 13.30311(a) constitute proper grounds for a hearing under 13.301(e) and 16 Texas Administrative Code (TAC) § 24.239(h)?

A request for a hearing to determine whether an STM transaction, including a request for initial rates under TWC § 13.3011, is in the public interest constitutes proper grounds for a hearing. Under TWC § 13.301(e), the Commission may hold a hearing in an STM proceeding if . . . “there are concerns that the transaction may not serve the public interest, after the application of the considerations provided by [TWC] § 13.246(c)” Under TWC § 13.246(c), the Commission is required to consider the following factors: adequacy of service, need for additional service, effect on proximate landowners and utilities, the applicant’s ability to provide adequate service, the feasibility of obtaining service from an adjacent retail public utility, the applicant’s financial ability, environmental integrity, probable improvement of service or lowering of cost, and effect on the land.⁷

An acquiring utility’s request to charge its initial rates under TWC § 13.3011 is part of an overall STM transaction. Moreover, a specific public-interest consideration under TWC § 13.246(c) and 16 TAC § 24.239(h)(5)(H) for STM transactions is the probable improvement of service or lowering of cost to consumers.⁸ Therefore, a hearing under TWC § 13.301(e) and 16 TAC § 24.239(h) regarding whether an STM transaction serves the public interest may include a request to charge initial rates.

II. Issues to be Addressed

The Commission must provide to the ALJ a list of issues or areas to be addressed in any proceeding referred to SOAH.⁹ After reviewing the pleadings submitted by the parties, the Commission identifies the following issues that must be addressed in this docket:

Application

1. Did Texas Water Utilities give proper notice to the public in accordance with TWC § 13.301(a)(2) and 16 Texas Administrative Code (TAC) § 24.239(b) and (e)?

⁷ See also 16 TAC § 24.239(h)(5).

⁸ TWC § 13.246(c)(8).

⁹ Tex. Gov’t Code § 2003.049(c).

2. Did Texas Water Utilities comply with the notice requirements of TWC § 13.246 and 16 TAC § 24.235, including mailing notice by first-class mail to each owner of a tract of land that is at least 25 acres and is wholly or partially included in the requested area according to the most current tax appraisal rolls of the applicable central appraisal district at the time the Commission received the application for the CCN under TWC § 13.246(a-1) and 16 TAC § 24.235(b)(2)?
3. What is the effective date of the proposed transaction?
4. Was the application filed at least 120 days before the effective date of the transaction in accordance with TWC § 13.301(a) and 16 TAC § 24.239(b)?
5. Did Southern Horizons notify Texas Water Utilities of the requirements of TWC § 13.301 and provide a copy of 16 TAC § 24.239 before signing an agreement to sell, assign, lease, or rent its facilities in accordance with TWC § 13.301(k) and 16 TAC § 24.239(r)?
6. Were Southern Horizons' facilities or systems partially or wholly constructed with customer contributions in aid of construction derived from specific surcharges approved by the Commission under TWC § 13.301(j) and 16 TAC § 24.239(q)?
 - a. If so, were these surcharges over and above revenues required for normal operating expenses and return?
 - b. If so, did Southern Horizons provide Texas Water Utilities with a written disclosure relating to the contributions before the date of the sale or transfer?
 - i. Did the disclosure contain the total dollar amount of the contributions?
 - ii. Did the disclosure contain a statement that the contributed property or capital may not be included in invested capital or allowed depreciation expense by the Commission in rate-making proceedings?

Public Interest

7. Will approving the proposed transaction, including the charging of initial rates, serve the public interest under TWC § 13.301(d), (e), and (g) and 16 TAC § 24.239(g)–(h)?
 - a. Has Texas Water Utilities demonstrated adequate financial, managerial, and technical capability for continuous and adequate service to the service area being acquired and to any areas currently certificated to Southern Horizons under TWC §§ 13.301(b), (c), and (e), 13.246(c), and 16 TAC § 24.239(f), (h), and (j)?

