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State Office of Administrative Hearings

Kristofer S. Monson
Chief Administrative Law Judge

June 29, 2023

Stephen Journeay, Commission Counsel
Commission Advising and Docketing Management
William B. Travis State Office Building
1701 N. Congress, 7th Floor
Austin, Texas 78701

VIA EFILE TEXAS

RE: SOAH Docket No. 473-20-4071.WS; PUC Docket No. 50788; Ratepayers Appeal of the Decision by Windermere Oaks Water Supply Corporation to Change Water and Sewer Rates

Dear Mr. Journeay:

Please find attached a Proposal for Decision (PFD) in this case. By copy of this letter, the parties to this proceeding are being served with the PFD.

Please place this case on an open meeting agenda for the Commissioners' consideration. Please notify the undersigned Administrative Law Judges and the parties of the open meeting date, as well as the deadlines for filing exceptions to the PFD, replies to the exceptions, and requests for oral argument.

Enclosure

CC: Service List

SOAH Docket No. 473-20-4071 **Suffix: WS**
PUC Docket No. 50788

BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS

RATEPAYERS APPEAL OF THE DECISION BY WINDERMERE OAKS WATER SUPPLY CORPORATION TO CHANGE WATER AND SEWER RATES

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SOAH Docket No. 473-20-4071 **Suffix: WS**
PUC Docket No. 50788

BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS

RATEPAYERS APPEAL OF THE DECISION BY WINDERMERE OAKS WATER SUPPLY CORPORATION TO CHANGE WATER AND SEWER RATES

PROPOSAL FOR DECISION

The ratepayers (Ratepayers) appealed the Windermere Oaks Water Supply Corporation's decision to recover the cost of certain outside legal expenses through water and sewer base rates. The Staff of the Public Utility Commission of Texas (Commission) supports removing the legal expenses from the revenue requirement. For the reasons explained below, the administrative law judges (ALJs) find that it was reasonable for Windermere to include the outside legal expenses in base rates, but that it failed to properly offset the revenue requirement with other revenues. Therefore, the ALJs recommend that the Commission grant this appeal, fix rates as set out herein, and award the rate-case-expense amount supported by Windermere.

I. JURISDICTION, NOTICE, AND PROCEDURAL HISTORY

The Commission has jurisdiction over this matter pursuant to Texas Water Code section 13.043. The State Office of Administrative Hearings (SOAH) has jurisdiction over matters relating to the conduct of the hearing and issuance of a proposal for decision (PFD) pursuant to Texas Government Code section 2003.049.

On February 11, 2020,[1] Windermere's board of directors approved a rate increase that took effect on March 23, 2020. Within 90 days, on April 27, 2020, the Ratepayers appealed the board's decision. The petition was signed by 52 of 271 active connections. The Commission found the petition sufficient and referred the case to SOAH, requesting the assignment of an ALJ to conduct a hearing and issue a PFD, if necessary.

A hearing on the merits convened in December 2021, resulting in a PFD recommending dismissing this matter.[2] On June 30, 2022, the Commission remanded this matter to SOAH, finding that the ALJs erred by addressing, as a threshold matter, only whether the appealed rates were unreasonably preferential, prejudicial, or discriminatory, without also addressing whether the rates were just and reasonable.

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[1] The parties refer to the date governing body made its decision alternatively as February 1 and February 11, 2020. Evidence shows that the rates were approved at the February 11, 2020 board meeting. WOWSC Ex. 2 (Gimenez Dir.), Attachments JG-7 (February 11, 2020 board meeting minutes) and JG-1 (Tariff approved on February 11, 2020); WOWSC Ex. 3 (Gimenez Reb.), Attachments JG-24 (Feb. 1, 2020 board meeting, considering budget) and JG-39 (identical to JG-7). Accordingly, the ALJs find the relevant date to be February 11, 2020.

[2] *Ratepayers Appeal of the Decision by Windermere Oaks Water Supply Corporation to Change Water and Sewer Rates*, Docket No. 50788, Proposal for Decision (Mar. 31, 2022).

On remand, the ALJs allowed supplemental testimony to address customer characteristics and variable rates.[3] Windermere filed supplemental direct testimony of Grant Rabon. Staff filed supplemental direct testimony of Stephen Mendoza and Anna Givens. Ms. Givens also adopted the testimony of Staff witness Maxine Gilford. Windermere filed supplemental rebuttal testimony of Mike Nelson, Joe Gimenez, and Jamie Mauldin. Ms. Mauldin also filed supplemental direct testimony on rate-case expenses.

A second hearing on the merits convened on March 22, 2023, via videoconference. After the hearing, WOWSC exhibits 35, 36, 37, 38, 39, 40, 42, and 44 were admitted under the rule of optional completeness.[4] The record closed on May 2, 2023, with the submission of reply briefs.

II. SCOPE OF REVIEW

An appeal under section 13.043(b) of the Water Code shall be heard de novo, considering only the information available to the governing body at the time it made its decision, and shall fix in its final order the rates the governing body should have fixed in the action from which the appeal was taken.[5] Information available after the

[3] SOAH Order No. 23 at 2 (Sept. 26, 2022).

[4] SOAH Order No. 33 (Apr. 27, 2023).

[5] Tex. Water Code § 13.043(e).

rate decision may also be considered to the extent that it sheds light on what conditions existed at the time of the decision.[6]

The scope of appellate review is further set out in section 13.043(j), which states, in relevant part—

> In an appeal under this section, the utility commission shall ensure that every appealed rate is just and reasonable. Rates shall not be unreasonably preferential, prejudicial, or discriminatory but shall be sufficient, equitable, and consistent in application to each class of customers.

On remand, the Commission clarified that this language requires three initial inquiries: (1) whether the rates are just and reasonable; (2) whether they are unreasonably preferential, prejudicial, or discriminatory; and (3) whether they are sufficient, equitable, and consistent in application.[7] Upon finding that the rates run afoul of any of these criteria, the Commission shall fix the rates the governing body should have fixed in the action from which the appeal was taken, using "a methodology that preserves the financial integrity of the retail public utility."[8]

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[6] *Ratepayers Appeal of the Decision by Bear Creek Special Utility District to Change Rates*, Docket No. 49351, Order on Rehearing, Conclusion of Law 7A (Nov. 19, 2021). *See also Petition for Review of Certain Rate Making Actions of the City of Austin*, Docket No. 6560, Examiner's Report at 15 (Apr. 16, 1986). The Examiner's Report in Docket No. 6560 (after amendment in respects not relevant here) was adopted by the Commission. Docket No. 6560, Order at 1 (Apr. 25, 1986); *see also Petition by Homeowners United for Rate Fairness to Review Austin Rate Ordinance No. 20120607-055*, Docket No. 40627, Supplemental Preliminary Order at 6 (Dec. 13, 2012).

[7] Order Remanding Proceeding at 3-5 (June 30, 2022).

[8] Tex. Water Code § 13.043(e), (j).

Finally, the Commission may also consider evidence of reasonable expenses incurred by the retail public utility in the appeal proceedings.[9]

III. DISCUSSION

The primary issue in this appeal is whether Windermere's rates should include certain outside legal expenses relating to three lawsuits stemming from a 2015-2016 sale of corporate land to a then-board member, Dana Martin. To finance the legal expenses while maintaining normal operations, Windermere included $171,337 in base rates.[10]

Ratepayers and Staff argue that the inclusion of these outside legal expenses in rates is not just and reasonable, and therefore, the expenses should be removed from the revenue requirement. Windermere asserts that the outside legal expenses were necessary and justified, and therefore, their inclusion in rates is just and reasonable.

Ratepayers further allege a panoply of wrongdoings by Windermere board members involving failures to comply with its bylaws, articles of incorporation, tariff, the Internal Revenue Code, and bank loan covenants, citing information available after the board made its decision, or without any citation. These arguments are addressed only to the extent they are supported by relevant facts, authority, citation,

[9] Tex. Water Code § 13.043(e).

[10] Throughout this proposal for decision, "base rates" refers to the fixed monthly charge, which was appealed, as distinguishable from the variable volumetric charge, which was not.

cogent argument, within the scope of this proceeding, and not raised for the first time in reply briefs.[11] Therefore, much of Ratepayers' argument is not addressed.[12]

A. BACKGROUND

1. The Corporation

Windermere is a non-profit water supply and sewer service corporation subject to chapters 49 and 67 of the Water Code, as well as the Texas Business Organizations Code.[13] Windermere is managed by a member-elected board of directors.[14] Directors must be members and customers of the corporation.[15] Although directors are authorized to receive compensation for their services, Windermere's directors do not.[16] Windermere serves approximately 271 water connections and 245 sewer connections.[17] Of these, many residential connections are

[11] SOAH Order No. 31 at 2-3.

[12] *See* WOWSC HOM2 Reply Brief at 4 ("Because Ratepayers' factual and legal misstatements are too widespread to fully address in the body of this brief, WOWSC prepared a spreadsheet detailing each unsupported statement of fact, misstatement of fact and law, and mischaracterization of evidence in the record."), Exhibit 1.

[13] WOWSC Ex. 2 at 5 (Gimenez Dir.); Tex. Water Code § 67.004 (stating that water supply corporations are subject to the Texas Non-Profit Corporation Act). The Texas Non-Profit Corporation Act was repealed January 1, 2010, and is now chapter 22 of the Business Organizations Code. House Comm. on Bus. & Indus., Bill Analysis at 1, Tex. H.B. 1156, 78th Leg., R.S. (2003) ("Unless otherwise noted, the provisions of this Code are nonsubstantive revisions of comparable provisions found in the ... Texas Non-Profit Corporation Act...."); *id.* at 63 ("Chapter 22 codifies the provisions relating to nonprofit corporations currently located in Art. 1396-1.01 *et seq.*"); Tex. Bus. Orgs. Code § 2.010(2) ("A nonprofit corporation may not be organized or registered under this code to conduct its affairs in this state to . . . engage in water supply or sewer service except as an entity incorporated under Chapter 67, Water Code.").

[14] WOWSC Ex. 2 at 5-6 (Gimenez Dir.); Tex. Water Code §§ 67.005-.0075.

[15] WOWSC Ex. 2 at 5-6 (Gimenez Dir.); Tex. Water Code § 67.0051(a)(2).

[16] WOWSC Ex. 2 at 6 (Gimenez Dir.), Attachment JG-2 (Bylaws); Tex. Water Code § 67.006(c).

[17] WOWSC Ex. 2 (Gimenez Dir.) at 9; WOWSC Ex. 8 (Nelson Reb.) at 7.

second homes, and approximately 75 are airport hangars.[18] One hangar, Windermere Hangars, used by four entities, was constructed before the corporation was formed and previously received water from another service provider.[19] Windermere has one class of members, as defined by the Water Code.[20] Windermere's system has experienced, and expects, significant customer growth.[21]

2. The Land Sale

In December 2015, Windermere's board voted to sell 4.3 acres of airport land to then-board member, Dana Martin, for $200,000.[22] However, the board failed to include the subject of the prospective sale in the notices of the public meetings approving the sale, as required by the Texas Open Meetings Act (TOMA).[23] The sale closed in 2016.

3. The Lawsuits

A group of ratepayers (including Patti Flunker) sought to undo the land sale and, in March 2018, sued Windermere on grounds that the board acted without

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[18] WOWSC Ex. 2 (Gimenez Dir.) at 20; WOWSC Ex. 26 (Gimenez Supp. Dir.) at 15.

[19] Staff HOM2 Ex. 17 (Windermere response to Staff RFI No. 6-10).

[20] Tex. Water Code § 13.002(11) ("Member" means a person who holds a membership in a water supply or sewer service corporation and is a record owner of a fee simple title to property in an area served by a water supply or sewer service corporation or a person who is granted a membership and who either currently receives or will be eligible to receive water or sewer utility service from the corporation. In determining member control of a water supply or sewer service corporation, a person is entitled to only one vote regardless of the number of memberships the person owns.).

[21] WOWSC Ex. 2 (Gimenez Dir.) at 12; WOWSC Ex. 26 (Gimenez Supp. Reb.) at 6.

[22] WOWSC Ex. 2 (Gimenez Dir.), Attachment JG-12 at 7; WOWSC Ex. 3 (Gimenez Reb.) at 12, Attachment JG-21 at 8. In 2015, the board consisted of Bob Mebane, Pat Mulligan, Mike Madden, Dana Martin, and Bill Earnest. WOWSC Ex. 3 (Gimenez Reb.), Attachment JG-21 at 8-9.

[23] Tex. Gov't Code § 551.041.

proper notice under the TOMA (the *TOMA Lawsuit*).[24] The trial court, on November 14, 2018, and court of appeals, on June 21, 2019, both denied the requested remedy, on grounds that the land sale was no longer voidable, and the Texas Supreme Court refused review.[25]

Separately, in July 2018, many of the same ratepayers, as well as Double F Hangar Operations, LLC, sued Windermere and five former directors in their capacity as directors for their involvement in the land transaction (the *Double F Hangar Lawsuit*).[26] Alleging that the land was sold "for a fraction of its market value," the plaintiffs sought to compel Windermere to initiate a lawsuit against Ms. Martin to break the land sale contract. Subsequently, the plaintiffs amended their suit to name three active directors in their capacity as directors.[27] As such, Windermere retained multiple law firms to provide proper defenses for both the corporation and its directors.[28] However, according to Windermere President Mr. Gimenez, breaking the sales contract would have subjected Windermere to legal

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[24] WOWSC Ex. 2 (Gimenez Dir.) at 17-18; WOWSC Ex. 3 (Gimenez Reb.) at 9; *TOMA Integrity v. Windermere Oaks Water Supply Corp.*, No. 47531 (33rd Dist. Ct., Burnet County, Tex. Dec. 12, 2017) (*TOMA Lawsuit*).

