

# Public Utility Law Section 2018 Annual Conference

*Latest Hot Topics in the Water Utility Industry*

*August 10, 2018*

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## *Hot Topics:*

- Wholesale Rate Appeals
- CCNs, Cities, and Annexation

# Wholesale Rate Appeals

## *Hot Topic #1*

- Agency review of contractual rates has evolved over the decades, and accelerated since 2014.
  - ❖ Water Code Provisions (based on early statutes):
    - § 11.036 – water used with or without contract
    - § 11.041 – denial of water from conserved or stored supply
    - § 12.013 – wholesale water furnished by a city to another political subdivision.

- Water Code Chapter 13:
  - § 13.043(f) – review of reasonableness of charges by wholesale provider.
  - § 13.044 – de novo review where special district required to purchase from a city.
- Case law in 1960's and 1970's - expanded rate jurisdiction to contracts other than property owners adjacent to irrigation canals.

- 1985 – rate review jurisdiction transferred from Public Utility Commission to Texas Water Commission.
- What did TWC/TCEQ do?
  - Agencies can't adjudicate contract rights – *Railroad Comm'n v. City of Austin*, 512 S.W.2d 345 (Tex.Civ.App. – Austin 1974).
  - *Texas Water Comm'n v. City of Fort Worth*, 875 S.W.2d 332 (Tex.App. – Austin 1994, no pet.):

Even with the agreement of parties, the agency may not review contractual rates without **first** finding the rate adversely affects the public interest by being unreasonably preferential, prejudicial, or discriminatory.

New rules adopted by TWC in order to comply with *Fort Worth* opinion – now 16 TAC §§ 24.128 -.138. Formalize bifurcated process for review of rates.

- Before getting started– are rates charge pursuant to a contract?
  - No – go straight to SOAH for evidentiary hearing on the rate.
  - Yes – go to SOAH for evidentiary hearing on public interest.
- First hearing– determination of public interest.
- Second hearing – determination of appropriate rates.

# What is this thing called “public interest”?

- How can you tell if it has been violated?
- Rule defines public interest by applying criteria for its violation.

§ 24.133 – A rate adversely affect the public interest if at least one of four criteria have been violated:

1. The rate impairs the seller's ability to continue to provide service – based on financial integrity and operational capability.
2. The rate impairs the purchaser's ability to do so.



3. The rate evidences the seller's abuse of monopoly power. PUC must weigh "all relevant factors," including:
  - a. disparate bargaining power of parties – any alternatives for purchaser?
  - b. seller failed to reasonably demonstrate changed conditions as basis for change in rates;
  - c. seller changed the computation of the revenue requirement from one methodology to another;
  - d. other valuable consideration received by a party incident to the contract;

- e. incentives necessary to encourage regional projects or water conservation methods;
- f. seller's obligation to meet federal and state discharge and drinking water standards;
- g. rates charged in Texas by other sellers for resale of water or sewer service;
- h. the seller's rates charged to its retail customers, compared to retail rates charged by the purchaser as a result of the wholesale rates charged by the seller.

4. The protested rate is unreasonably preferential, or discriminatory, compared to the wholesale rates the seller charges other wholesale customers.

§ 24.133(b): The PUC shall not determine public interest based on an analysis of the seller's cost of service.

## § 24.31. Cost of Service.

- The cost of rendering service – includes allowable expenses and return on invested capital.
- Listing of allowable expenses – O&M, depreciation, taxes, trade association memberships, advertising and donations.
- Listing of non-allowable expenses – advocacy, political candidates, religious causes, support for increased consumption of water, and the like.
- Description of methods of calculating return on invested capital (aka rate base).

# Wholesale Rate Appeals

Back to wholesale rate appeals:

- SOAH hearing on public interest; PFD with FoF and CoL on whether rates adversely affect the public interest.
- PUC finds no adverse affect on public interest – final order dismissing/denying the petition.