- i. Is adequate service currently being provided to the requested area under TWC § 13.246(c)(1) and 16 TAC § 24.239(h)(5)(A)?
- ii. Is there a need for additional service in the requested area under TWC § 13.246(c)(2) and 16 TAC § 24.239(h)(5)(B)?
- iii. What is the effect of approving the transaction on Southern Horizons, Texas Water Utilities, the landowners in the area, and any retail public utility of the same kind already serving the area within two miles of the boundary of the requested area under TWC § 13.246(c)(3) and 16 TAC § 24.239(h)(5)(C)?
- iv. What is the ability of Texas Water Utilities to provide adequate service under TWC § 13.246(c)(4) and 16 TAC § 24.239(h)(5)(D)?
- v. What is the feasibility of obtaining service from an adjacent retail public utility under TWC § 13.246(c)(5) and 16 TAC § 24.239(h)(5)(E)?
- vi. Is Texas Water Utilities able to demonstrate the financial ability to provide the necessary capital investment to ensure the provision of continuous and adequate service to every customer within the requested area under TWC § 13.246(c)(6), TWC § 13.251, and 16 TAC § 24.239(h)(4)?
- vii. What is the effect on the financial stability of Texas Water Utilities, including, if applicable, the adequacy of the debt-equity ratio of Texas Water Utilities if the transaction is approved under 16 TAC § 24.239(h)(5)(F)?
- viii. If Texas Water Utilities has not demonstrated adequate financial capability, should the Commission require Texas Water to provide financial assurance under TWC § 13.246(d) and 16 TAC § 24.239(f)?
- ix. If the Commission requires Texas Water Utilities to provide financial assurance, what form and amount of financial assurance should the Commission require under TWC § 13.246(d) and 16 TAC §§ 24.11 and 24.239(f)?
- x. What impact does this transaction have on the environmental integrity of the requested area under TWC § 13.246(c)(7) and 16 TAC § 24.239(h)(5)(G)?

- xi. Is there a probable improvement of service or lowering of cost to consumers in the requested area resulting from approving the transaction under TWC § 13.246(c)(8) and 16 TAC § 24.239(h)(5)(H)?
 - xii. What is the effect, if any, on the land to be included in the certificated area under TWC § 13.246(c)(9)?
- b. Does Texas Water Utilities have a history of noncompliance with the requirements of the Commission, the Texas Commission on Environmental Quality (TCEQ), or the Department of State Health Services under TWC § 13.301(e)(3)(A) and 16 TAC § 24.239(h)(3)(A)?
 - c. Under 16 TAC § 24.239(h)(5)(I), has Southern Horizons or Texas Water Utilities failed to comply with any Commission or TCEQ order? Have the conditions of any judicial decree, compliance agreement, or other enforcement order not been substantially met?
 - d. Does Texas Water Utilities have a history of continuing mismanagement or misuse of revenues as a utility service provider under TWC § 13.301(e)(3)(B) and 16 TAC § 24.239(h)(3)(B)?
 - e. What is the experience of Texas Water Utilities as a utility service provider under TWC § 13.301(b) and 16 TAC § 24.239(h)(2)?
8. Does the water system being purchased from Southern Horizons have any deficiencies or problems that need correction to be in compliance with the rules of the Commission or TCEQ?
- a. If so, what are those deficiencies or problems?
 - b. What is the estimated cost of addressing these deficiencies or problems?
 - c. How and when will those deficiencies or problems be corrected?
 - d. Does Texas Water Utilities have access to adequate financial resources to timely correct those deficiencies and problems?
9. Should the Commission approve Texas Water Utilities' purchase and transfer of Southern Horizons' water system identified in the application and operated under water CCN number 12863?

Cancellation of Transferor's Certificate of Convenience and Necessity

10. Should the Commission cancel Southern Horizons' water CCN number 12863 under TWC § 13.254(a)?

Amendment of Transferees' Certificates of Convenience and Necessity

11. Does the service area encompassed by this transaction require construction of a physically separate water system?
12. If so, has Texas Water Utilities met the requirements of TWC § 13.241(d) and 16 TAC § 24.227(b)?
13. Is amending Texas Water Utilities' water CCN necessary for the service, accommodation, convenience, or safety of the public under TWC § 13.246(b) and 16 TAC § 24.227(c)?
14. If applicable, what are Texas Water Utilities' efforts to extend retail utility service to any economically distressed areas located within Texas Water Utilities' certificated service areas under 16 TAC § 24.227(g)?
15. Should the Commission amend Texas Water Utilities' CCN to include the uncertificated area described by the supplemented application and the area encompassed by water CCN number 12863?
16. Should the Commission decertify the area Texas Water Utilities has requested to be decertified under TWC § 13.254?
- a. Has service ever been provided by Southern Horizons or Texas Water Utilities to the area that Texas Water Utilities has requested to decertify under TWC § 13.254 and 16 TAC § 24.245(d)?