[25] WOWSC Ex. 26 (Gimenez Supp. Reb.) at 9; *TOMA Integrity, Inc. v. Windermere Oaks Water Supply Corp.*, No. 06-19-00005-CV, 2019 WL 2553300 (Tex. App.—Texarkana June 21, 2019, pet. denied).

[26] WOWSC Ex. 2 (Gimenez Dir.) at 18-19; WOWSC Ex. 3 (Gimenez Reb.), Attachment JG-25 (*Double F Hangar Lawsuit* First Amended Petition) at Bates 19, 26; *Rene Ffrench, John Richard Dial, Stuart Bruce Sorgen, and as Representatives for Windermere Oaks Water Supply Corporation v. Friendship Homes & Hangars, LLC, WOWSC, and its Directors William Earnest; Thomas Michael Madden; Dana Martin; Robert Mebane, and Patrick Mulligan (originally styled Double F Hangar Operations, LLC, Lawrence R. Ffrench, Jr., Patricia Flunker, and Mark A. McDonald v. Friendship Homes & Hangars, LLC, and Burnet County Commissioners Court*, No. 48292 (33rd Dist. Ct., Burnet County, Tex. July 9, 2018) (*Double F Hangar Lawsuit*).

[27] WOWSC Ex. 2 (Gimenez Dir.) at 19.

[28] WOWSC Ex. 3 (Gimenez Reb.) at 7, Attachment JG-22 at 19-20.

liability and countersuits.[29] Thus, Windermere concluded that the claims offered limited upside and, as such, took "a neutral stance," refraining from acceding to plaintiffs' claims to avoid incurring additional legal costs.[30] This litigation was ongoing at the time of the board's decision to increase rates.

At the same time, the plaintiffs in these lawsuits began requesting information from the corporation under the Texas Public Information Act (PIA).[31] The number of PIA requests grew from an average of four per year to 46 in 2019.[32] This volume placed significant demand on the corporation's resources and required hiring a Public Information Officer and legal counsel to ensure compliance with the PIA and avoid future lawsuits.[33]

One PIA request, submitted on May 28, 2019, by Danny Flunker, sought "all legal invoices from 3/7/18 to today's date," which encompassed information relating to the pending lawsuits.[34] Windermere sought to withhold the information as privileged.[35] The Texas Attorney General initially determined the information

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[29] WOWSC Ex. 3 (Gimenez Reb.) at 12.

[30] WOWSC Ex. 3 (Gimenez Reb.) at 12.

[31] WOWSC Ex. 2 (Gimenez Dir.) at 14-15, 21; *see also* Voluminous Attachment to WOWSC Ex. 3 (PIA requests); Staff Ex. 4 (Gilford Dir.) at 9 ("A review of these requests indicates that many of them were, in some way, connected to the ongoing litigation."), Attachment MG-8.

[32] WOWSC Ex. 2 (Gimenez Dir.) at 14; WOWSC Ex. 3 (Gimenez Reb.) at 25-26.

[33] WOWSC Ex. 2 (Gimenez Dir.) at 14-15, 21; *see also* Voluminous Attachment to WOWSC Ex. 3 (PIA requests); Staff Ex. 4 (Gilford Dir.) at 9 ("A review of these requests indicates that many of them were, in some way, connected to the ongoing litigation."), Attachment MG-8 (Windermere response to Staff RFI No. 2-3).

[34] WOWSC Ex. 3 (Gimenez Reb.), Attachment JG-34 at 1, 11.

[35] WOWSC Ex. 3 (Gimenez Reb.), Attachment JG-34 at 9-10 (June 12, 2019 Letter to Attorney General Ken Paxton).

was not privileged.[36] In September 2019, Windermere sued to prevent disclosure (the *Paxton Lawsuit*).[37] This case was pending at the time the board made its decision to change rates.

Mr. Gimenez also testified to the attendant circumstances occurring in conjunction with the lawsuits. In spring of 2019, Patti Flunker, along with plaintiffs in the *Double F Hangar Lawsuit*, ran for seats on the board of directors—and were not elected.[38] Some of the same litigants attempted unsuccessfully to recall Mr. Gimenez.[39] Some of the same litigants began posting video recordings of board meetings and depositions online. These activities increased the involvement of outside counsel, for fear of litigation regarding board action.[40]

4. Legal Expenses (Preliminary Order (PO) Issue 8)

As the legal demands continued, the costs mounted. Historically, Windermere's annual legal expenses were less than $3,000.[41] However, in 2018, Windermere spent $37,981 defending itself in the *TOMA Lawsuit*.[42] In 2019, costs rose higher still. In the *Double F Hangar Lawsuit* discovery and depositions began in

[36] WOWSC Ex. 3 (Gimenez Reb.), Attachment JG-34 at 22-25 of 33.

[37] WOWSC Ex. 3 (Gimenez Reb.) at 9-10, Attachment JG-34 at 26; WOWSC Ex. 26 (Gimenez Supp. Reb.) at 8.

[38] WOWSC Ex. 2 (Gimenez Dir.) at 6.

[39] WOWSC Ex. 2 (Gimenez Dir.) at 21-22.

[40] WOWSC Ex. 2 (Gimenez Dir.) at 19.

[41] WOWSC Ex. 2 (Gimenez Reb.) at 18; WOWSC Ex. 7 (Nelson Dir.), Attachment MN-5 at 2.

[42] WOWSC Ex. 2 (Gimenez Dir.) at 17.

September and October of 2019.[43] The November 2019 legal invoices from Lloyd, Gosselink, Rochelle & Townsend, P.C. (Lloyd Gosselink) were $30,012 for services rendered in the *TOMA* and *Double F Hangar lawsuits*, and $17,579 for general counsel services.[44] For the same month, the Enoch Kever law firm billed $14,488.[45] Overall, the 2019 legal expenses soared to $166,000 (over $100,000 in late 2019 alone) for litigation that was likely to continue into 2020 or beyond.[46]

According to Mr. Gimenez, Windermere attempted to mitigate legal expenses associated with the *Double F Hangar Lawsuit* by entering into a settlement agreement to recover an extra $20,000 from Ms. Martin through mediation.[47]

5. Allied World's Action

To cover the costs of defending itself in the *Double F Hangar Lawsuit*, Windermere submitted a claim to its insurance provider, Allied World Specialty Insurance Company (Allied World).[48] On December 19, 2019, Allied World denied coverage, citing multiple exclusions, including the Profit, Advantage or Remuneration exclusion for expenses incurred due to "the insured gaining any profit, advantage, or remuneration to which the insured is not legally entitled," as well as the Violation of Law exclusion for damages, defense expenses, "costs, or loss

[43] WOWSC Ex. 3 (Gimenez Reb.) at 7; Tr. at 254 (Gimenez Dir.) (Dec. 2, 2021).

[44] WOWSC Ex. 3 (Gimenez Reb.) at 7; Tr. at 255 (Gimenez Dir.) (Dec. 2, 2021).

[45] WOWSC Ex. 3 (Gimenez Reb.) at 7.

[46] WOWSC Ex. 2 (Gimenez Dir.) at 17-18; WOWSC Ex. 7 (Nelson Dir.) at 6.

[47] WOWSC Ex. 3 (Gimenez Reb.) at 18-19; WOWSC Ex. 26 (Gimenez Supp. Reb.) at 10-11.

[48] The insurance claim submission is not in evidence. The ALJs infer this fact from the denial.

arising from an insured's willful violation of any federal, state, or local law, rule, or regulation."[49]

On February 1, 2020, the board announced it had hired the Shidlofsky Law Firm to review this claim and challenge the denial of coverage in federal court.[50] This action resulted in additional legal fees that Windermere would incur.[51]

6. Other Financial Commitments

At the same time, Windermere faced other financial commitments related to system operation improvements. These improvements included acquiring a new pumping barge, a propane generator, updating SCADA[52] system software, a new security system, and other improvements to serve customer growth.[53] Windermere also made a financial commitment to conservation projects to receive matching grant money from the Lower Colorado River Authority.[54]

In January of 2020, Windermere had $136,079 in financial commitments for operational improvements, with only $150,000 of liquid assets in the bank, and an outstanding loan balance of $224,546.[55]

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[49] WOWSC Ex. 3 (Gimenez Reb.), Attachment JG-26 at 9-10.

[50] WOWSC Ex. 3 (Gimenez Reb.) at 18, Attachment JG-24 at 6.

[51] Tr. at 300, 363 (Gimenez Cross, Redir.)(Dec. 2, 2021).

[52] SCADA is an acronym for Supervisory Control and Data Acquisition.

[53] WOWSC Ex. 2 (Gimenez Dir.) at 8-9, 12.

[54] WOWSC Ex. 2 (Gimenez Dir.) at 11-12; WOWSC Ex. 3 (Gimenez Reb.) at 8.

[55] WOWSC Ex. 3 (Gimenez Reb.) at 7-8; WOWSC Ex. 7 (Nelson Dir.), Attachment MN-3 (Dec. 31, 2019, Summary

Windermere treasurer Mike Nelson testified that Windermere set up a payment agreement with Lloyd Gosselink and Enoch Kever to pay each firm $10,000 per month until the balance of its legal fees was paid off.[56] Therefore, Windermere included $250,000 for legal expenses in its 2020 budget.[57] With this inclusion, the 2020 budget showed a net loss of $174,515.[58] Windermere determined that it was not feasible to pay the entirety of its legal bills without depleting its operating cash.[59] When Allied World denied coverage, Windermere recognized that it would have to increase rates to ensure system integrity.[60]

7. The Board's Decision

Sometime in early 2020, Windermere consulted the Texas Rural Water Association (TRWA) regarding increasing rates to maintain the financial integrity of the corporation.[61] Using Windermere's 2019 year-end financials, TRWA performed a rate analysis, which determined a total revenue requirement of $576,192 on a

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of Income/Expenses).

[56] Tr. 198-99 (Nelson Cross) (Dec. 1, 2021); *see also* Staff HOM2 Ex. 41 (Windermere response to Staff RFI No. 8-5 at 1-2).

[57] Staff HOM2 Ex. 41 at 2 (showing that WOWSC's 2020 budget grouped "appraisal" and "legal" expenses together, totaling $250,000); *see, e.g.*, WOWSC Ex. 27 (Nelson Supp. Reb.), Attachment MN-12 at 13 (showing the February 2022 budget related to underlying lawsuits was $20,000).

[58] WOWSC Ex. 7 (Nelson Dir.) at 9, Attachment MN-4 (2020 budget); *see also* Staff HOM2 Ex. 41 (Windermere response to Staff RFI No. 8-5) (identical).

[59] WOWSC Ex. 3 (Gimenez Reb.) at 7-8.

[60] WOWSC Ex. 3 (Gimenez Reb.) at 17.

[61] WOWSC Ex. 3 (Gimenez Reb.) at 7. Although the TRWA rate analysis was clearly available at the time the board made its rate decision, the exact date that Windermere contacted TRWA to conduct the analysis is not clear from the record.

cash-needs basis.[62] Of this, $171,337 was listed for legal fees identified in the 2020 budget.[63] The TRWA rate analysis resulted in a base rate of $174.59 per month for water and sewer combined.[64]

On February 11, 2020, Windermere's board of directors approved the rates that are subject to this appeal.[65] The board approved a base rate of $156.80.[66] This rate was lower than the rate in the TRWA analysis because, unlike TRWA, Windermere did not update its depreciation rates to minimize the burden on its members as it addressed the 2020 budget shortfall.[67] This rate is allocated as $90.39 for water and $66.41 for wastewater, a 60%/40% split.[68] There was no change to the gallonage rates, which were not appealed.[69] Mr. Gimenez testified that the board's

[62] WOWSC Ex. 7 (Nelson Dir.) at 6, 8, Attachment MN-2; Staff HOM2 Ex. 25 (Windermere supp. response to Staff RFI No. 1-1); Staff HOM2 Ex. 26 (Windermere response to RFI No. 1-5).

[63] WOWSC Ex. 7 (Nelson Dir.), Attachment MN-2; Staff HOM2 Ex. 25 (Windermere supp. response to Staff RFI No. 1-1).

[64] WOWSC Ex. 7 (Nelson Dir.) at 8, Attachment MN-2; WOWSC Ex. 10 (Nelson Dir., Errata) at 7. Mr. Nelson testified that although the actual number of customers was 271, the TRWA analysis used 253 because this number remained in the rate sheet from the previous 2018 rate analysis. *Id*.

[65] WOWSC Ex. 2 (Gimenez Dir.) at 11; WOWSC Ex. 3 (Gimenez Reb.), Attachment JG-39. In 2019, the board consisted of Joe Gimenez, Dorothy Taylor, Mike Nelson, and Bill Earnest. WOWSC Ex. 3 (Gimenez Reb.), Attachment JG-21 at Bates 8.

[66] WOWSC Ex. 3 (Gimenez Reb.) at 34; Ratepayers HOM2 Ex. 41 (Windermere response to Staff RFI No. 1-16).

