

JOINT COMMITTEE ON OVERSIGHT OF BEXAR METROPOLITAN WATER DISTRICT

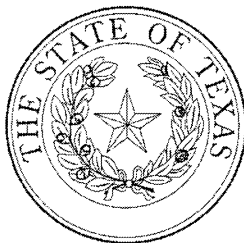
**Report to the 83rd Texas Legislature
December 21, 2012**

**Co-Chairmen:
State Senator Carlos I. Uresti
State Representative Lyle Larson**

Senator Carlos I. Uresti,
Co-Chair
Senate District 19

Senator Jeff Wentworth
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Bexar County, Precinct 3



Representative Lyle Larson,
Co-Chair
House District 122

Representative José Menéndez
House District 124

Don Durden

BEXAR METROPOLITAN WATER DISTRICT OVERSIGHT COMMITTEE

December 21, 2012

The Honorable Troy Fraser
Chairman of the Senate Committee on Natural Resources
P.O. Box 12068
Capitol Station
Austin, Texas 78711

The Honorable Allan Ritter
Chairman of the House Committee on Natural Resources
Room E2.104, Capitol Extension
Austin, Texas 78701

Dear Gentlemen:

The Joint Committee on Oversight of Bexar Metropolitan Water District (District) respectfully submits the following interim report. This report represents the final action of this committee as District customers voted to dissolve the District and merge with the San Antonio Water System, a process that is well underway and is proceeding smoothly.

Respectfully yours,

Handwritten signature of Carlos I. Uresti in black ink.

CARLOS I. URESTI

Handwritten signature of Jeff Wentworth in black ink.

JEFF WENTWORTH

Handwritten signature of Kevin A. Wolff in black ink.

KEVIN A. WOLFF

Handwritten signature of Lyle Larson in black ink.

LYLE LARSON

Handwritten signature of Jose Menendez in black ink.

JOSE MENENDEZ

Handwritten signature of Don Durden in black ink.

DON DURDEN

TABLE OF CONTENTS

EXECUTIVE SUMMARY	4
BACKGROUND AND HISTORY	7
OVERSIGHT COMMITTEE COMPOSITION AND PROCEEDINGS	13
ISSUES AND FINDINGS	14
RECOMMENDATIONS	17

EXECUTIVE SUMMARY

The Bexar Metropolitan Water District (District or BexarMet), created by the Texas Legislature in 1945, was dissolved in 2012 pursuant to legislation passed by the 82nd Legislature. The dissolution followed a vote by customers in which 74 percent were in favor of getting rid of the District and merging it with the San Antonio Water System (SAWS). The integration of the two utilities involved assimilating about 93,000 BexarMet connections into SAWS water services.

The District suffered for years from a poor relationship between management and its elected board of directors, casting the utility in a bad public light and leading to customer distrust of board and management decisions. Customers complained for years about inadequate service, unsafe water conditions and excessive rates. Concerns about the District's inability to resolve customer complaints prompted legislative intervention in 2007. The legislature created the Joint Committee on Oversight of Bexar Metropolitan Water District (Committee) to monitor operation, management and governance of the District and to recommend reform measures to the legislature for its consideration. The 2007 legislation also called for financial and management audits by the State Auditor's Office and the Texas Commission on Environmental Quality (TCEQ). These audits, completed in 2008, found significant deficiencies and made dozens of recommendations for improvements. The Committee also made reform recommendations to the legislature, but legislators were given assurances by District officials that they would reform the District from within. But by the time the legislature met again in 2011, only 75 percent of the audit recommendations had been completed.

After receiving numerous letters, telephone calls and hours of testimony, the Committee found in 2010 that the Bexar Metropolitan board of directors was incapable of functioning as a policy-making body. It further found that the District's governing body was dysfunctional to the extent that it was not capable of either fulfilling its responsibilities to its customers or rehabilitating itself.

The Committee recommended the election whereby customers would vote whether to dissolve the district, and the legislature in 2011 passed Senate Bill 341 setting it up. That election was held in November 2011, and customers voted for dissolution by a significant margin. Representatives of the Committee, TCEQ and SAWS met over several months after the election to plan the transition from BexarMet to SAWS. The formal dissolution of the District was approved by the governing body of TCEQ on May 30, 2012.