# Wholesale Rate Appeals

PUC finds adverse affect on public interest – remand to SOAH for hearing on the rates; NOT a final order.

- Within 90 days, seller must file a cost of service study and information supporting the rates.
- SOAH hearing on rates; PFD; Commission sets rates consistent with Chapters 12 and 13 to calculate the cost of service.

Number of cases in which the TWC/TCEQ found  
wholesale rates to be adverse to public interest: 0

Number of cases, to date, in which the PUC has found  
wholesale rates to be adverse to public interest: 0

# Wholesale Rate Appeals

*So, what's the point?*

TWC/TCEQ – Referral to SOAH; public interest hearing based on the rule.

PUC – Referral to SOAH with Preliminary Order setting out issues to be determined and issues not to be determined.



## 2014 – 2016 PUC Preliminary Orders (about 5 pages)

- Issues to be addressed:

- Jurisdiction?
- Is petition sufficient under rules?
- Is rate charged pursuant to a written contract?
- If so, has petitioner met its burden of proving rate adversely affects the public interest criteria listed in 24.133(a)?
- Should interim rates be set?

# Wholesale Rate Appeals

2017 – PUC Preliminary Order in Docket No. 46662 (Cities of Garland, Mesquite, Plano, and Richardson appealing rate charged by North Texas Municipal Water District) (28 pages)

- Issues to be addressed include all of the above, plus:
  - Are rates just and reasonable; unreasonably preferential, prejudicial, or discriminatory, sufficient, equitable, and consistent in application to each class of customer?

# Preliminary Order Issues

- What is the seller's cost of debt?
- What are the seller's costs to operate and maintain its facilities and systems?
- What is the total cost to run the seller's systems?
- What are the seller's annual gross revenues?
- What are the seller's net revenues?

# Preliminary Order Issues

- Are any of the outstanding bonds of the seller payable from or secured by ad valorem taxes in whole or in part?
- What is the total capacity of the seller to deliver water?
- What is the total demand for water on an average basis?
- What is the minimum take of each of the seller's member cities?

# Preliminary Order Issues

- What entities other than member cities purchase water from the seller?
  - Under what terms?
  - What is gross amount of revenues received?
  - Is any revenue pledged to support any bonds issued by the seller?
  - How is this revenue accounted for in determining rates?
  - Is any such revenue used to offset the member cities' annual payment?
- How is the cost responsibility to run, operate, and maintain the district allocated?

# Wholesale Rate Appeals

## Points to Ponder:

- Preliminary Orders in all wholesale rate appeals since 46662 are similar.
  - Now up to 51 issues (counting sub-parts) – many of which address cost of service components.
- Starting in Docket 47742, issue not to be addressed: Whether the Commission has the authority to revise rates for water service established by contract.
- Staff testimony in Docket 46662 suggests take-or-pay provisions in a wholesale contract violate the public interest.

Stay tuned – Public Interest HOM in 46662 set for October.

## ***Hot Topic #2: CCNs, Cities, and Annexations***

Certificate of Convenience and Necessity (CCN) – an exclusive service area in exchange for the provision of continuous and adequate retail utility service.

- Can be dually-certified with another provider; generally by agreement only.

CCNs also were “there and back again” – started at PUC in 1975; transferred to Texas Water Commission in 1986; back to PUC in 2014.

# Who needs a CCN in order to provide retail utility service?

- Investor-owned utilities, water supply or sewer service corporations providing potable water to the public, or sewage disposal services for the public (fewer than 15 connections – may be exempt).



Who doesn't need CCN, but can get one?

- Cities, other political subdivisions of the state, but can't interfere with another utility's CCN area.

# How can you lose a CCN?

Traditionally –

- failure to provide continuous and adequate service in all or part of the area,
- agree in writing to allow another utility to provide service without amending the CCN,
- failure to file a cease and desist action when CCN holder becomes aware of service in the area by another utility. § 13.254(a).

## Cracks in the armor:

- Owner of 50 acres or more, not platted, not actually receiving service – petition for “expedited” release.