[67] Ratepayers HOM2 Ex. 41 (Windermere response to Staff RFI No. 1-16); Staff HOM2 Ex. 25 (Windermere supp. response to Staff RFI 1-1).

[68] WOWSC Ex. 3 (Gimenez Reb.) at 35; WOWSC Ex. 7 (Nelson Dir.), Attachment MN-1; Ratepayers HOM2 Ex. 41 (Windermere response to Staff RFI No. 1-16).

[69] Ratepayers HOM2 Ex. 41 (Windermere response to Staff RFI No. 1-16); Tr. at 553, 558 (Mendoza Cross) (Dec. 3, 2021).

intention was to lower base rates as soon as the legal fees were fully paid in accordance with the payment agreements.[70]

B. SYSTEM AND CUSTOMER CHARACTERISTICS (PO ISSUE 1)

In its remand order, the Commission stated, "On remand, Windermere must bring forth evidence in this initial inquiry regarding the characteristics of its customers to demonstrate that the single rates it charges customers for water and sewer service are just and reasonable."[71] Drawing on the American Water Works Association M1 Manual, Windermere expert witness Grant Rabon testified that when in establishing customer classes, the utility should consider the location of its customers, service characteristics, and demand patterns.[72] Customer classes should only consider factors that impact a utility's costs to provide water and sewer services.[73]

Applying these guidelines, Mr. Rabon testified that all of Windermere's customers reside in the same subdivision and receive the same potable water and sewer service from the same facilities and water source.[74] He stated that all Windermere customers have similar water uses, are served from the same facilities

[70] WOWSC Ex. 2 (Gimenez Dir.), Attachment JG-7 at 4 (notice of rate increase states "The Board also committed to reducing rates once the suits against it are dropped, settled, or decided in its favor."); WOWSC Ex. 26 (Gimenez Supp. Reb.) at 13-14.

[71] Order Remanding Proceeding at 7 (June 30, 2022).

[72] WOWSC Ex. 24 (Rabon Supp. Dir.) at 5, Attachment GR-2.

[73] WOWSC Ex. 24 (Rabon Supp. Dir.) at 7.

[74] WOWSC Ex. 24 (Rabon Supp. Dir.) at 7.

and water source, are similarly located, and are all members of the water supply corporation.[75]

Regarding demand patterns, Mr. Grant testified that, although the airport hangar accounts have a higher peak-to-average demand difference than the single-family residential (SFR) accounts, SFR accounts more consistently use Windermere's services and, therefore, have a much higher level of demand.[76] These variances offset each other and, as such, each customer imposes a similar cost on Windermere's provision of service.[77] Mr. Rabon further testified that Windermere's inclining block rate design allows for additional recovery from SFR accounts that consume more water, which further mitigates the need to segregate airport hangar and SFR accounts.[78]

Mr. Rabon concluded that because Windermere's customers reside in the same location, receive the same service, and impose similar costs on the system, the customers have similar characteristics. It is therefore appropriate to group all Windermere customers in a single class and charge the customers a single rate.[79]

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[75] WOWSC Ex. 24 (Rabon Supp. Dir.) at 7.

[76] WOWSC Ex. 24 (Rabon Supp. Dir.) at 9.

[77] WOWSC Ex. 24 (Rabon Supp. Dir.) at 9.

[78] WOWSC Ex. 24 (Rabon Supp. Dir.) at 9.

[79] WOWSC Ex. 24 (Rabon Supp. Dir.) at 10.

1. Staff's Position

In its reply brief, Staff argues that given the different demand patterns of SFRs and the hangar, having inclining block rates does not obviate the need for properly defined classes.[80]

2. Ratepayers' Position

Ratepayers argue that Mr. Rabon's conclusion overlooks customers such as Windermere Hangars, which is used by four entities.[81] Ratepayers argue that, on a pro rata basis, each of those connections pays only $22.60 for water and $16.60 for sewer, instead of the $90.39 for water and $66.41 for sewer per connections set by the board.[82]

3. Windermere's Position

Windermere states that it has only one class of customers. The 75 active airport hangars use little water,[83] and therefore pay modest amounts in volumetric charges, but pay the same base rates as every other active connection.[84] Thus, overall, Windermere argues, the airport hangar accounts and SFR accounts both impose similar costs on providing service.[85]

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[80] Staff HOM2 Reply Brief at 4.

[81] Staff HOM2 Ex. 17 (Windermere response to Staff RFI No. 6-10).

[82] Ratepayers HOM2 Reply Brief at 6.

[83] Mr. Rabon testified that 40% of the hangars have zero water usage. WOWSC Ex. 24 (Rabon Supp. Dir.) at 9.

[84] WOWSC Ex. 9 (Rabon Reb.) at 6; WOWSC Ex. 2 (Gimenez Dir.) at 20.

[85] WOWSC Ex. 24 (Rabon Supp. Dir.) at 9.

Regarding Windermere Hangars, Windermere argues that it was constructed before Windermere was formed, received water from another provider, and its use by four entities was grandfathered.[86] In Windermere's view, it would be improper and unnecessary for it to establish a separate customer class for a single, grandfathered property as Ratepayers suggest, where that one property nevertheless has a similar cost to serve relative to all other Windermere connections.[87] Thus, Windermere argues, except for this single grandfathered property, all Windermere members reside in the Windermere Oaks subdivision, receive the same potable water and wastewater service from the same facilities and water source, and have a similar demand pattern.[88]

4. Analysis

The preponderance of evidence shows that Windermere's customers do not differ in meaningful ways. They share substantially similar locations, service characteristics, and demand patterns. Mr. Rabon's testimony is unrebutted. Although Staff contends that inclining block rates does not obviate the need for properly defined classes, Staff has not explained what it means by "properly defined classes." Multiple defined customer classes in water utilities are rare. Rather,

[86] Staff HOM2 Ex. 17 (Windermere response to Staff RFI No. 6-10).

[87] WOWSC Ex. 24 (Rabon Supp. Dir.) at 9.

[88] WOWSC Ex. 24 (Rabon Supp. Dir.) at 10.

differences in cost allocation are normally addressed through meter size.[89] Here, there is no evidence of any meter size other than ¾" and 5/8" meters.[90]

Although the airport hangars have a greater peak-to-average demand, the evidence shows that they have relatively low usage, and therefore recovering the additional costs through volumetric charges would result in an unreliable revenue stream for fixed costs. Thus, recovery through base rates ensures that all customers share the expense equally. Although the one hangar with four users is anomalous, the ALJs are persuaded that Windermere reasonably chose to treat this pre-existing connection the same as other customers on its system, particularly where its demand on the system is no different than other similarly situated customers. The Water Code does not forbid preferential, prejudicial, or discriminatory rates, only those that are unreasonably so.[91] The ALJs therefore find that Windermere's treatment of all of its 271 customers equally is reasonable and is sufficient, equitable, and consistent in application to each class of customers.

C. INFORMATION AVAILABLE AFTER WINDERMERE'S RATE DECISION

Although significant amounts of post-decision evidence were admitted into the record without objection, such information may only be considered to determine

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[89] *See* WOWSC Ex. 24 (Rabon Supp. Dir.), Attachment GR-2 (American Water Works Association M1 Manual) at Bates 18 ("Because the classification of some customers may be difficult and because there may be large variations within the commercial class, some utilities now classify customers based on meter size.").

[90] WOWSC Ex. 2 (Gimenez Dir.), Attachment JG-7 (Notice of Rate Increase) at 4.

[91] Tex. Water Code § 13.043(j).

the conditions at the time the board made its decision.[92] The ALJs therefore limit their review to the following subsequent events, which shed light on the reasonableness of the board's February 11, 2020 decision to increase rates.

1. Paxton Lawsuit

After being sued by Windermere, the Attorney General reversed his position and agreed that the information requested pursuant to the PIA could be withheld under a claim of privilege.[93] Although the exact date of this reversal is not in evidence, the ALJs infer that it happened after the rate decision, and close in time to when the requester, Danny Flunker, intervened on July 14, 2020, to challenge that decision (engaging attorney Kathryn Allen—the ratepayer representative in this proceeding).[94] Facing this threat of continued litigation, Windermere decided to release the requested information to reduce legal expenses.[95]

2. Double F Hangar Lawsuit

In the *Double F Hangar Lawsuit*, in May 2021, the court granted summary judgment and dismissed plaintiffs' claims against seven of the eight directors.[96] With respect to the one remaining former director, Ms. Martin, the jury found she had

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[92] Docket No. 6560, Examiner's Report at 15 (Apr. 16, 1986); *see also* Docket No. 40627, Supplemental Preliminary Order at 6 (Dec. 13, 2012).

[93] WOWSC Ex. 3 (Gimenez Reb.) at 29-30, Attachment JG-34 at 30 (PIA requestor Danny Flunker's Plea in Intervention, alleging, "Thereafter, the Attorney General apparently determined that additional information could be withheld from disclosure under a claim of privilege.").

[94] WOWSC Ex. 3 (Gimenez Reb.) at 29, Attachment JG-34; WOWSC Ex. 26 (Gimenez Supp. Reb.) at 8.

[95] WOWSC Ex. 26 (Gimenez Supp. Reb.) at 8.

[96] WOWSC Ex. 3 (Gimenez Reb.) at 10, 19, Attachment JG-20.

breached her fiduciary duty to Windermere by engaging in the land transaction, and had acquired the property for $70,000 less than fair market value.[97] According to Mr. Gimenez, this award was to be split equally between the plaintiffs and Windermere, each receiving $35,000.[98] Additionally, based on an indemnification and legal defense contract, which becomes effective only after a final determination, Windermere will collect from Ms. Martin the legal fees associated with her defense, or approximately $50,000, if the judgment is not appealed.[99] In comparison, plaintiffs spent over $400,000 in legal fees.[100]

3. Allied World Lawsuit

In Windermere's suit against its insurance provider for refusing coverage, the federal district court ruled in favor of Windermere and held that Allied World owes Windermere for defense costs related to the *Double F Hangar Lawsuit*.[101] Windermere expects this award to be between $400,000 and $500,000.[102] However, it is unclear when or if Windermere will recover these proceeds because Allied World appealed the ruling, which is currently pending at the U.S. Court of Appeals for the Fifth Circuit.[103]

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[97] WOWSC Ex. 26 (Gimenez Supp. Dir.) at 9, Attachment JG-43.

[98] Tr. at 776 (Gimenez Cross) (Mar. 22, 2023).

[99] WOWSC Ex. 26 (Gimenez Supp. Dir.) at 11-12, Attachment JG-45 (Sworn Statement Regarding Indemnification and Payment of Defense Costs).

[100] WOWSC Ex. 26 (Gimenez Supp. Dir.), Attachment JG-44 at 3 (Bates 40).

[101] WOWSC Ex. 26 (Gimenez Supp. Dir.) at 12, Attachment JG-48.

[102] Tr. at 776 (Gimenez Cross) (Mar. 22, 2023).

[103] WOWSC Ex. 26 (Gimenez Supp. Dir.) at 13, Attachment JG-47.

4. Other Activities

Around May of 2020, the same ratepayer litigants sent a letter to the Burnett County sheriff, copying federal and state representatives, other law enforcement, and news outlets, accusing current and former board members of "serious crimes" that have the "earmarks of organized criminal activity."[104]

5. Legal Expenses

Windermere has continued to pay both Lloyd Gosselink and Enoch Kever $10,000 per month for legal expenses, in accordance with Windermere's 2020 budget.[105] Nevertheless, legal expenses continue to accrue.[106] The legal expenses have ballooned to a total of $1.78 million.[107]

D. REVENUE REQUIREMENT (PO ISSUE 7)

According to Windermere, the appealed rates are set to meet a revenue requirement of $576,192.[108] Windermere used the cash-needs method to develop its revenue requirement,[109] which included a capital expenditure reserve,[110] a

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[104] WOWSC Ex. 2 (Gimenez Dir.) at 20, Attachment JG-14.

[105] *See, e.g.*, Ratepayers HOM2 Ex. 119 (Windermere 2021 GL, attachment to Windermere's response to Ratepayers RFI No. 8-24) at Bates 1-6.

[106] Tr. at 268 (Gimenez Cross) (Dec. 2, 2021).

[107] *See* Ratepayers HOM2 Ex. 144B (showing the following annual legal debt: 2019-$121,619.17; 2020-$289,385.18; 2021-$282,676.49; 2022-$91,647.43; 2023-$12,908.30). Presumably, these legal expenses include the costs of this appeal.

[108] WOWSC Ex. 7 (Nelson Dir.), Attachment MN-2.

[109] Staff Ex. 4 (Gilford Dir.) at 8.

[110] Staff Ex. 1 (English Dir., First Errata) at 3.

debt-service coverage ratio (DSCR),[111] expenses for an operations contract with Water Management, Inc., and insurance.[112] The revenue requirement also includes $171,337 allocated to legal expenses.[113] Only the inclusion of outside legal expenses is at issue.[114]

1. Staff's Position

Staff witness Gilford recommended removing the entire amount of legal expenses for a total revenue requirement of $404,855.[115] Ms. Gilford explained her recommendation as follows:

> The expenses are associated with multiple civil matters that originate with a decision to enter into a real estate transaction with a sitting Windermere Board member. While I do not have an opinion one way or another as to whether the transaction was appropriate, I understand why some might have concerns that the transaction was not conducted at arm's length. Given the plausibility of these concerns, Windermere has failed to show that the legal expenses incurred to litigate these matters are just and reasonable expenses that may be recovered through rates. Nor has Windermere shown how these expenses result in benefits to its ratepayers such as lowered rates or improved service. Further, the outcome of the [Double F Hangar] matter is not yet known, so a decision on what amount, if any, should be recovered in rates, is premature.[116]

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[111] Staff Ex. 1 (English Dir., First Errata) at 3.