The 2011 legislation gives SAWS up to five years to operate the former BexarMet District as a special project before fully integrating it into SAWS operations. But by July 2012, SAWS had integrated the billing and customer service systems. About 250 employees were on the BexarMet payroll when SAWS assumed management in January 2012, and by November, SAWS reported

that number had been reduced to approximately 150 through retirements, attrition and movement into SAWS positions.

One concern raised by the Committee and the legislation was the issue of representation within SAWS for customers who live outside the San Antonio city limits, since those customers do not vote for City Council members who appoint SAWS trustees. The legislation required the SAWS board to appoint and consult quarterly with an advisory committee composed of former BexarMet customers. That 16-member committee was established and reported to the SAWS board in August 2012 that it was pleased with the progress of the integration.

While the customers of BexarMet had their opportunity to vote in November of 2011, the fact that these customers have no formal vote in the appointment of SAWS' trustees at the utility is a concern for some customers going forward. The San Antonio City Council appoints the SAWS Board of Trustees. These trustees represent the entire service area and all customers, regardless of whether customers live with the city limits. It is important to recognize that both SAWS and CPS Energy have always served tens of thousands of customers outside the City of San Antonio's corporate limits. The dissolution of the BexarMet District and assumption by SAWS has not materially altered that structure. Nonetheless, we urge the San Antonio City Council to consider appointing members to the SAWS board from those parts of BexarMet's former service areas that are outside the city limits in the future.

SAWS has historically charged higher rates to customers who live outside the city limits (OCL) based on the costs to provide those services further outside their centralized service area and to partially offset the risks associated with the ownership of the system by the City of San Antonio. SAWS also contracts with nationally recognized consultants to perform detailed rate studies before implementing new rate structures. While it is well recognized that this type of rate distinction is a common practice among other utilities, in light of the increasing urbanization of Bexar County, the Committee urges SAWS to consider the impacts of this policy in its rate study that ultimately incorporates the District Special Project (DSP) rates into the SAWS rates, with an eye to bringing the ICL and OCL rates closer to each other.

The City of San Antonio currently requires SAWS to transfer approximately 2.7 percent of its gross revenues to the City of San Antonio. Officials in Somerset and other small cities served by SAWS contend that this acts essentially as a franchise fee, and that instead of money from their customers going to San Antonio, at least part of this money should be going back to their cities. Because SAWS has shown the city payment is not a franchise fee, and because BexarMet did not pay franchise fees, we encourage SAWS to avoid franchise fee agreements with these cities that would raise rates for customers.

While any integration of this magnitude cannot be expected to occur without trials and hurdles along the way, SAWS has demonstrated to the community and to this Committee that it adequately planned for this integration, and that the integration is likely to continue rather seamlessly into the future. SB 341 calls for TCEQ to continue oversight of the transition. In addition to this oversight, state and locally elected officials are also very much in tune with the concerns of their respective customers and local issues. These officials, including those on this oversight Committee, will remain active and available to assist any customers throughout the service area with issues that they believe are not adequately being addressed.

SB 341 calls for the BexarMet Legislative Oversight Committee to be abolished on Jan. 1, 2013. This Committee agrees that this is the appropriate course into the future as this successful resolution to longstanding water service concerns no longer needs a full joint legislative committee. Therefore, we recommend that no further action is necessary by the legislature, and individual issues can best be managed through SAWS, TCEQ and individual legislators.

BACKGROUND and HISTORY

Texas water districts which provide drinking water to customers play an important role in protecting water resources and the public health, facilitating economic growth and job creation, and providing a high quality of life for the residents who live within their boundaries. As entities created by the legislature, these districts remain accountable to the State for the proper exercise of their powers and duties. As entities created by the legislature and despite their customers being given the right to vote for board representatives, these entities remain subject to the right of the legislature to reform, recreate or abolish a district if it determines it is not adequately and appropriately performing the functions for which it was created.

The Bexar Metropolitan Water District (District) suffered for years from a poor relationship between management and its elected board of directors and its customers. Continuing concerns about the entity's ability to provide adequate service for existing customers and for new residents and businesses in its rapidly growing service area prompted legislative intervention beginning in the early 2000's, and particularly with the 80th Texas Legislature in 2007. After years of unfulfilled promises by District officials to improve the dysfunctional district, the 82nd Texas Legislature gave the District's customers the right to vote to determine whether they wanted to keep the utility or merge it with another public utility in San Antonio. The customers in November 2011 overwhelmingly voted to merge the District with the San Antonio Water System (SAWS), a utility owned by the city of San Antonio. This merger was completed with the dissolution of the District on May 30, 2012, by the Texas Commission on Environmental Quality, although SAWS has up to five years to fully integrate the District into its existing rates and operations.

