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OPINION COMMITTEE

RQ-0961-CA

15 April 2011

The Honorable Greg Abbott
Attorney General of Texas
P.O. Box 12548
Austin, Texas 78711

FILE # HL-46725-11

I.D. # 46725

Re: Request for an Attorney General's Opinion Regarding Treatment of Existing Debt After Consolidation of Municipal Utility Districts Under Section 54.728, Texas Water Code

Dear General Abbott:

I respectfully request an Attorney General Opinion on behalf of Harris County Municipal Utility District No. 364 ("MUD 364") concerning implementing provisions of the consolidation procedure authorized by Section 54.728 of the Texas Water Code.

MUD 364 and Harris County Municipal Utility District No. 365 ("MUD 365") (singularly, a "District" and collectively, the "Districts") were each created, effective June 26, 1996, by Orders of the Texas Natural Resource Conservation Commission, now known as the Texas Commission on Environmental Quality (the "Commission"), pursuant to Article XVI, Section 59 of the Texas Constitution. Each District operates in accordance with Chapters 49 and 54 of the Texas Water Code and is subject to the continuing supervision of the Commission. The principal functions of each District are to finance, construct, own and operate waterworks, wastewater and drainage facilities, and to provide those facilities and services to their respective customers.

The Districts are located in northwest Harris County, approximately 28 miles northwest of downtown Houston. The land within the Districts is primarily comprised of the Coles Crossing subdivision, with MUD 364 created to serve the eastern portion of Coles Crossing and MUD 365 created to serve the western part of the subdivision. The Districts jointly own three (3) water wells, two (2) water treatment plants, a wastewater treatment plant and other related facilities and appurtenances. While both Districts have annexed additional property since creation, the Districts are still primarily comprised of property within Coles Crossing.

Recently, for various reasons, including the economies of scale that could be realized by accomplishing with a single entity the functions currently being performed by two (2) entities, the Districts have discussed the possibility of merging into a single, consolidated district (a

"Consolidated MUD"). After analyzing each District's outstanding debt, MUD 365 decided it did not want the Consolidated MUD to assume both Districts' outstanding debt, as authorized by Section 54.73, because MUD 364's current debt service obligations extend several years beyond MUD 365's debt service obligations. However, MUD 365 stated that, if the Consolidated MUD could service the debt each District incurred prior to consolidation by levying different debt service tax rates on the property within the former boundaries of each District, then MUD 365 would be willing to consider consolidation.

Section 54.731, entitled *Debts of Original Districts*, states the following:

- (a) After two or more districts are consolidated, the debts of the original districts shall be protected and may not be impaired. *These debts may be paid by taxes levied on the land in the original districts as if they had not consolidated* or from contributions from the consolidated district on terms stated in the consolidation agreement.
- (b) If each district assumed the other's bonds, notes, and other obligations, taxes may be levied uniformly on all taxable property within the consolidated district in payment of the debts.

(emphasis added)

The italicized language in Section 54.731(a) above appears to grant express authority to the Consolidated MUD to levy different debt service tax rates on the land in the Consolidated MUD according to the prior District boundaries and pay the debt service on each District's bonds in the same manner as each District would have done if they had not consolidated.

In addition, the Districts have both issued debt in the past that contain substantially the following covenant:

While the Bonds or any part of the principal thereof or interest thereon remain outstanding and unpaid, the District shall levy and annually assess and collect . . . a continuing direct annual ad valorem tax levied without legal limitation as to rate or amount *upon all taxable property within the District* sufficient to pay interest on the Bonds as same becomes due and to pay each installment of principal of the Bonds as the same matures . . . and said taxes are hereby pledged to payment of the interest on and principal of the Bonds and to no other purpose.

(emphasis added)

This language pledges each District's debt service tax revenue to the payment of the debt service requirements for the bonds and requires each District to levy a debt service tax rate on all taxable property within the District's boundaries that will be sufficient to pay the debt service requirements on such bonds.