[112] Staff Ex. 3 (Graham Dir.) at 9.

[113] WOWSC Ex. 7 (Nelson Dir.), Attachment MN-2.

[114] *See* Staff HOM2 Initial Brief at 7 ("Staff, through a comparison with Windermere's 2019 year-end financials, determined that the amounts for the categories other than legal and appraisal were reasonable.").

[115] Staff Ex. 4 (Gilford Dir.) at 6.

[116] Staff Ex. 4 (Gilford Dir.) at 12.

Ms. Gilford testified that she was unable to express an opinion on "the prudence of Windermere's managerial decisions to engage in litigation and incur $171,337 in outside legal expenses."[117] Ms. Gilford further testified, "While I understand that Windermere could not just ignore the TOMA and [Double F Hangar] suits, Windermere did not provide information as to why litigating these matters was a necessary choice as opposed to other options available at the time such as mediation."[118]

Ms. Gilford nevertheless testified that "it would be reasonable for the Commission to find that the portion of this amount that is attributable to PIA responses was a reasonable and necessary expense that is recoverable in rates" because "Windermere is obligated to respond to Public Information Act requests whether they are connected to litigation or not."[119] However, Ms. Gilford nevertheless recommended denying the expenses because "Windermere's response to Staff [RFI No.] 2-3 demonstrates that it did not know the specific amount of legal expenses incurred to respond to Public Information Act requests at the time the Board voted to increase rates."[120] That RFI response shows that Windermere spent "approximately" $44,682 for legal expenses to respond to PIA requests.[121]

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[117] Staff Ex. 4 (Gilford Dir.) at 13.

[118] Staff Ex. 4 (Gilford Dir.) at 13.

[119] Staff Ex. 4 (Gilford Dir.) at 15.

[120] Staff Ex. 4 (Gilford Dir.) at 15, Attachment MG-8 (Windermere response to Staff RFI No. 2-3).

[121] Staff Ex. 4 (Gilford Dir.) at 15, Attachment MG-8 (Windermere response to Staff RFI No. 2-3).

In briefing, Staff does not reference the above testimony, but argues that the legal expenses were imprudent.[122] Staff points to the claim denial by Allied World, mentioned above, based on the Profit, Advantage or Remuneration and Violation of Law exclusions.[123] As such, Staff argues, these legal expenses are akin to the self-insurance expenses denied by the Commission in Docket No. 35717 "for intentional torts or for employee misconduct such as discrimination."[124] Ms. Gilford testified that much like this decision, "I believe my recommendation to disallow Windermere's outside legal expenses protects its ratepayers from board member behavior that is unreasonable and contrary to public policy."[125]

On remand, Staff witness Givens recommended removing an additional $48,478 to offset Windermere's revenue requirement with other revenues from late and standby fees, which Windermere failed to do.[126] Removing these additional expenses from $404,855 results in a revenue requirement of $356,377.[127]

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[122] Staff HOM2 Initial Brief at 5.

[123] Staff Ex. 4 (Gilford Dir.) at 14-15, Attachment MG-11 (Windermere response to Staff RFI No. 2-7); Windermere Ex. 3 (Gimenez Reb.), Attachment JG-26 at 9-12.

[124] *Application of Oncor Electric Delivery Company, LLC for Authority to Change Rates*, Docket No. 35717, Order on Rehearing at Finding of Fact No. 99 (Nov. 30, 2009).

[125] Staff Ex. 4 (Gilford Dir.) at 14.

[126] Staff HOM2 Ex. 2 (Givens Supp. Dir.) at 7, Supplemental Attachment AG-4 at 9; Staff HOM2 Ex. 9 (Windermere response to Staff RFI No. 6-2).

[127] Staff HOM2 Ex. 2 (Givens Supp. Dir.) at 6, Supplemental Attachment AG-4 at 9.

Applying the 60%/40% split between water and sewer to a $356,377 revenue requirement, Windermere's water and sewer annual rate-setting revenue requirements equate to $213,826 and $142,551, respectively.[128]

Staff recommends that the over-recovered amount be refunded to customers over the same number of months it was collected in a compliance docket.

2. Ratepayers' Position

Ratepayers generally support Staff's position and argue that the rates are unjust and unreasonable because legal expenses do not directly relate to providing water service.[129] As such, Ratepayers argue that these legal expenditures provide no benefit to the ratepayers.

Ratepayers also argue that it was imprudent for Windermere to expend resources in the *Double F Hangar Lawsuit* to take a "neutral stance," as described by Mr. Gimenez.[130]

3. Windermere's Position

Windermere argues that its inclusion of legal expenses in rates was just and reasonable. First, Windermere maintains that the legal fees were necessary and

[128] Staff HOM2 Ex. 2 (Givens Supp. Dir.) at 6.

[129] Tr. at 53–54, 71–72 (Burris Cross), 208 (Nelson Cross) (Dec. 1, 2021); Tr. at 274–75 (Gimenez Cross); Tr. at 297, 371 (Gimenez Cross) (Dec. 2, 2021).

[130] Ratepayers HOM2 Initial Brief at 17.

unavoidable. The corporation incurred the fees defending itself against legal actions initiated by several members.[131] Windermere notes that, apart from the *Paxton Lawsuit* which it initiated to protect privileged information, Ratepayers initiated all underlying lawsuits.[132]

Second, as a matter of accounting, Windermere notes that the National Association of Regulatory Utility Commissioners chart of accounts, under which the Commission operates with respect to water and sewer utilities, defines "operation and maintenance" to include legal fees, and books these fees under Account 631, as does Windermere.[133]

Third, as a matter of law, Windermere argues that it had a legal obligation to pay legal expenses. Windermere maintains that Chapter 8 of the Texas Business Organizations Code authorizes and—in conjunction with corporate bylaws—arguably requires Windermere to advance defense costs to Windermere's current and former directors.[134]

Fourth, as a practical matter, Windermere notes that its board is composed of volunteer directors, and thus, it must encourage community members to serve. If the corporation refused to indemnify its directors, community members would not

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[131] WOWSC Ex. 2 (Gimenez Dir.) at 21-22; WOWSC Ex. 26 (Gimenez Supp. Reb.) at 7-11.

[132] WOWSC Ex. 3 (Gimenez Reb.) at 9; WOWSC Ex. 26 (Gimenez Supp. Reb.) at 7-8, 10.

[133] Tr. 845-47 (Givens Cross) (Mar. 22, 2023); WOWSC Ex. 17 (Windermere response to Ratepayers RFI No. 1-12 at 7); *see, e.g.*, WOWSC Ex. 27 (Nelson Supp. Reb.), Attachment MN-12 at 13.

[134] Tex. Bus. Orgs. Code § 8.051; WOWSC Ex. 2 (Gimenez Dir.), Attachment JG-2 (Bylaws) at Art. 8, § 18; WOWSC Ex. 26 (Gimenez Supp. Reb.) at 11.

volunteer. Rather, in such a litigious community, volunteering without protection from personal liability would chill board participation.[135]

Finally, Windermere emphasizes that it did everything it could to minimize legal fees through mediation and community meetings.[136] Windermere points to evidence that it has attempted to settle the matters brought against it by ratepayers.[137] Windermere further argues that if it had committed to plaintiffs' claims in the *Double F Hangar Lawsuit*, it would have incurred more outside legal expenses to recover through rates, given the disproportionate amount that the plaintiffs spent on legal fees relative to the verdict against Ms. Martin.[138] Additionally, Windermere argues that recent developments in the underlying litigation show that it has acted reasonably and limited legal fees to the benefit of its ratepayers.[139]

Regarding Ms. Gilford's testimony that Windermere failed to identify the specific amounts of legal expenses for responding to PIA requests,[140] Windermere points to testimony of Mr. Gimenez that the discovery response showing $44,682

[135] WOWSC Ex. 26 (Gimenez Supp. Reb.) at 11; Tr. at 206 (Nelson Cross)(Dec. 1, 2021).

[136] WOWSC Ex. 3 (Gimenez Reb.) at 18-19.

[137] WOWSC Ex. 3 (Gimenez Reb.) at 18-19.

[138] WOWSC Ex. 26 (Gimenez Supp. Reb.) at 11-12.

[139] WOWSC Ex. 26 (Gimenez Supp. Reb.) at 8-13.

[140] Staff Ex. 4 (Gilford Dir.) at 13.

was an underestimate because it was based on entries that were wholly related to PIA requests.[141]

Next, Windermere argues that the Commission's action in Docket No. 35717 is inapplicable, as it relates to an electric investor-owned utility (IOU), and thus, the equity investors selected the board members of the IOU and should therefore bear the financial costs related to intentional torts or employee misconduct, rather than the ratepayers. Unlike an IOU, Windermere does not have shareholders to pay for disallowed costs the utility must incur. It has volunteer board members who are duly elected by the members. Additionally, Windermere argues that Staff improperly assumes that allegations of bad behavior rise to the level of "intentional torts or employee misconduct." According to Windermere, Staff inappropriately relies on the Allied World's denial of insurance coverage instead of the court's subsequent reversal of that denial.

Regarding the deductions for other revenues, Windermere has stated that such late-fee and standby-fee revenues were "minimal" and therefore not included in its rate analysis.[142]

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[141] WOWSC Ex. 3 (Gimenez Reb.) at 21; Staff Ex. 4 (Gilford Dir.), Attachment MG-8 (Windermere response to Staff RFI No. 2-3).

[142] Staff HOM2 Ex. 9 (Windermere response to Staff RFI No. 6-2).

4. Analysis

a) Legal Expenses

It is undisputed that Windermere's legal expenses are extraordinary—whether the $279 thousand incurred in 2019, or the $1.78 million incurred to date (presumably, inclusive of this appeal).[143] However, the evidence overwhelmingly shows that Windermere could not have avoided the legal expenses to defend itself and its directors. Even Staff witness Gilford admitted that Windermere could not simply ignore the lawsuits.[144] In fact, Ms. Gilford found that legal costs incurred pursuant to a legal obligation (the PIA) were reasonable.[145]

As a non-profit water supply corporation,[146] the Water Code authorizes Windermere to "employ and compensate counsel to represent the corporation as the board determines is necessary."[147] Corporate directors enjoy significant protection against personal liability under the business judgment rule, safe harbor provisions for non-profit corporations, and the corporate bylaws.[148] A corporation has discretion in advancing legal expenses on behalf of directors and officers, which

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[143] Ratepayers HOM2 Ex. 144B.

[144] Staff Ex. 4 (Gilford Dir.) at 13.

[145] Staff Ex. 4 (Gilford Dir.) at 15.

[146] Tex. Water Code §§ 13.002(24), 67.007.

[147] Tex. Water Code § 67.013.

[148] *See Sneed v. Webre*, 465 S.W.3d 169, 178 (Tex. 2015) ("In Texas, the business judgment rule protects corporate officers and directors from being held liable to the corporation for alleged breach of duties based on actions that are negligent, unwise, inexpedient, or imprudent if the actions were 'within the exercise of their discretion and judgment in the development or prosecution of the enterprise in which their interests are involved.'"); Tex. Bus. Orgs. Code § 22.221; WOWSC Ex. 2 (Gimenez Dir.), Attachment JG-2 at Art. 8, § 18.

becomes mandatory if they prevail.[149] Advancement of expenses is an important corollary to indemnification in attracting officers, as it provides immediate interim relief from the personal legal expenses.[150] Indeed, failure to fund its officers' legal defense may have subjected Windermere to more legal expenses.

At the time it made its decision to raise rates, Windermere had already prevailed in the *TOMA Lawsuit*, was facing rapidly increasing legal expenses in the *Double F Hangar Lawsuit*, was incurring further legal expenses in resisting a PIA request seeking legal invoices, had the threat of additional lawsuits, and could reasonably anticipate that legal expenses would continue into 2020 and beyond. The record evidence does not support that Windermere could have reasonably avoided any of this.

Windermere is not subject to the ratemaking requirements of an IOU.[151] Therefore, as a matter of law, it is not subject to the requirement of basing its revenue requirement on a historical test year, adjusted for known and measurable changes. Instead, the reasonableness of its rates must be tested by whether they are set to "collect only expenses actually realized or which can be anticipated with reasonable certainty."[152] Windermere included $171,337 in its revenue requirement using only

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[149] Tex. Bus. Orgs. Code. §§ 8.051, .104-.105.

[150] *In re DeMattia*, 644 S.W.3d 225, 230 (Tex. App.—Dallas 2022, no pet.).

[151] *See* Tex. Water Code § 13.181(a) (providing that Subchapter F "shall not be applied to . . . water supply or sewer service corporations").