The District had been created by the Texas Legislature in 1945 to provide retail water service to historically underserved areas of the San Antonio metropolitan area. It had grown from 4,765 residential connections in 1945 to 93,000 residential and commercial connections at the time of its dissolution. In that time, its service area had grown from an area of South San Antonio to include territory over widespread areas of Bexar County and in two adjacent counties — Medina and Atascosa. (The District divested itself of holdings in public water supply systems in Comal County in early 2012.)

Rapid growth through purchases by the District in the late 1980s through the 1990s left the District with wide-ranging, disconnected systems that needed upgrades to infrastructure and proved difficult to manage. With the growth of the District through these acquisitions and rapid development, it began to encounter management problems, and its customers began complaining of inadequate service, unsafe water conditions, excessive rates and financial mismanagement. Three general managers were fired, one of them after his indictment for allegedly illegally wiretapping managers of the District, among other charges. The District, governed by a 7-

member board elected from single-member districts, showed poor economic performance and violated its bond covenants at least twice.

House Bill 1565 (80R - Puente), which established a legislative oversight committee, included other provisions intended to scrutinize past and current financial and management practices and policies of the District, including a financial and managerial audit of the District to be completed by the State Auditor's Office. The bill also required the TCEQ to conduct an on-site evaluation of the District.

The State Auditor's Office audit issued in October 2008 found that the District's board and management failed to establish adequate management and financial controls to safeguard the District's assets and ensure that the District's expenditures were reasonable and necessary. The audit also found that the board did not keep an official, board-approved budget, overspending its fiscal year 2007 operating budget by \$8.8 million without amending the budget. The audit found that the District failed to track and monitor its contracts. It found that even though the District's external auditor identified significant control weaknesses in the District's procurement, inventory and payroll functions since at least fiscal year 2006, the District failed to develop a formal plan to address these weaknesses.

The TCEQ report of its on-site evaluation issued in September 2008 found that BexarMet had a "poorly defined management structure." It further found that the agency had "neither a long-range strategic plan nor an asset management plan and lacks stated goals, objectives and performance measures." This led to BexarMet's operating almost entirely in a reactive mode with day-to-day issues elevated to crisis status. It further found there was a climate of friction and distrust between the board and management leading to ineffective or inappropriate decisions and low public confidence.

The Oversight Committee recommended to the 81st Legislature a number of reform options, including various forms of conservatorship, a receivership or mandatory auditing and supervision. Various bills, some of them providing for a conservatorship, were filed in the legislature. A version filed by Sen. Carlos Uresti that made it to a conference committee won unanimous Senate approval but failed to come to a House vote on the final day of the session. That bill would have allowed District customers to vote for dissolution of the District under a conservatorship.

The 82nd Legislature approved Senate Bills 271 and 341 to address the ongoing problems at BexarMet. As the bills were being debated in April 2011, the BexarMet general manager fired 30 employees accused of cheating on a licensing test administered by the TCEQ.

SB341 set up a process to call for a vote by BexarMet ratepayers on the dissolution of the utility, pending the approval of the election and the results by the U.S. Department of Justice under the Voting Rights Act.

In the event that voters did not approve the dissolution of BexarMet, SB271 instituted governance reform measures to be put in place to help address the longstanding issues with the agency's governing board. These included board candidate qualifications, board training requirements, board member recall provisions, board ethics provisions, board member term limits, political contribution limits and continued legislative oversight of the District.

The BexarMet board filed a legal challenge in federal court to SB341 on June 21, 2011, a day after the law went into effect, alleging that the new law illegally took power away from the board of directors by allowing the Texas Commission on Environmental Quality (TCEQ) to make certain decisions. The lawsuit asked for a temporary restraining order against implementation of the bill.