Questions have arisen regarding whether a Consolidated MUD's levy of two (2) different debt service tax rates within its taxing jurisdiction would violate the "equal and uniform" taxation requirement of Article VIII, Section 1(a) of the Texas Constitution. In addition, other questions have been asked related to how the Consolidated MUD should determine the debt service tax rate it will levy on land annexed by the Consolidated MUD in the future and how the Consolidated MUD should fund debt service payments on debt issued after consolidation. Finally, questions have been raised regarding how consolidation may affect the Districts' respective obligations to holders of their pre-consolidation bonds.

No case law or Attorney General opinions have been found that specifically address a Consolidated MUD's payment of pre-consolidation debt. In addition, no examples of developed municipal utility districts consolidating without the Consolidated District assuming each constituent district's debt have been identified. However, similar issues have been raised in the past related to a municipal utility district's authority to designate defined areas, issue debt to fund facilities specifically to serve those defined areas and levy different debt service tax rates within each defined area, as provided by Chapter 54, Subchapter J, Texas Water Code. In addition, the Attorney General's Office has issued numerous opinions approving defined area bond issues and opining that such bond issue "has been issued in accordance with law and is a valid and binding obligation of the Issuer" and "is payable from the proceeds of an ad valorem tax levied, without limit as to rate or amount, upon all taxable property within the [defined area] within the Issuer." *See, e.g.,* Travis County Water Control & Improvement District No. 17 Steiner Ranch Defined Area Unlimited Tax Bonds, Series 2009A.

The Districts desire to proceed with consolidation in an effort to operate their joint water, wastewater and drainage facilities more efficiently and cost effectively, but would like to better understand how they may legally implement the statutory procedures outlined in the Texas Water Code.

Questions presented

Accordingly, MUD 364 requests your interpretation and guidance concerning the meaning and applicability of Section 54.731 of the Texas Water Code in this context. Specifically, the Districts seek your guidance on how a Consolidated MUD should levy its debt service taxes and how consolidation may impact the Districts' respective obligations to holders of their currently outstanding bonds. In this regard, we seek guidance from you on the following questions:

- 1) Whether Article VIII, Section 1(a) of the Texas Constitution, which requires that taxation shall be equal and uniform, prohibits a Consolidated MUD from levying different debt service tax rates on the property within each of the former municipal utility districts that consolidated to form the Consolidated MUD for the purpose of funding debt service payment on each district's pre-consolidation debt?
- 2) If you determine a Consolidated MUD may levy different debt service tax rates as described in Item 1 above, whether a Consolidated MUD can legally levy a third (3rd) different debt service tax rate on property the Consolidated MUD annexes

that was never part of either District? If so, can the Consolidated MUD legally levy this third (3rd) debt service tax rate based on the higher of the rate levied on property in the constituent districts? If not, how can a Consolidated MUD legally determine the debt service tax rate to levy on such annexed property?

- 3) If you determine a Consolidated MUD may levy different debt service tax rates as described in Item 1 above, whether a Consolidated MUD can legally levy a district-wide debt service tax rate for the purpose of funding debt service obligations on debt issued by the Consolidated MUD after consolidation?
- 4) Whether each District's bond covenant to their respective bondholders to levy a debt service tax upon all taxable property within the District would require a Consolidated MUD to levy a single debt service tax rate on all taxable property within its boundaries? If so, does this covenant require the Consolidated MUD to apply those tax revenues to debt service on all bonds issued by each District prior to consolidation?

Thank you for your attention to this matter. Please let me know if I can be of further assistance.

Very truly yours,



W. A. Callegari

cc: The Honorable Dan Patrick, Texas Senate
The Honorable Allen Fletcher, Texas House of Representatives
Board of Directors, Harris County Municipal Utility District No. 364
Ms. Robin S. Bobbitt, Johnson Radcliffe Petrov & Bobbitt PLLC
Ms. Susan M. Edwards, Allen Boone Humphries Robinson LLP