[152] *See Petition of Paloma Lake Municipal Utility District No. 1, et al. Appealing the Ratemaking Actions of the City of Round Rock in Travis and Williamson Counties*, Docket No. 48836, Order on Appeal of SOAH Order No. 17 at 3 (Apr. 29, 2022).; *see also Suburban Util. Corp. v. Pub. Util. Comm'n of Tex.*, 652 S.W.2d 358, 362 (Tex. 1983).

legal expenses paid through October of 2019,[153] even though it incurred $279,445 in legal fees in 2019.[154] Having established a payment agreement, and reasonably anticipating future litigation, Windermere reasonably budgeted for $250,000 in legal expenses, which its then-existing revenue stream fell short of by $174,515.[155] Thus, Windermere reasonably included $171,337 in its revenue requirement, based on bills actually paid in 2019.

Subsequent events bear out Windermere's legal strategies at the time it made its rate decision. Windermere prevailed in persuading the Attorney General to change his opinion in the *Paxton Lawsuit*; prevailed with respect to all but one director in the *Double F Hangar Lawsuit*; and also prevailed in its suit against Allied World to recover legal defense coverage. Although the outcomes of these suits could not be known at the time the board made its rate decision, they shed light on the reasonableness of Windermere's assessment of its legal position. These outcomes show that Windermere was not maintaining untenable or frivolous positions.

Moreover, the evidence shows that Windermere attempted to mitigate the legal expenses to its members: it sought coverage from its insurance provider, Allied World; successfully moved for summary judgment in the *Double F Hangar Lawsuit*; participated in mediation and secured an additional $20,000 from Ms. Martin; engaged in community outreach; and released the privileged information sought in

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[153] WOWSC Ex. 3 (Gimenez Reb.) at 16-17.

[154] Ratepayers HOM2 Ex. 144B.

[155] WOWSC Ex. 7 (Nelson Dir.) at 9, Attachment MN-4; *see also* Staff HOM2 Ex. 41 (Windermere response to Staff RFI No. 8-5) (identical).

the *Paxton Lawsuit* rather than engage in further litigation. Additionally, Windermere executed an indemnification agreement to recover the legal fees associated with Ms. Martin's defense, should she be found liable.[156] Thus, the ALJs find ample evidence that Windermere reasonably explored other options at available at the time, such as mediation, and that "litigating these matters was a necessary choice."[157]

Additionally, the evidence does not support Staff's assertion that Windermere was spending "without limit or check."[158] Although subsequent events show that one former board member—Ms. Martin—breached her fiduciary duty, for that wrong she stands to pay Windermere $35,000 for the land sale and $50,000 as reimbursement for legal fees. The evidence does not support that Windermere or any other directors were liable. The ALJs find that, as Windermere argues, the board did what it needed to do to keep the utility afloat in the face of ever-increasing legal fees, reflecting reasonable management of a water and sewer utility.[159]

The sum of evidence to the contrary is Ms. Gilford's testimony that the outside legal expenses were unreasonable because "some might have concerns that the [2016 land sale] transaction was not conducted at arm's length," and that these concerns may be plausible.[160] This is mere speculation. Moreover, whether the

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[156] WOWSC Ex. 26 (Gimenez Supp. Reb.) at 11, Attachment JG-45.

[157] *See* Staff Ex. 4 (Gilford Dir.) at 13.

[158] Staff HOM1 Initial Brief at 3; Staff HOM2 Initial Brief at 4.

[159] WOWSC HOM1 Reply Brief at 14.

[160] Staff Ex. 4 (Gilford Dir.) at 12.

transaction was conducted at arm's length is a separate inquiry from whether it was reasonable for Windermere to defend itself and indemnify its directors at the time the board made its decision to raise rates. Finally, subsequent events showed that Windermere's actions were within the range of reasonable options.

The outcome of the *Double F Hangar Lawsuit* is now known. Plaintiffs spent $400,000 for a finding that Ms. Martin had underpaid by $70,000, of which they stand to recover half. Mr. Gimenez testified that Windermere's "neutral stance" allowed the corporation to proceed without further litigation entanglements that would have cost more.[161] Windermere's position may not have directly lowered rates or improved service, but it protected, or attempted to protect, ratepayers against even more expensive alternatives. Windermere's legal expenses were incurred in defense of legal actions initiated against it, and, as Mr. Nelson testified, "[W]e would not have a Water Supply Corporation if it did not defend itself."[162] As such, the board's decision did result in benefits to its ratepayers, notwithstanding Ms. Gilford's testimony to the contrary.[163]

Furthermore, Staff's contention that Allied World's insurance claim denial is akin to the Commission's self-insurance denial in Docket No. 35717 is not persuasive. First, Allied World's denial has been overturned. Although still subject to appeal, the federal court's ruling tends to show that Allied World's basis for denial

[161] Tr. at 298-99 (Gimenez Cross).

[162] Tr. at 208 (Nelson Cross).

[163] Staff Ex. 4 (Gilford Dir.) at 12.

was unwarranted. Second, the evidence does not show that the board's actions here rise to the level of intentional torts. Third, the public policy concerns addressed in Docket No. 35717 are distinguishable. Here, Windermere is a member-owned, non-profit corporation, with no source of directors or revenue except from its members, whereas Docket No. 35717 involved an IOU with shareholders motivated by profit. Here, although one former board was found to have committed misconduct, ratepayers are not protected against such behavior by prohibiting Windermere from defending itself and advancing or indemnifying its former and current officers against legal expenses. Rather, this result would be contrary to the public policy of encouraging director participation in non-profit corporations.[164] Indeed, public policy—codified in law—favors advancing the legal expenses of non-profit corporate officers.

Finally, Ms. Gilford's determination that Windermere did not know the specific amount associated with responding to PIA requests is not supported by the record. Windermere's response to Staff RFI No. 2-3 provided $44,682 as an approximation, explaining:[165]

> Lloyd Gosselink Rochelle & Townsend, P.C. did not distinguish between different matters when invoicing the WOWSC if the work was performed by the same person on the same day. While some entries were solely for work related to the PIA requests, others included work on separate matters, including assistance with member challenges to board actions on interpretations of bylaws and the articles of incorporation, a member removal petition, and compliance with Open Meetings Act law, including a new law of the 2019 Texas Legislature

[164] Staff Ex. 4 (Gilford Dir.) at 14.

[165] Staff Ex. 4 (Gilford Dir.), Attachment MG-8 (Windermere response to Staff RFI No. 2-3).

> relating to member comments. Therefore, it is not possible to discern the exact time spent on which activity. Accordingly, this figure is an estimate as the billing practice does not allow for a specific calculation.[166]

The response makes clear that the estimate relates to the challenge of segregating the PIA response costs from other legal expenses billed. The accuracy of the $171,337 is not challenged and appears to have been an underestimate, given that it was based only on expenses paid in 2019, and as subsequent events have demonstrated. Under these circumstances, any lack of precision does not justify the complete disallowance of legal expenses, of which the PIA costs are a subset, as advocated for by Staff and Ratepayers. The just and reasonable standard does not require that Windermere set rates "to recover [its] cost of service down to the cent."[167] Rather, Windermere's rates "must be set within a range of reasonable values."[168] Windermere has met this standard.

Finally, removing all legal expenses from Windermere's revenue requirement, as Staff proposes, is facially suspect, because any entity must be expected to incur some legal expenses that are reasonable and necessary for operations. Windermere established that prior to the onset of the litigation at issue here, it incurred $3,000 or less in legal expenses per year, which no one disputes was reasonable.

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[166] Staff Ex. 4 (Gilford Dir.), Attachment MG-8 (Windermere response to Staff RFI No. 2-3).

[167] Docket No. 48836, Order on Appeal of SOAH Order No. 17 at 3 (Apr. 29, 2022).

[168] *Id.*

For the reasons set out above, the ALJs find that the board's decision to incur the legal expenses was reasonable and that the inclusion of $171,337 in Windermere's revenue requirement was just and reasonable.

b) Other Revenues

Windermere does not defend its failure to remove $48,478 to account for late and standby fees.[169] In a discovery response, Windermere attributed this omission to those expenses being minimal. However, as Staff points out, these fees constituted approximately 11% of Windermere's revenue requirement. The only Windermere witness to address this issue, Mr. Nelson, did not argue that this amount should not be removed, only that doing so, in conjunction with removing the legal expenses, would lead to the corporation's financial collapse.[170] Accordingly, the ALJs find that Windermere's revenue requirement should be adjusted downward to account for the $48,478 in other revenues identified by Ms. Givens.

The ALJs therefore find that Windermere's rates are not just and reasonable due to its failure to account for other revenues and that its revenue requirement should be adjusted accordingly. The ALJs recommend setting rates based on a revenue requirement of $527,714, which is calculated by removing $48,478 from the $576,192 revenue requirement that Windermere based its rates on.[171]

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[169] Staff HOM2 Ex. 2 (Givens Supp. Dir.) at 6, Supplemental Attachment AG-4 at 9; Staff HOM2 Ex. 9 (Windermere response to Staff RFI No. 6-2).

[170] WOWSC Ex. 27 (Nelson Supp. Reb.) at 4-5.

[171] The ALJs are mindful that Staff raised this issue only on remand, the scope of which was limited to addressing customer characteristics and mathematic calculations of variable rates. *See* SOAH Order No. 23 at 2 (Sept. 26, 2022). However, Windermere made no objection and did not oppose this reduction.

E. METHODOLOGY FOR CALCULATING RATES

In fixing the rates the governing body should have fixed in the action from which the appeal was taken, the Commission "shall use a methodology that preserves the financial integrity of the retail public utility."[172] The ALJs find only that the failure to offset for other revenues is unjust and unreasonable. As noted above, no one argued that this adjustment alone would affect Windermere's financial integrity. However, the parties provided extensive testimony and briefing on the impact of removing the legal fees from the revenue requirement. To ensure that the Commission can consider the entirety of the parties' positions, the ALJs now review those arguments.

Staff witness Gilford testified that she supports the inclusion of outside legal expenses so long as Windermere provides sufficient evidence demonstrating that recovery of the expenses is necessary to preserve its financial integrity.[173]

In response, Windermere witness Nelson testified that if the legal expenses are removed from the revenue requirement, it would severely impact Windermere's ability to (a) maintain binding loan covenants; (b) make required repairs and improvements to aging equipment, such as the clarifier and water tank; (c) react to and mitigate environmental challenges, such as zebra mussels; and (d) retain current

[172] Tex. Water Code § 13.043(e), (j).

[173] Staff Ex. 4 (Gilford Dir.) at 16.

legal counsel or find subsequent counsel, putting the organization at risk from additional litigation from the same small group of members challenging the rates.[174]

Notwithstanding this evidence, Staff argues that, as the Commission found in *Town of Woodloch*, "[c]onsiderations of financial integrity cannot, however, be treated as a trump card that overrides the utility's obligation to comply with the standard requirements for proving its water and sewer rates."[175]

Windermere responds, first, that the policy announced in *Town of Woodloch* is inapplicable. Windermere notes that the Commission reached this conclusion due to Woodloch's inclusion of discretionary operation and maintenance expenses that the ALJ ultimately found improper.[176] Here, Windermere argues, it did not include any discretionary and extraneous expenses in its revenue requirement, but rather necessary legal fees.[177] The ALJs agree. The expenses at issue in *Town of Woodloch* are distinguishable from those at issue in the instant case. Windermere has not attempted to include discretionary or extraneous expenses. Instead, the legal expenses were unavoidable and necessary to continue its existence.

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[174] WOWSC Ex. 8 (Nelson Reb.) at 5-6.

[175] *Appeal of Water and Sewer Rates Charged by the Town of Woodloch CCN Nos. 12312 and 20141*, Docket No. 42862, Order at Conclusion of Law No. 13 (Mar. 7, 2016).

[176] Docket No. 42862, Proposal for Decision at 9-10, 22-23 (Oct. 29, 2015).

[177] Staff Ex. 4 (Gilford Dir.) at 12; Tr. at 844 (Givens Cross) (Mar. 22, 2023); *see also* Prehearing Conference Tr. at 21 (Mar. 21, 2023) (granting Staff's motion for Ms. Givens to adopt Ms. Gilford's testimony).

Nevertheless, Staff goes on to identify other sources of potential revenue that would preserve Windermere's financial integrity.

F. OTHER REVENUE SOURCES

1. Staff's Position

Ms. Gilford testified that she did not oppose Windermere recovering the legal expenses from ratepayers, only doing so through base rates.[178] She stated that "[t]he outside legal expenses are extraordinary, unusual, and non-recurring and do not represent a normal, ongoing cost of providing water and wastewater utility services."[179] As such, "[a] surcharge would be the most appropriate way to recover the outside legal expenses incurred because the surcharge would terminate once the full amount is recovered."[180] However, she could not recommend recovery of the legal expenses through a surcharge because Windermere's tariff at the time did not authorize a surcharge.[181] Instead, Ms. Gilford noted that Windermere is preapproved for a loan of up to $300,000 from CoBank from which the legal expenses could be paid to preserve its financial integrity.[182]

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[178] Tr. at 530-32 (Gilford Clarifying) (Dec. 3, 2021).

[179] Staff Ex. 4 (Gilford Dir.) at 12-13.

[180] Staff Ex. 4 (Gilford Dir.) at 17.

[181] Staff Ex. 4 (Gilford Dir.) at 17; *see also* Tr. at 857 (Givens Cross) (Mar. 22, 2023); Tr. at 529-32 (Gilford Clarifying) (WOWSC could recover legal expenses through a surcharge) (adopted by Anna Givens). WOWSC Ex. 27 (Nelson Supp. Reb.), Attachment MN-8 (Staff response to WOWSC RFI No. 1-1).