Meanwhile, the Texas Secretary of State, working with the Texas Attorney General's office, filed the necessary paperwork in early July 2011 to seek pre-clearance of the election with the U.S. Department of Justice (DOJ) under the Voting Rights Act. The DOJ is required to give an answer to such pre-clearance requests within 60 days. This set up a tight deadline for the election to get on the November ballot as key state and local deadlines occurred around Sept. 7.

In a mid-July hearing on BexarMet's federal motion for a restraining order, BexarMet witnesses contended that the law placed restrictions on the issuance of BexarMet bonds that caused its short-term credit agreements to be cancelled. They argued that this usurped the power of the board and could lead to layoffs due to cancellation of capital improvement projects.

In early August, the utility's general manager laid off 34 employees, blaming it on the inability to get credit due to the legislation. But a federal judge determined otherwise.

U.S. District Court Judge Orlando Garcia in mid-August issued an order denying the request for a restraining order, saying BexarMet had not proved any of its contentions and that its inability to maintain its credit line was its own fault for entering into the credit agreement in December 2010 with a provision that the agreement would go into default upon enactment of legislation that provided for the dissolution of the district. "BexarMet entered into the agreement with full knowledge that such legislation was pending, and assumed the risks associated with entering into that type of agreement. Plaintiff's injury, if any, resulted from its own actions," the judge wrote in his order.

The BexarMet board voted days later to have its lawyers request a review of the decision by the 5th Circuit Court of Appeals.

As the Sept. 6, 2011, date for a decision by the DOJ approached, Senators Carlos Uresti and Jeff Wentworth sent a letter on Sept. 1 to BexarMet Board President Guadalupe Lopez, with copies to all board members, asking that a board meeting be called for the evening of Sept. 6 to approve the required resolutions and contracts for a November election. They failed to do so.

On Sept. 6, the DOJ issued a letter in which they did not interpose any objection to the law, effectively pre-clearing it for an election. On Sept. 7, in an interview published in the San Antonio Express-News, BexarMet board President Guadalupe Lopez said she had no intention of calling an emergency board meeting to try to meet deadlines in order to have the measure on the November ballot.

The refusal of the board to act prompted several actions by other parties on Sept. 7.

On that date, Senator Uresti once again sent a letter to the board president and all board members asking them to "take all necessary action to order an election be held on this issue for November 2011."

Secondly, as contemplated in the legislation if recalcitrance was shown on BexarMet's part, the Texas Attorney General's Office, on behalf of the Texas Commission on Environmental Quality, filed a petition for a writ of mandamus with the Fourth Court of Appeals in San Antonio seeking to compel the BexarMet board of directors "to call and then hold a statutorily-required election allowing the Board's electorate to determine whether to dissolve the controversial Bexar Metropolitan Water District."

Further and most importantly, U.S. District Court Judge Orlando Garcia issued an advisory in the lawsuit BexarMet had filed in his court asking what issues remained in the suit. The advisory stated that "in light of preclearance, the Plaintiff shall take all necessary steps with all due deliberate speed to set the election as mandated by the Legislature and precleared by the Department of Justice." The judge told the board to report two days later on what steps had been taken in setting up the required election. Judge Garcia further stated in the advisory that "failure to call and set this election for this November, 2011, may result in referral to the Department of Justice for interfering with the voting rights of all BexarMet customers."

These actions resulted in the BexarMet board calling an emergency meeting, which required 2-hours-notice, for the late morning of Sept. 8, 2011, at which time the board, with two members absent, voted 3-2 to order the election for November.

Two high-ranking executives at BexarMet — the general counsel and finance director — resigned within two weeks. It later was revealed that the finance director resigned after the general manager learned he had accepted an expense-paid trip to Las Vegas from a contractor after being a key negotiator in a multimillion dollar lawsuit between the two entities. This allegation was investigated by the Bexar County district attorney's office, but as of the date of publication of this report, no criminal charges have been filed.

In October of 2011, the city of San Antonio's City Council, in anticipation of a potential vote to dissolve the District, passed an ordinance authorizing SAWS to assume operation of the District if ratepayers voted to approve dissolution of the District. The ordinance allowed SAWS to operate Bexar Metropolitan Water District as a separate unit until the system integration is complete. Under this ordinance creating a District Special Project, all rates collected and all operating expenses and debt service will remain separate until the integration is complete.