Essentially has to show a better service deal is available from another provider.

§ 13.254(a-1).

## More cracks:

- Owner of 25 acres or more in certain counties, not receiving service – petition for “streamlined expedited” release.
  - No showing of better deal required. (33 counties – large cities and surrounding counties.)
  - By statute, existence of federal debt is irrelevant
- Area incorporated or annexed by a city within CCN of WSC, SUD, or FWSD (or other if service area is entirely within Houston). § 13.255.
  - City is entitled to be singly-certified.

Compensation for economic impact caused by loss of CCN area required by § 13.254 and § 13.255.

- Commission must determine if property is rendered useless or valueless to the decertified retail public utility.
- Generally same process for both 13.254 and 13.255.
- § 24.113(n), (o).

## CCNs and Annexation – what's up?

General law cities (generally under 5,000 population) for most annexations must receive request from landowners or voters prior to annexing additional areas.

- Cities with 1,000 – 5,000 may annex unilaterally if providing the area with water or sewer service (plus other considerations). Loc. Gov't Code § 43.033.

Home Rule cities (generally over 5,000 population, with charter) could unilaterally annex areas.

## **Annexation - big changes in 2017 – S.B. 6 – very complicated.**

- Tier 1 counties – less than 500,000 population.
- Tier 2 counties – is not a Tier 1 county, or is a Tier 1 county that voted to be a Tier 2 county.
- Tier 1 municipality – city located in one or more Tier 1 counties proposing to annex area located in one or more Tier 1 counties.
- Tier 2 municipality – city located wholly or partly in Tier 2 county, or wholly located in one or more Tier 1 counties that proposes to annex area wholly or partly located in a Tier 2 county.

# Got that?

Tier 2 counties (by population):

Harris, Dallas, Tarrant, Bexar, Travis, Hidalgo, El Paso, Denton, Fort Bend.

- In order for Tier 2 municipalities to annex areas, must obtain landowner and/or voter approval of annexations.
- Numerous provisions making it much harder to annex areas by these cities.
  - Could impact cities' ability to use § 13.255 to gain single CCN.
  - Could incentivize cities to condition provision of utility service on annexation.
  - Could impact cities' decision to seek or keep CCN.



16 TAC § 24.85(a) – every retail public utility shall serve each qualified service applicant within its CCN.

- Qualified Service Applicant: an applicant who has met all of the retail public utility's requirements contained in its tariff, schedule of rates, or service policies and regulations for extension of service.

## Cities' service policies and regulations:

- Utility service ordinances may require out-of-city applicants for service to petition for annexation as a condition of receiving service.
- Voluntary annexation is outside voting/approval requirements of S.B. 6 (avoids Tier 2 restrictions).

If city holds a CCN for the area, is it meeting obligation of § 24.85(a) to provide service to all qualified applicants?

If the annexation petition isn't provided, is the applicant a "qualified applicant"?

## PUC Docket No. 48489 – *Complaint of Consolidated Towne East Holdings, Ltd, against the City of Laredo* (June 2018)

- Property outside city limits, within city's water and sewer CCNs and ETJ.
- Owner requested development approval and utility service.
- City required petition for voluntary annexation as condition for utility services.
- Owner claims annexation imposes significant financial burden – so high as to constitute a denial of service.

## City contests jurisdiction:

- Owner is asking PUC to approve the plat.
- Tex. Water Code § 13.2501 and Loc. Gov't Code § 212.0115 prohibit provision of utility services unless plat has been approved.

City denies it has refused service – refers to provisions of interlocal agreement.

- Annexation requirement in effect for many years.
- City is not required to make development profitable.

Staff's position:

- The CCNs give PUC jurisdiction over the complaint.
- Beyond that – this needs to go to SOAH.

Is the property owner a “qualified applicant”?

Can the city condition provision of utility service upon receipt of a request for annexation?

No preliminary order yet – stayed tuned.

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QUESTIONS?