[182] WOWSC Ex. 4 (Gilford Dir.) at 16.

As an alternative to not recovering the legal expenses at all, Staff recommends that Windermere recover the money by some alternate method, including equity buy-in fees, selling assets, non-member income, the $35,000 from Ms. Martin as a result of the $70,000 award,[183] and the anticipated $400,000 to $500,000 from the Allied World insurance judgment.[184] These sources of revenues, Staff argues, would allow Windermere to preserve its financial integrity.

Finally, in briefing, Staff recommends a suite of oversight measures: compliance filings, an independent management audit, financial reports, and a compliance docket to track repayment of Windermere's existing legal debt and its incurrence of legal debt moving forward. Staff cites no applicable authority for such measures. Absent the invocation of Texas Water Code section 13.004, the ALJs are not aware of Commission authority over a water supply corporation beyond reviewing the rates appealed under section 13.043. Moreover, Staff's recommendations are premised on unsupported assertions that Windermere inappropriately incurred unlimited legal expenses. Based on the record presented, such measures would be unnecessarily punitive. Accordingly, these recommendations are not further addressed.

2. Windermere's Position

Windermere argues that neither disallowing the $171,337 of legal expenses from the revenue requirement nor using funds from its CoBank loan to offset legal

[183] Tr. at 776 (Gimenez Cross) (Mar. 22, 2023).

[184] WOWSC Ex. 26 (Gimenez Supp. Dir.) at 12; Tr. at 776 (Gimenez Cross) (Mar. 22, 2023).

expenses is tenable.[185] First, wholly disallowing the outside legal expenses from rates will risk financial ruin for the utility.[186] To fund necessary capital expenditures, Windermere entered into a credit agreement with CoBank (after the board's rate decision) in September 2020 that requires it to maintain a debt service coverage ratio (DSCR) of 1.25 to 1.00.[187] Mr. Gimenez testified that the Windermere subdivision continues to grow by roughly six houses each year, and has 130 vacant lots and 40 additional hangars that could soon be developed.[188] Finally, Windermere must soon expand its sewer plant, replace raw water pumps, and replace its clarifier system.[189]

Windermere argues that Staff's proposals would result in financial collapse within a year. Mr. Nelson testified that Staff's proposed rates, applied to Windermere's FY2022 billing data, which incorporates the corporation's necessary legal payments,[190] have the following financial impact: (1) after 11 months, Windermere would have no funds to meet its loan covenant reserves; (2) after 12 months, Windermere would exhaust its checking and money market account

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[185] *See* Staff Ex. 4 (Gilford Dir.) at 16.

[186] WOWSC Ex. 9 (Rabon Reb.) at 8; WOWSC Ex. 3 (Gimenez Reb.) at 22, Attachment JG-19.

[187] WOWSC Ex. 26 (Gimenez Supp. Reb.) at 5; WOWSC Ex. 27 (Nelson Supp. Reb.), Attachment MN-13 at 11, 18 of 19 (Bates 118, 125).

[188] WOWSC Ex. 26 (Gimenez Supp. Reb.) at 6.

[189] WOWSC Ex. 26 (Gimenez Supp. Reb.) at 6-7.

[190] WOWSC Ex. 27 (Nelson Supp. Reb.), Attachment MN-12 at 5 of 91 (Bates 21).

balances and, therefore, be incapable of paying its bills; and (3) after 12 months, Windermere would not meet its loan covenant's DSCR.[191]

With Staff's recommended refund, Windermere contends that it would experience the following impacts: (1) after six months, Windermere would have no funds to meet its loan covenant reserves; (2) after seven months, Windermere would exhaust its checking and money market account balances; and (3) after 12 months, Windermere would not meet its loan covenants' DSCR.[192]

Mr. Nelson further testified that these analyses assume that Windermere receives all standby and late fees in the first month of the year, has no capital expenditures throughout the year, and has complete access to its account balance and standby and late fees.[193] As such, the analyses represent ideal outcomes and, under realistic conditions, Windermere's default timeline would accelerate.[194]

The fallout would include that, within a year, Windermere's loans would become immediately payable, likely leading to a quick sale of property vital to the corporation's operations.[195] Windermere would violate its CoBank DSCR and, therefore, fail to secure new loans for capital improvements.[196] It would also default

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[191] WOWSC Ex. 27 (Nelson Supp. Reb.) at 8; Attachment MN-11.

[192] WOWSC Ex. 27 (Nelson Supp. Reb.) at 9, Attachment MN-14.

[193] WOWSC Ex. 27 (Nelson Supp. Reb.) at 8-9.

[194] WOWSC Ex. 27 (Nelson Supp. Reb.) at 8-9.

[195] WOWSC Ex. 27 (Nelson Supp. Reb.) at 10.

[196] WOWSC Ex. 27 (Nelson Supp. Reb.) at 10.

on its legal bills, subjecting itself to increased legal liability.[197] In sum, Staff's proposals would inevitably lead to bankruptcy or receivership and, ultimately, impact Windermere's customers' ability to receive water and sewer services.[198]

Second, Mr. Nelson testified that the CoBank loans are dedicated to specific uses: (1) finance various capital expenditures; (2) refinance indebtedness to First United Bank and Trust; and (3) purchase a new clarifier/pre-treatment tank and UV treatment equipment.[199] Windermere must use these funds as expressly provided in the covenants and may not pay for outside legal services with them.[200] Thus, Windermere did not have the option to use its CoBank loan to pay for the then-existing legal costs being incurred due to lawsuits filed against Windermere.[201] Additionally, it was not an option to borrow capital for the purpose of paying operating expenses, such as legal expenses,[202] and seeking other commercial loans would have placed Windermere in an even less desirable situation, due to higher interest rates and shorter durations.[203] Mr. Nelson testified that as a non-profit water supply corporation, Windermere does not have any shareholders and, therefore, may only realistically pay its legal expenses and maintain its credit through rates.[204]

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[197] WOWSC Ex. 27 (Nelson Supp. Reb.) at 10.

[198] WOWSC Ex. 27 (Nelson Supp. Reb.) at 10.

[199] WOWSC Ex. 8 (Nelson Reb.) at 6.

[200] WOWSC Ex. 8 (Nelson Reb.) at 6.

[201] WOWSC Ex. 9 (Rabon Reb.) at 10-11.

[202] WOWSC Ex. 9 (Rabon Reb.) at 10-11.

[203] WOWSC Ex. 3 (Gimenez Reb.) at 6.

[204] WOWSC Ex. 27 (Nelson Supp. Reb.) at 11.

Windermere expert Mr. Rabon testified that not recovering these costs through rates risks the financial ruin of the utility— "an outcome which would not benefit ratepayers, lower rates, or improve service."[205] Windermere has committed to immediately reducing its base rates once it pays its legal debt in full.[206] Windermere argues that it is therefore reasonable and necessary for it to recover the 2019 legal expenses through rates.

Responding to Staff's proposed other sources of revenue, Windermere argues that equity-buy-in revenue is inconsistent and unreliable because the fees are only paid when a customer requires a new tap.[207] For example, the corporation received $8,000 equity-buy-in fees in 2015 and $50,600 in 2019.[208]

Regarding Staff's recommendation that Windermere satisfy its legal liability with the Allied World settlement, Ms. Martin's indemnification costs, and the *Double F Hangar Lawsuit* damages,[209] Windermere notes that this revenue is still subject to judicial review. The *Allied World* decision is on appeal, and it is therefore unclear exactly when or if Windermere will recover the 2019 insurance settlement proceeds.[210] Ms. Martin's indemnification agreement only takes effect after a court

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[205] WOWSC Ex. 9 (Rabon Reb.) at 8-9.

[206] WOWSC Ex. 26 (Gimenez Supp. Reb.) at 13-14; *see also* WOWSC Ex. 3 (Gimenez Reb.), Attachment JG-39 at 4 (Notice of Rate Increase).

[207] WOWSC Ex. 2 (Gimenez Dir.), Voluminous Attachment to WOWSC Ex. 2 at 42.

[208] Staff HOM2 Ex. 48 (Windermere response to Staff RFI No. 8-4).

[209] Staff HOM2 Initial Brief at 10.

[210] WOWSC Ex. 2 (Gimenez Dir.) at 12-13, Attachment JG-48.

makes a "final determination."[211] Because the plaintiffs in the *Double F Hangar Lawsuit* indicated they will appeal, it is unclear when or if Windermere will ultimately recover Ms. Martin's legal fees or damages.[212] Therefore, this revenue is unreliable and may never materialize.

Regarding Staff's suggestion that Windermere sell "assets that are not being used in the provision of service," "its land," or "sell itself to another functioning utility,"[213] Windermere argues that this is contrary to preserving financial integrity, and without precedent.[214] Moreover, as a non-profit water supply corporation, the only assets Windermere owns it uses "in furtherance of the legitimate business of a water supply cooperative."[215] It therefore has no excess assets to sell.

In contrast, Windermere notes that recovery of the legal expenses through a surcharge would allow it to preserve its financial integrity, and to that end, Windermere will adopt a resolution to amend its tariff to allow for a surcharge to recover its legal expenses.[216] As such, Windermere requests that, if the Commission ultimately adopts Staff's rates, the Commission also authorize a surcharge or assessment for the corporation to recover its underlying legal fees.

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[211] WOWSC Ex. 26 (Gimenez Supp. Reb.), Attachment JG-45.

[212] WOWSC Ex. 2 (Gimenez Dir.) at 12.

[213] Staff HOM2 Initial Brief at 8; WOWSC Ex. 27 (Nelson Supp. Reb.), Attachment MN-10.

[214] Tr. at 866 (Givens Cross) (Mar. 22, 2023)(unable to identify any precedent for recommending that a water retail water utility be required to sell land or itself to pay for its costs of service).

[215] WOWSC Ex. 2 (Gimenez Dir.), Attachment JG-2 at 2 of 22.

[216] WOWSC Ex. 26 (Gimenez Supp. Reb.) at 14 (testifying that the surcharge mechanism was expected to be approved on February 10, 2023); WOWSC Ex. 27 (Nelson Supp. Reb.) at 5.

However, Mr. Rabon testified that "while the nature of this expense might make it a better candidate for recovery via a pass-through rate mechanism, such as a surcharge, the reality is that there is no incentive for WOWSC to maintain the rates at current levels any longer than is necessary to ensure the financial integrity of the utility."[217] Mr. Rabon notes that Windermere is a non-profit water supply corporation with unpaid volunteer board members. As such, there are no outside equity investors.[218] All revenue ultimately accrues to the benefit of ratepayers, and expenses are the responsibility of ratepayers, with no remaining profits going to investors.[219]

Windermere argues that its financial integrity depends on recovery of the appealed rates or a surcharge, and emphasizes that after it pays its legal debt in full, it will immediately reduce its base rates.[220]

a) Analysis

The ALJs are not aware of any authority to require, or even expect, a governing body, on appeal, to exhaust all other sources of revenue—including selling itself—in evaluating financial integrity. Instead, the Commission is authorized to "fix in its final order the rates the governing body should have fixed in the action from which the appeal was taken," and in so doing, "use a methodology that

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[217] WOWSC Ex. 9 (Rabon Reb.) at 9.

[218] WOWSC Ex. 9 (Rabon Reb.) at 9-10.

[219] WOWSC Ex. 9 (Rabon Reb.) at 9.

[220] WOWSC Ex. 26 (Gimenez Supp. Reb.) at 13-14; *see also* WOWSC Ex. 3 (Gimenez Reb.), Attachment JG-39 at 4 (Notice of Rate Increase).

preserves the financial integrity of the retail public utility."[221] Thus, the rates themselves must preserve the financial integrity of retail public utility.

In the context of an IOU, preserving financial integrity is linked to its ability "maintain its credit and to attract capital."[222] Although Windermere may not need to attract capital, it must nevertheless maintain its credit. The credible evidence shows that adopting Staff's recommendation would have a catastrophic impact on Windermere's ability to maintain its credit. Specifically, the evidence shows that by removing the legal expenses and requiring refunds, within a year Windermere would have no funds to meet its loan covenant reserves; exhaust its checking and money market account balances; and would not meet its loan covenants' DSCR.[223] The fallout would be even more disastrous: Windermere's loans would become immediately payable, likely leading to a quick sale of property vital to its operations;[224] Windermere would violate its CoBank DSCR and, therefore, fail to secure new loans for capital improvements;[225] Windermere would default on its legal bills, subjecting itself to increased legal liability;[226] and ultimately lead to bankruptcy or receivership.[227]

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[221] Tex. Water Code § 13.043(e), (j).

[222] *Suburban Util. Corp.*, 652 S.W.2d at 362.

[223] WOWSC Ex. 27 (Nelson Supp. Reb.) at 9, Attachment MN-14.

[224] WOWSC Ex. 27 (Nelson Supp. Reb.) at 10.

[225] WOWSC Ex. 27 (Nelson Supp. Reb.) at 10.

[226] WOWSC Ex. 27 (Nelson Supp. Reb.) at 10.

[227] WOWSC Ex. 27 (Nelson Supp. Reb.) at 10.

No party credibly rebuts this evidence. Staff and Ratepayers point to various financial figures as evidence of Windermere's financial condition, alternatively claiming that Windermere was flush with case and never needed to increase rates to pay for the legal expenses *and* was insolvent at the end of 2019.[228] There also appears to be significant confusion regarding the interplay between the use of historical data in the TRWA analysis and the forward-looking 2020 budget in arriving at the rates ultimately adopted by the board. However, not being bound by the requirement to set rates using on a historical test year adjusted for known and measurable changes,[229] Windermere has more latitude in how it arrives at its rates.