The election was held on Nov. 8, 2011, and voters approved the dissolution of the Bexar Metropolitan Water District by a margin of more than 74 percent to 26 percent. A majority of voters in six of the district's seven voting districts approved the dissolution and the merger with the San Antonio Water System.

In order to become official, the election results had to be approved by the U.S. Department of Justice's Voting Rights Division to ensure that voting patterns had not shown the law and election to have a discriminatory effect. That approval came on Jan. 27, 2012, clearing the way for the BexarMet board to be dissolved and for the San Antonio Water System to assume management and operation of BexarMet the next day as a District Special Project.

Meanwhile, a BexarMet transition work group had started meeting every two weeks following the election to oversee the steps necessary to implement the transition to SAWS and the formal dissolution of BexarMet by the TCEQ. That group consisted of representatives from TCEQ, SAWS, the BexarMet Legislative Oversight Committee and, until Jan. 27, 2012, the BexarMet district. The transition required the transfer of all property, contracts, permits, employees, liabilities and other assets of BexarMet to SAWS within 90 days.

The New Mexico Environmental Finance Center, a contractor hired by TCEQ, identified all property, permits and contracts that needed to be transferred.

The necessary transfers were made, and the governing body of TCEQ on May 30, 2012, issued an order officially dissolving BexarMet. As the election was held more quickly than anticipated, the tasks called for in the legislation in evaluating the District were able to be pared back by the TCEQ staff and its contractor from the original scope of work, saving the District and SAWS an

estimated \$800,000. The TCEQ staff and its contractor completed in October 2012 the required report evaluating the Bexar Metropolitan Water District.

OVERSIGHT COMMITTEE COMPOSITION AND PROCEEDINGS

Since the previous report was issued to the 82nd Legislature in January 2011, and as required by SB 341, the Oversight Committee has included State Senator Carlos I. Uresti and State Representative Lyle Larson as co-chairmen. Also on the Committee were State Senator Jeff Wentworth, State Representative José Menéndez, Bexar County Commissioner Kevin A. Wolff and gubernatorial appointee Don Durden. One gubernatorial appointee position remained vacant after the resignation of Rhonda Harris in early 2011.

Representatives of the Committee met many times with the teams from the TCEQ and SAWS planning the transition to SAWS following the election in late 2011 and into the summer of 2012. Since the last legislative session, the Committee conducted the following public hearings to receive public testimony regarding the District, the election and the transition to SAWS. The dates and locations of these hearings are listed below.

March 26, 2012, 9 a.m.
San Antonio Central Library Auditorium, San Antonio

August 2, 2012, 9 a.m.
Hollywood Park City Hall, Hollywood Park

Note: For access to these hearing postings and the associated minutes and witness lists, please see: <http://www.senate.state.tx.us/75r/senate/commit/c875/c875.htm> and click on "Schedule and Bills Referred to Committee."

ISSUES AND FINDINGS

Concerns were raised during the legislative session about several potential issues regarding a dissolution of BexarMet and a merger with SAWS. Most issues were addressed in the legislation, or subsequently by SAWS, however, some concerns still exist and should be further addressed by SAWS going forward.

Chief among these concerns was the perception of the potential loss of representation by BexarMet customers who live outside the city limits of San Antonio. The BexarMet board was elected by all of its customers, and worries were raised that because the board members of SAWS are appointed by the San Antonio City Council, those BexarMet customers living outside the San Antonio city limits would no longer have a formal vote to elect members of the board.

Although these customers truly would not have formal elected representation, most BexarMet customers live within the city limits of San Antonio, and therefore that concern is isolated to a smaller subset of former BexarMet customers. It is an issue that exists already with SAWS customers, as well as the sister electric agency, CPS Energy, who serves customers in several counties. Members of the SAWS Board of Trustees are appointed from quadrants and halves of the entire SAWS service area, regardless of city limits, however, currently, all SAWS trustees reside within San Antonio.

The legislation further addressed this issue by requiring SAWS to establish an advisory committee of former BexarMet customers. These customers represent former BexarMet service areas, and included representatives from surrounding counties, residential and business interests, suburban cities and governmental entities. The legislation required the SAWS board to consult quarterly with the advisory committee, where the panel's representatives could report any problems or concerns with the transition and integration into SAWS.