Post-Transaction Requirements

17. Does Southern Horizons currently retain any customer deposits including any membership fees or other types of retained funds from its members under 16 TAC § 24.239(k) and (l)?
- a. If so, what is the total amount of those retained funds under 16 TAC § 24.239(k)(3)?
 - b. Does Southern Horizons have the proper records to allow retained funds and any unpaid interest to be returned under 16 TAC § 24.239(k)(4)?
 - c. Will retained funds be returned to customers or transferred to Texas Water Utilities under 16 TAC § 24.239(l)?

Initial Rates

18. What are the initial rates Texas Water Utilities is requesting to charge the customers to be acquired from Southern Horizons?
19. Were the initial rates requested by Texas Water Utilities shown in a Texas Water Utilities' tariff filed with the Commission for another water system owned by Texas Water Utilities under TWC § 13.3011(a)(1)?
20. Were the initial rates Texas Water Utilities seeks to implement in force for a different Texas Water Utilities water system on February 2, 2023, the date the application was filed in this proceeding, under TWC § 13.3011(a)(2)?
21. Should the Commission approve the initial rates requested by Texas Water Utilities? If not, what rates should the Commission approve?

Fair Market Valuation

22. Was Texas Water Utilities' notice of intent to use fair market value proper under TWC § 13.305(c)(1) and 16 TAC § 24.238(d)?
23. Did the Commission's executive director select three utility valuation experts to perform appraisals of Southern Horizons under TWC § 13.305(c)(2) and 16 TAC § 24.238(e)?
24. Did the application include copies of the three appraisal reports completed by the utility valuation experts selected by the Commission's executive director under TWC § 13.305(h)(1) and 16 TAC § 24.238(f)(5)?
25. Was the purchase price agreed to by Southern Horizons and Texas Water Utilities included in the application under TWC § 13.305(h)(2)?
26. Was the fair market value for Southern Horizons properly calculated under TWC § 13.305(f) and 16 TAC § 24.238(f)–(j)?
27. Was the ratemaking rate base for Southern Horizons included in the application the lesser of the fair market value or the purchase price agreed to by Southern Horizons and Texas Water Utilities under TWC § 13.305(g) and (h)(3) and 16 TAC § 24.238(b)(3)–(4)?

28. Were the known transaction and closing costs incurred by Texas Water Utilities to be requested for review and recovery in Texas Water Utilities' rate base in a future rate case included in the application under TWC § 13.305(g) and 16 TAC § 24.238(k)?

III. Effect of Preliminary Order

The Commission's discussion and conclusions in this Order regarding threshold legal and policy issues should be considered dispositive of those matters. Questions, if any, regarding threshold legal and policy issues may be certified to the Commission for clarification if the SOAH ALJ determines that such clarification is necessary. As to all other issues, this Order is preliminary in nature and is entered without prejudice to any party expressing views contrary to this Order before the SOAH ALJ at hearing. The SOAH ALJ, upon his or her own motion or upon the motion of any party, may deviate from the non-dispositive rulings of this Order when circumstances dictate that it is reasonable to do so. Any ruling by the SOAH ALJ that deviates from this Order may be appealed to the Commission. The Commission will not address whether this Order should be modified except upon its own motion or the appeal of a SOAH ALJ's order. Furthermore, this Order is not subject to motions for rehearing or reconsideration.

Signed at Austin, Texas the _____ day of _____ 2024.

PUBLIC UTILITY COMMISSION OF TEXAS

THOMAS J. GLEESON, CHAIRMAN

LORI COBOS, COMMISSIONER

JIMMY GLOTFELTY, COMMISSIONER

KATHLEEN JACKSON, COMMISSIONER