Although non-recurring expenses may be more perfectly recovered by IOUs through a surcharge, Windermere's tariff did not authorize recovery of costs through a surcharge at the time the board made its decision.[230] Ms. Gilford made clear that her quarrel was not with Windermere recovering the cost of the legal fees from its customers, only doing so through rates.[231] However, the evidence does not show that Windermere could reasonably have recovered the legal expenses by other means. The evidence shows that Staff's proposed alternate revenue streams are insufficient and not guaranteed. Importantly, many of them were not available at the time the board made its decision and depended on the outcome of the pending lawsuits, which in turn depended on the funds generated by the rates that Staff and Ratepayers now

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[228] *Compare* Ratepayers HOM2 Initial Brief at 24 *with* Staff HOM2 Initial Brief at 10.

[229] Tex. Water Code § 13.181(a) (Subchapter F "shall apply only to a utility and shall not be applied to . . . water supply or sewer service corporations.").

[230] Tr. at 529-32 (Gilford Clarifying)

[231] Tr. at 529-32 (Gilford Clarifying).

oppose. The CoBank loan was dedicated to costs of system improvements. Even if loan money were used, Windermere would still have to pay off the loan—presumably, with interest—with funds from its members. Therefore, using borrowed money is not a different funding source. Finally, unlike an IOU, Windermere can change its rates at any time, which it committed to do as soon it paid off its legal balances.[232]

3. Rate Design and Allocation

Windermere did not adopt the rate supported by the TRWA study. Instead, Windermere increased the base rate to recover enough additional funds to makes its monthly payments to the law firms. Mr. Nelson explained how the board arrived at its rate design:

> So, my understanding was we wanted to increase our monthly cash flow or revenue by, say, almost $16-$17,000 per month so we could make legal payments of $20,000, [$]10,000 to both law firms. And so when we looked at that, that meant increasing base rates by around $65 or so. And so we split the $65 60 percent/40 percent, 60 percent for water and 40% for wastewater. And so we added -- so we multiplied that and added that to the previous base rates, came up with the new base rate, combined about $156, and that was below the $174.59 here in [the TRWA] model. And so we felt like we could work with our legal teams and with a $10,000 a month payment, and so we did not increase rates above that once we felt like we could achieve the $10,000 monthly payments to both law firms.[233]

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[232] WOWSC Ex. 3 (Gimenez Reb.), Attachment JG-39 at 4 (Notice of Rate Increase); Tr. at 198 (Nelson Cross) (Dec. 1, 2021).

[233] Tr. at 204-05 (Nelson Cross) (Dec. 1, 2021); *see also* Ratepayers Ex. 41.

Thus, Windermere changed only its base rate. Only a small portion of its overall rate revenue is generated by the volumetric charges.[234]

a) Staff's Position

Staff witness Steven Mendoza testified regarding rate design. Adopting the revenue requirement of $356,377 recommended by Ms. Givens, and the 60%/40% water/sewer allocation, Mr. Mendoza recommended a water base rate of $40.43 and a sewer base rate of $29.81.[235] Mr. Mendoza further recommended that the Commission establish the following tiered volumetric rates for water service:

- 0-2,000 gallons: $4.36 per 1,000 gallons
- 2,001-4,000 gallons: $5.52 per 1,000 gallons
- 4,001-8,000 gallons: $7.76 per 1,000 gallons
- 8,001-15,000 gallons: $11.84 per 1,000 gallons
- 15,001 or more gallons: $14.27 per 1,000 gallons[236]

Finally, Staff recommends that the Commission establish a volumetric rate of $6.55 per 1,000 gallons for sewer service.[237] Staff argues that the entirety of non-recurring expenses should not be recovered through base rates.[238]

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[234] WOWSC Ex. 9 (Rabon Reb.) at 5.

[235] Staff HOM2 Ex. 1 (Mendoza Supp. Dir.) at 17-18.

[236] Staff HOM2 Ex. 1 (Mendoza Supp. Dir.) at 18.

[237] Staff HOM2 Ex. 1 (Mendoza Supp. Dir.) at 18.

[238] Staff HOM2 Ex. 1 at 10 (referencing the TRWA rate design, which allocated 61.48% of Windermere's revenue requirement to base rates).

Staff witness Spencer English recommended reclassifying what Windermere treated as depreciation as a Capital Expenditure Reserve and treating it as customer-contributed capital.[239] This recommendation is not contested.

b) Windermere's Position

Windermere argues that Staff's proposed rate design is unsuitable for Windermere's service area due to the nature of its members. Specifically, many Windermere connections are second homes and hangar owners and use minimal water, and therefore pay minimal volumetric rates.[240] Accordingly, under Staff's proposed rate design, permanent residents effectively subsidize temporary residents with higher volumetric rates.[241]

Windermere expert witness Rabon testified that setting fixed and variable rates is a policy judgment, which may fluctuate depending on the policy objectives.[242] Windermere argues that its decision to set higher base rates more equitably ensures that all connections, whether permanent or temporary, pay for the system, and is a policy judgment best left to the locally elected board of directors.

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[239] Staff Ex. 1 (English Dir.) at 3.

[240] WOWSC Ex. 26 (Gimenez Supp. Reb.) at 15.

[241] WOWSC Ex. 26 (Gimenez Supp. Reb.) at 15.

[242] WOWSC Ex. 9 (Rabon Reb.) at 5.

c) Analysis

The ALJs find that Windermere reasonably designed its rates to recover a larger percentage of its revenue requirement through base rates, given the customer characteristics. Although Staff presented an alternative rate design, it did not provide any basis for finding that Windermere's rate design is unreasonable. As Mr. Rabon opined, the higher allocation to base rates is intended to prioritize revenue stability.[243] Given its ability to change rates at any time, the motivation that a ratepayer-controlled board would have in reducing rates as soon as possible, and the certainty with which it needed to ensure recovery, the ALJs find that Windermere's fixed versus variable allocation was reasonable. Accordingly, the ALJs recommend that the Commission allow the corporation to continue collecting rates in accordance with the rate design effective March 2020.

G. RATE CASE EXPENSES

Windermere requests $478,184.04 in reasonable and necessary legal and consultant rate case expenses incurred through January 31, 2023.[244] This total includes $85,662 of legal expenses incurred from May 23, 2022, through January 31, 2023.[245] In support of its request, Windermere notes this appeal has involved complex and novel legal issues that required counsel's time and attention, including the consultation of an expert, a remand, and a second hearing on the merits.[246]

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[243] Tr. at 422 (Rabon Cross) (Dec. 2, 2021).

[244] WOWSC Ex. 28 (Mauldin 5th Supp. Dir.) at 4-5.

[245] WOWSC Ex. 28 (Mauldin 5th Supp. Dir.) at 6.

[246] WOWSC Ex. 4 (Mauldin Dir.) at 10.

Windermere further requests that it be allowed to update its rate case expenses after the close of the record and request a recovery of trailing expenses in a compliance proceeding where its residual rate case expenses can be reviewed.[247]

Staff supports awarding recovery of rate case expenses, but only those incurred up until January 31, 2022.[248] Ms. Givens testified that this "encompasses the first hearing on the merits, all of the information that was produced for that hearing, as well as briefs and reply briefs."[249] Drawing on the guidelines in 16 Texas Administrative Code section 24.44, Staff recommended that $379,000 of the amount requested by Windermere is reasonable and should be recovered, based on evaluated Ms. Mauldin's testimony.[250] Staff further recommends that any expenses incurred after January 31, 2022, should be evaluated in a compliance docket so that the Commission may fully evaluate the appropriateness of the recovery of any additional expenses.

Ratepayers oppose recovery of any rate case expenses. First, Ratepayers argue that Windermere and Staff's testimony supporting their recommendations should be stricken. These requests, which were included in Ratepayers' post-hearing briefing, are overruled as untimely and unsubstantiated. Next, Ratepayers claim that Windermere misrepresented its revenue requirement, and it would therefore be against public policy to award rate case expenses. This claim is unsupported and not

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[247] Windermere HOM2 Initial Brief at 13.

[248] Tr. at 864 (Givens Cross) (Mar. 22, 2023).

[249] Tr. at 864 (Givens Cross) (Mar. 22, 2023).

[250] Staff HOM2 Initial Brief at 11.

further addressed. In reply brief, Ratepayers argue that Staff fails to provide a sufficient detailed explanation on how the criteria in 16 Texas Administrative Code section 24.44 apply to Windermere's rate case expenses.

The ALJs find that Staff's support of rate case expenses only through January 31, 2022, fails to account for the additional expenses of remand briefing, discovery, testimony, a second hearing on the merits, and post-hearing briefing, reasonably incurred in the following 12 months. The evidence of the reasonableness of the legal and consultant incurred by Windermere in the appeal proceedings presented by Ms. Mauldin is unrebutted. Given the length, complexity, and novel issues presented by this case, the ALJs find $478,184.04 in rate case expenses to be reasonable and comparable to the rate case expenses awarded in other, arguably less complex, rate appeals.[251] The ALJs therefore recommend that Windermere be authorized to recover $478,184.04. Because this amount does not account for expenses incurred after January 31, 2023, the ALJs recommend that Windermere file an affidavit or supplemental testimony closer in time to the Commission's consideration of this matter reflecting the current total, or allow Windermere to recovery trailing rate case expenses through a compliance docket.

1. Recovery Mechanism

Staff recommends that rate case expenses be recovered through a surcharge over a five-year period to avoid financial burden on the customers. Windermere requests recovery over a 42-month period.

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[251] *Ratepayers Appeal of the Decision by Bear Creek Special Utility District to Change Rates*, Docket No. 49351, Order on Rehearing at Finding of Fact No. 56 (Nov. 19, 2021) (awarding $409,000 in rate case expenses).

With 271 connections, the currently supported amount of rate case expenses, $478,184.04, spread over 42 months, will be approximately $42 per month per customer.[252] Over five years, or 60 months, this amount would be closer to $29 per month. Although more mitigating of the impact on ratepayers, a five-year recovery period is unusually long. While still unusually long, the ALJs find that a 42-month recovery period balances the need to mitigate the bill impact on a relatively small number of customers and Windermere's need to recover its rate case expenses in a timely manner.

Additionally, Ms. Gilford recommended recovering the rate case expenses through a surcharge that would terminate once Windermere collects the amount awarded. The ALJs agree and recommend that the rate case expenses be recovered through a surcharge until the earlier of 42 months after the surcharge takes effect or full recovery of the final amount awarded.

IV. CONCLUSION

The ALJs find that the appealed rates are not unreasonably preferential, prejudicial, or discriminatory and are sufficient, equitable, and consistent in application to each class of customers. Moreover, the ALJs find that the inclusion of $171,337 in outside legal expenses, and their recovery through base rates, is just and reasonable, particularly where the governing body, which can change rates at any time without Commission approval, has already committed to reducing the rates as soon as its legal expenses are paid. However, the ALJs find the Windermere's failure

[252] This is calculated by dividing the total rate case expense amount by the total number of connections, divided by 42 months.

to offset its revenue requirement with late and standby fees was not just and reasonable. Accordingly, the ALJs recommend a revenue requirement of $527,714 ($576,192 minus $48,478) and that the over-collection be refunded to customers over the same period as it was collected, namely, March 23, 2020 until the Commission's final decision.

The ALJs recommend allocating 60% of this revenue requirement to water, or $316,628.40, and 40% to sewer, or $211,085.60.

The ALJs further find Windermere's rate design reasonable and recommend no re-allocation of costs to the variable rate.

Finally, the ALJs recommend that the Commission allow Windermere to recover its rate case expenses through a surcharge until the earlier of 42 months after the surcharge takes effect or full recovery of the amount awarded. Windermere should update its rate case expenses closer in time to the Commission's final decision in this matter, or allow Windermere to recovery trailing rate case expenses through a compliance docket.

The ALJs recommend that Staff submit number running consistent with the above recommendations to be available for the Commission open meeting to consider this matter.

V. FINDINGS OF FACT

General and Procedural Findings

1. Windermere Oaks Water Supply Corporation (WOWSC) is a non-profit water supply corporation operating under chapter 67 of the Texas Water Code (TWC).

2. WOWSC's Public Water System Identification Number is 0270035.

3. WOWSC's water utility and sewer service Certificates of Convenience and Necessity numbers are 12011 and 20662.

4. WOWSC is managed by a member-elected Board of Directors, where each director must be a resident of the State of Texas, a member, and a customer of WOWSC.

5. WOWSC has five board members, and the Board of Directors elects its officers.

6. The Board of Directors made its decision affecting water and sewer rates on February 11, 2020.

7. On April 27, 2020, certain ratepayers of WOWSC (Ratepayers) filed a petition under TWC § 13.043(b) to appeal WOWSC's decision to change rates.

8. Greater than 10% of WOWSC's total active connections at the time of filing signed the petition to contest the rate increase.

9. The appealed rates became effective on March 23, 2020.

10. No party requested an effective date other than the original one proposed by WOWSC.

11. Only the fixed rates for water and sewer service were appealed.

12. On June 23, 2020, the Commission Administrative Law Judge (ALJ) issued Order No. 3 finding the petition administratively complete.