The 16-member committee was formed in April 2012 and met monthly. They were provided presentations on requested topics by SAWS staff. At the August 2012 meeting of the SAWS Board of Trustees, committee Chairwoman Betty Sutherland of suburban Castle Hills, and Vice-Chairman Tony Cadena of suburban Somerset, reported that the committee had been provided all information it had requested and that there were no problems or complaints about the way the merger was proceeding. They reported that the committee was pleased that SAWS had been able to cut costs and avoid a rate increase for the current fiscal year after seeing that the customers likely would have faced a projected double-digit rate increase.

The advisory panel solution to the representation problem is not perfect, but it does provide an even stronger voice for former BexarMet customers directly to the SAWS board, a voice that many existing SAWS customers do not have. SAWS already served a substantial number of

households outside the city limits of San Antonio, customers who have no formal vote on the San Antonio City Council, which appoints the board. Indeed, customers of many utilities in the state have no formal vote in the operation of their utility other than appealing to TCEQ if they believe rates have been unjustly raised.

Consolidating a large water utility into SAWS' existing operations offered opportunities for operational breakdowns, leaving customers without adequate service. But SAWS handled the transition for customers seamlessly, transitioning to a single Website and consolidated billing services by July 2012. The oversight committee in its meetings received very few complaints about the process of integrating the two utilities.

SAWS is operating the former BexarMet as a "special project" as authorized in the legislation. Although the legislation allows SAWS to operate BexarMet as a special project for up to five years, SAWS officials said they are trying to fully integrate the former BexarMet into SAWS even sooner. SAWS officials told the oversight committee in August that they had achieved the utility's top 10 list of short-term goals. Those included operationally integrating BexarMet employees; integrating the customer service functions; developing a special project budget; developing a Medina Lake backup water supply plan for the South Side service area; eliminating through an interconnection the trucking of water to the Anaqua Springs residential area; establishing the BexarMet Integration Advisory Committee; integrating the billing and information systems; implementing safety and security measures at former BexarMet facilities; and conducting analyses of BexarMet water supplies and contracts.

In order to balance the budget without a rate increase, SAWS officials reported that they had restructured \$100 million of BexarMet's \$250 million debt, saving as much as \$2.2 million per year and renegotiated or terminated imprudent BexarMet contracts.

Integrating the BexarMet workforce with SAWS was another challenge. About 250 employees were on the BexarMet payroll when SAWS assumed management in January 2012. SAWS reported that the number of employees on the special project budget had shrunk to around 150 by November 2012. The reduction was attributed to retirements, attrition and movement into SAWS vacant positions.

SAWS officials stated that their intention is to move all those employees into SAWS positions as quickly as possible, but they have to work within the budget constraints of both SAWS and the special project.

Through cost reductions on service contracts, renegotiation of energy costs with CPS Energy, interconnects of infrastructure, refinancing and prudent financial management, SAWS officials kept the special project budget from rising, resulting in no rate increase for customers. SAWS

also was able to include a 2.5 percent raise for the special project employees, the first pay raise in three years for the former BexarMet employees.

RECOMMENDATIONS

SAWS, with its integration of Bexar Metropolitan Water District, has a significant number of customers who reside outside the corporate limits of San Antonio, either in other cities' jurisdictions or in outlying portions of Bexar, Medina and Atascosa counties. Although SAWS established a customer committee with input, the fact that these customers have no vote in the appointment of SAWS trustees is a concern going forward to some customers. Given that all current SAWS board members are currently from within the city limits of San Antonio, the City of San Antonio should consider appointing members to the SAWS board from outside the city limits, and potentially from the former BexarMet areas, to ensure that a broader perspective of considerations are more formally represented on the SAWS board. This is already allowed through SAWS' creation ordinance and through the local appointment process, and therefore no formal state legislation is necessary at this point. Also of note is that in the case of ratemaking, the TCEQ has authority for OCL customer appeals, and these customers might also seek assistance through the TCEQ, as well as through their state representative or senator.

SAWS has historically charged higher rates to customers who live outside the city limits (OCL) based on the costs to provide those services and to partially offset the risks associated with the ownership of the system by the City of San Antonio. SAWS also contracts with nationally recognized consultants to perform detailed rate studies before implementing new rate structures.

The fact that SAWS, in its rate structure, charges higher rates to customers who live outside the city limits is a source of tension among some customers outside the city limits. While there is a difference between SAWS ICL and OCL rates, DSP residential monthly charges nevertheless remain higher than both SAWS ICL and OCL monthly charges at all consumption levels between 4,000 and 23,000 gallons a month. SAWS OCL monthly residential charges exceed DSP water charges only at monthly consumptions of less than 4,000 gallons a month and at seasonal-only consumptions of greater than 23,000 gallons per month. DSP commercial charges at monthly consumptions of 25,000 gallons to 200,000 gallons are over 2 times higher than SAWS ICL commercial rates and at least 1.8 times higher than SAWS OCL commercial rates.

The Committee urges SAWS to pursue a rates study to consider the impacts of this policy of charging out-of-city customers more for the same service it provides to its customers within the city limits. This study would coincide with the full integration of District Special Project rates, and would consider the impact that a change in this rate may have on the DSP and SAWS customers living in the city limits as well.

Another potential issue of concern by some is the practice by the city of San Antonio of taking up to 2.7 percent of SAWS' gross revenues and moving it into the city budget. Officials in Somerset and other small cities served by SAWS contend that this acts essentially as a franchise

fee, and that instead of money from their customers going to San Antonio, at least part of this money should be going back to their cities. SAWS is wholly owned by the City of San Antonio and this fee is to partially compensate the city for the responsibilities of ownership, including the liabilities, which are inseparable from the ownership of one of the largest water and sewer utilities in the country. On the other hand, a franchise fee, based on revenues generated within a particular city, is sometimes paid to non-owner cities for the right to use their right of way to provide services within those cities, although it cannot be required of a municipal water utility. BexarMet did not pay franchise fees to these cities, and any such fees would be passed directly to the customers of each city and constitute a rate increase in direct proportion to the amount of the franchise fee. Because SAWS has shown the city payment is not a franchise fee, and because BexarMet did not pay franchise fees, we encourage SAWS to avoid franchise fee agreements with these cities that would raise rates for customers.

Because so much of the new territory taken in through the BexarMet acquisition lies outside the city limits, the Committee also encourages SAWS to continue to look at the entire operation when it comes to capital improvement projects. Spending on system improvements and expansions should not be given a lower priority because the needed projects lie outside the city limits. We understand that this is not the current SAWS policy, and in fact, SAWS is investing heavily throughout the areas outside of the city limits to accommodate the growing economic development.

Full integration of the DSP employees into SAWS positions, with equal pay and benefits, remains a focus of this Committee's members. The most important element of providing adequate water service is to have high performing employees. We recognize the impact that the transition has had on both SAWS and DSP employees and their families, and we appreciate SAWS management's continued focus on integrating these employees. SAWS was recognized for the second year in a row as a "Top Workplace" for large companies, and this is due, in part, to the newest DSP employees, who also provided their independent reviews to the *San Antonio Express-News*. However, there remains some insecurity on the part of these employees as evidenced in the survey, on a higher level than SAWS employees, albeit still positive about their working conditions. We encourage SAWS to remain vigilant about incorporating the DSP workforce into a more seamless environment, including pay and benefit parity, and to ensure that development opportunities are available equally to all employees.

SB 341 provided a fair and equitable process to ensure that the customers of the former BexarMet water district were able to set their own course for the water services to be provided into the future through an election, a transition into SAWS, and further oversight of the transition at the TCEQ. While any integration of this magnitude is not without trials and hurdles along the way, SAWS has demonstrated to the community and to this Committee that it adequately planned for this integration, and that the integration is likely to continue rather seamlessly into

the future. The TCEQ has also done a remarkable job assisting all parties involved in this process. The agency is fully capable of leading the state oversight efforts over the next few years to ensure that the customers of the former BexarMet system continue receiving adequate water services from SAWS into the future. In addition to this oversight, state and locally elected officials are also very much in tune with the concerns of their respective customers and local issues. These officials, including those on this oversight Committee, will remain active and available to assist any customers throughout the service area with issues that they do not believe are adequately being addressed.

Section 3.02 of SB 341 calls for this oversight Committee to be abolished on January 1, 2013. This Committee agrees that this is the appropriate course into the future as this successful resolution to longstanding water service concerns no longer needs a full joint legislative committee. Therefore, we recommend that no further action is necessary by the Legislature, and individual issues can be best managed through SAWS, TCEQ and individual legislators.