13. On June 23, 2020, the Public Utility Commission of Texas (Commission) referred the appeal to the State Office of Administrative Hearings (SOAH), requesting the assignment of a SOAH ALJ to conduct a hearing and issue a proposal for a decision, if necessary.

14. In its referral order, the Commission required Ratepayers and WOWSC to file a list of issues by July 1, 2020, and allowed Commission staff (Staff) to file its list of issues by that date if desired.

15. On July 16, 2020, the Commission entered a Preliminary Order, including 11 issues to be addressed in the SOAH proceeding.

16. On March 10, 2021, WOWSC filed the direct testimonies of George Burris, Joe Gimenez, III, Mike Nelson, and Jamie L. Mauldin.

17. On April 7, 2021, Ratepayers filed the direct testimonies of Danny Flunker, Patti Flunker, Kathryn Allen, and Bill Stein.

18. On May 5, 2021, Staff filed the direct testimonies of Maxine Gilford, Spencer English, Heidi Graham, and Stephen Mendoza.

19. On June 7, 2021, WOWSC filed its rebuttal testimony of Mike Nelson, Joe Gimenez, III, and Grant Rabon.

20. On June 7, 2021, WOWSC filed its first supplemental direct testimony of Jamie L. Mauldin.

21. On June 17, 2021, Ratepayers filed the errata testimonies of Danny Flunker, Patricia Flunker, and Bill Stein.

22. On November 19, 2021, WOWSC filed its second supplemental direct testimony of Jamie L. Mauldin.

23. On November 23, 2021, Staff filed its first errata to the direct testimony of Spencer English and its supplemental direct testimony of Maxine Gilford.

24. On November 29, 2021, WOWSC filed its errata to the direct testimony of Mike Nelson.

25. On December 1, 2021, a three-day hearing on the merits was held via Zoom before SOAH ALJs Christiaan Siano and Daniel Wiseman and was attended by representatives for WOWSC, Ratepayers, and Staff.

26. Under SOAH Order No. 15, the parties filed initial post-hearing briefs on December 30, 2021, and reply briefs on January 25, 2022.

27. SOAH Order No. 15 directed WOWSC to file an exhibit supporting rate case expenses in its brief and a motion to reopen the record and admit the exhibit into evidence.

28. On December 30, 2021, WOWSC filed a motion to reopen the record and admit evidence supporting rate cases expenses.

29. On February 15, 2022, SOAH Order No. 17 re-opened the evidentiary record and admitted WOWSC Exhibit 22 related to WOWSC rate case expenses.

30. On March 31, 2022, the SOAH ALJs issued a Proposal for Decision recommending that the Commission dismiss Ratepayers' appeal and allow WOWSC to recover $345,227.03 in rate case expenses, plus any trailing expenses incurred after December 31, 2021, through a surcharge over 42 months.

31. On May 25, 2022, WOWSC filed its fourth supplemental direct testimony of Jamie L. Mauldin.

32. On June 15, 2022, the Commission ALJ issued Order No. 4 admitting the fourth supplemental direct testimony of Jamie L. Mauldin into evidence.

33. On June 30, 2022, the Commission issued an order rejecting the Proposal for Decision and remanding the proceeding to SOAH to address all the standards prescribed under TWC § 13.043(j).

34. On October 28, 2022, WOWSC filed its supplemental testimony of Grant Rabon.

35. On December 1, 2022, Ratepayers filed their supplemental direct testimonies of Robert Gaines and Kathryn Allen.

36. On December 19, 2022, WOWSC filed its first errata to the rebuttal testimony of Mike Nelson.

37. On January 6, 2023, SOAH Order No. 27 granted WOWSC's Motion to Strike Ratepayers' Supplemental Direct Testimonies of Robert Gaines and Kathryn Allen.

38. On January 10, 2023, Staff filed its supplemental direct testimonies of Anna Givens and Stephen J. Mendoza.

39. On January 10, 2023, Staff filed a motion for Anna Givens to adopt the testimony of Maxine Gilford, which was granted at the hearing on the merits.

40. On February 10, 2023, WOWSC filed its supplemental rebuttal testimonies of Joe Gimenez, III and Mike Nelson.

41. On February 10, 2023, WOWSC filed its fifth supplemental direct testimony of Jamie L. Mauldin.

42. On March 16, 2023, WOWSC filed its errata to the fifth supplemental direct testimony of Jamie L. Mauldin.

43. On March 22, 2023, a one-day hearing on the merits was held via Zoom before SOAH ALJs Christiaan Siano and Daniel Wiseman and was attended by representatives for WOWSC, Ratepayers, and Staff.

44. Under SOAH Order No. 31, the parties filed initial post-hearing briefs on April 11, 2023, and reply briefs on May 2, 2023, on which date the record closed.

Evidentiary Record

45. At the first hearing on the merits, the SOAH ALJs admitted the following items into the evidentiary record:

    a. Ratepayers Exhibit Nos. 2-33, 35-38, 40-44, 46-48, 50-53;

    b. Staff Exhibit Nos. 1-5; and

    c. WOWSC Exhibit Nos 1-19.

46. At the second hearing on the merits, the SOAH ALJs admitted the following items into the evidentiary record:

    a. Ratepayers HOM-2 Exhibit Nos. 74, 81, 119, 121, 128-136, 139-143, 144A, 144B, 145-155;

    b. Staff HOM-2 Exhibit Nos. 1-58; and

    c. WOWSC Exhibit Nos. 24-28, 30, 32-33.

Background

47. WOWSC's initial Articles of Incorporation were signed on November 9, 1995.

48. WOWSC has one class of members, as defined by TWC § 13.002(11), and its purpose is to furnish water and sewer service to these members.

49. All board members are volunteers and receive no dividends, stock, bonuses, nor other compensation.

50. WOWSC's bylaws allow it to pay up to $5,000 annually to a board director for the provision of business services to the corporation.

51. WOWSC has contracted for water management services with Water Management, Inc., owned by George Burris.

52. WOWSC does not employ in-house legal counsel, but does use outside counsel for legal matters affecting the corporation.

53. At the WOWSC Board meeting on February 11, 2020, the Board of Directors approved a rate increase, in consultation with the Texas Rural Water Association (TRWA) recommendations.

54. At the time of decision to increase rates, WOWSC had 271 water connections and 245 sewer connections.

55. WOWSC considered its mounting legal expenses, required maintenance and operation costs, and necessary repairs to the system in its decision to raise rates.

56. Prior to the rate increase, WOWSC had a minimum water service availability charge of $50.95 and a minimum sewer service availability charge of $40.12.

57. The rate increase was made only to the base rates, resulting in a water service base charge of $90.39 per month and sewer service base charge of $66.41 per month. The rate change was based on a debt service coverage ratio of 1.25.

Revenue Requirement

58. The use of the cash-needs method to establish a revenue requirement was appropriate in this case.

59. TRWA used the cash-needs method in its analysis.

60. A debt service coverage ratio of 1.25 is reasonable and required pursuant to WOWSC's credit agreement with its lender.

61. The Capital Expenditure Reserve totaling $53,273 is reasonable.

62. The amount paid to Water Management, Inc. for operations is reasonable.

63. The amount paid to Water Management, Inc. paid to Corix for subcontracting operations is reasonable.

64. The total WOWSC budgeted amount of $14,160 for insurance is reasonable.

65. The inclusion of outside legal expenses in WOWSC's revenue requirement is reasonable.

66. Excluding outside legal expenses from WOWSC's revenue requirement would not preserve the financial integrity of WOWSC.

67. WOWSC's failure to offset its revenue requirement by late fees and stand by fees was not just and reasonable.

68. WOWSC's net revenue requirement should be $527,714.

Rate Design

69. WOWSC provides water and sewer service.

70. WOWSC serves no meter size except for the 5/8″ x 3/4″ meter.

71. Water and sewer service each have a single base rate applicable to a single meter size.

72. WOWSC has one class of customers.

73. WOWSC charges all customers the same rates.

74. Because WOWSC's customers reside in substantially similar locations, receive the same service, and impose similar costs on WOWSC, the customers have similar characteristics.

75. It is appropriate to charge all WOWSC customers the same rates.

76. WOWSC has approximately 75 active connections for service at airport hangars, where there is limited use of water.

77. The rate increase is applied to the base rate, rather than the volumetric rate, to provide equitable rates for all customers.

78. The revenue requirement of $527,714 should be allocated 60%, or $316,628.40, to water service and 40%, or $211,085.60, to sewer service.

Rate Case Expenses

79. WOWSC incurred rate case expenses since the initiation of this proceeding, beginning on April 27, 2020, through the date of this filing.

80. The rate case expenses of $478,184.08 incurred from April 27, 2020, through January 31, 2023, are reasonable.

81. Staff supports the recovery of rate case expenses in this proceeding.

82. A 42-month recovery period for rate case expenses is reasonable.

83. It is appropriate for WOWSC to recover the rate case expenses through a surcharge.

84. The surcharge should be calculated based on recovering the approved rate-case expenses over a 42-month recovery period, and should continue until the earlier of 42 months after the rider takes effect or the approved amount is fully recovered.

VI. CONCLUSIONS OF LAW

1. WOWSC is a nonprofit water supply corporation. TWC § 13.002(24).

2. WOWSC is a retail public utility. TWC § 13.002(19); 16 TAC § 24.3(31).

3. The Commission has authority over this proceeding under TWC § 13.043 and 16 Texas Administrative Code (TAC) § 24.101.

4. SOAH has jurisdiction over this proceeding under Texas Government Code § 2003.049.

5. This docket was processed in accordance with the requirements of the TWC, Administrative Procedure Act, and Commission rules.

6. In a rate appeal brought under TWC § 13.043, the Commission must find that the utility established rates that were just and reasonable; were not unreasonably preferential, prejudicial, or discriminatory; and were sufficient, equitable, and consistent in application to each class of customers. TWC § 13.043(j).

7. The utility bears the burden of proof to establish that the contested rates are just and reasonable. 16 TAC § 24.12.

8. Ratepayers' petition was timely filed under TWC § 13.043(c) and 16 TAC § 24.101(b), and meets the 10% ratepayer-signature threshold established under TWC § 13.043(c) and 16 TAC § 24.103(b).

9. The Commission hears this appeal de novo.

10. Under TWC § 13.043(e), the Commission may in an appeal brought under TWC § 13.043(b) consider the information that was available to the governing body of the retail public utility at the time the governing body set the rates appealed; any information that shows, or tends to show, the information that was available to the governing body at the time it set the rates appealed; and evidence of reasonable expenses incurred by the retail public utility in the appeal proceedings

11. The Commission shall fix the rates that the governing body should have fixed at the time it made its decision. TWC § 13.043(e).

12. In an appeal under TWC § 13.043, the Commission must use a methodology that preserves the financial integrity of the retail public utility. TWC § 13.043(j).

13. The appealed rates, as modified in the Findings of Fact, are just and reasonable.

14. The appealed rates are not unreasonably preferential, prejudicial, or discriminatory.

15. The appealed rates are sufficient, equitable, and consistent in application to each class of customers.

16. The rates set, as described in the Findings of Fact, will preserve the financial integrity of WOWSC in compliance with TWC § 13.043(j).

17. The revenue requirement for a utility that uses the cash needs method can include operations and maintenance expenses, debt service requirements, and capital expenditures that are not debt-financed. *Black v. City of Killeen*, 78 S.W.3d 686, 694 (Tex. App.—Austin 2002, pet. denied).

18. The Commission may allow the recovery of WOWSC's reasonable expenses incurred in the appeal proceedings. TWC § 13.043(e).

19. WOWSC should recover its reasonable rate case expenses through a surcharge. TWC § 13.043(e).

20. The Commission may allow WOWSC to impose a surcharge to recover lost revenues and rate case expenses. TWC § 13.043(e).

21. The Commission may order refunds of revenues over-collected. TWC § 13.043(e).

VII. PROPOSED ORDERING PARAGRAPHS

1. The Commission adopts the proposal for decision, including findings of fact and conclusions of law.

2. WOWSC's revenue requirement of $527,714 is approved.

3. The Commission fixes the following base rates charges effective March 23, 2020: water $_____; sewer $_____.

4. Beginning with the next billing cycle after the date of this Order, WOWSC must on a monthly basis issue the following refunds over a period of ___ consecutive months or until a net amount of $_____ has been refunded, whichever occurs first.

5. The Commission approves a monthly surcharge of $_____ per connection to recover WOWSC's rate-case expenses of $478,184.08. Beginning with the next billing cycle after the date of this Order, WOWSC may collect the monthly surcharge for 42 months or until $478,184.08 is collected, whichever occurs first.

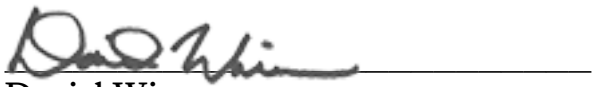
6. WOWSC's depreciation expense shall be reclassified as Capital Expenditure Reserve.

7. All surcharges and refunds authorized by this Order must be implemented in Docket No. _____, *Compliance Docket for Docket No. 50788* (*Ratepayers' Appeal of the Decision the Windermere Oaks Water Supply Corporation to Change Rates*).

8. The Commission denies all other motions and any other requests for general or specific relief that the Commission has not expressly granted.

SIGNED June 29, 2023.

Christiaan Siano
Administrative Law Judge



Daniel Wiseman
Administrative Law Judge

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