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DOCKET NO. 43074

APPLICATION OF J&S WATER §
COMPANY, LLC AND UTILITIES §
INVESTMENT COMPANY, INC. FOR §
SALE, TRANSFER, OR MERGER OF §
FACILITIES AND CERTIFICATE §
RIGHTS IN HARRIS COUNTY §

PUBLIC UTILITY COMMISSION

OF TEXAS

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COMMISSION STAFF’S RECOMMENDATION ON FINAL DISPOSITION

Commission Staff (Staff) of the Public Utility Commission of Texas (Commission) files its Recommendation on Final Disposition. Staff recommends that the Commission approve the application and the proposed sale and transfer transaction. In support of its Recommendation on Final Disposition, Staff states the following:

I. Background

On September 9, 2014, J&S Water Company, LLC (J&S Water) filed an application requesting approval of the sale and transfer of a water system and sewer system and corresponding certificates of convenience and necessity (CCN Nos. 12085 and 20658) for a certificated area in Harris County, Texas. J&S Water is the seller, and Utilities Investment Company, Inc. (Utilities Investment) is the purchaser. The proposed effective date is February 1, 2015.

On June 30, 2015, Staff recommended that the application be deemed administratively complete. Staff also recommended that notice of the application be provided on the forms recommended by Staff.

On July 28, 2015, Utilities Investment submitted affidavits regarding the provision and publication of notice of the application. Utilities Investment provided notice of its application to affected parties on July 10 and 20, 2015.

On October 13, 2015, the Administrative Law Judge entered Order No. 11, which established October 19, 2015 as the deadline for Staff to either request a hearing or file its recommendation on final disposition. Staff’s Recommendation on Final Disposition is timely filed.

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II. Applicable Legal Standards

The Texas Water Code details the requirements for the sale of a water or sewer system. The relevant portions of the Texas Water Code state:

(a) A utility or a water supply or sewer service corporation, on or before the 120th day before the effective date of a sale, acquisition, lease, or rental of a water or sewer system that is required by law to possess a certificate of public convenience and necessity or the effective date of a merger or consolidation with such a utility or water supply or sewer service corporation, shall:

- (1) file a written application with the utility commission; and
- (2) unless public notice is waived by the utility commission for good cause shown, give public notice of the action.

(b) The utility commission may require that the person purchasing or acquiring the water or sewer system demonstrate adequate financial, managerial, and technical capability for providing continuous and adequate service to the requested area and any areas currently certificated to the person.¹

The Commission's substantive rules detail similar requirements for the sale of a water or sewer system.² The purchaser "must demonstrate adequate financial, managerial, and technical capability for providing continuous and adequate service to the requested area and any areas currently certificated to the person."³

With regard to the sale and transfer of a certificate of convenience and necessity, the Texas Water Code states that a certificate of convenience and necessity may not be sold "unless the utility commission has determined that the purchaser . . . is capable of rendering adequate and continuous service to every consumer within the certificated area, after considering the factors under Section 13.246(c) [of the Texas Water Code]."⁴ The factors to be considered by the Commission are:

- (1) the adequacy of service currently provided to the requested area;
- (2) the need for additional service in the requested area, including whether any landowners, prospective landowners, tenants, or residents have requested service;

¹ Tex. Water Code § 13.301(a)-(b).

² See generally 16 Tex. Admin. Code § 24.109.

³ 16 Tex. Admin. Code § 24.109(b).

⁴ Tex. Water Code § 13.251. See also 16 Tex. Admin. Code § 24.112(b).

- (3) the effect of the granting of a certificate or of an amendment on the recipient of the certificate or amendment, on the landowners in the area, and on any retail public utility of the same kind already serving the proximate area;
- (4) the ability of the applicant to provide adequate service, including meeting the standards of the commission, taking into consideration the current and projected density and land use of the area;
- (5) the feasibility of obtaining service from an adjacent retail public utility;
- (6) the financial ability of the applicant to pay for the facilities necessary to provide continuous and adequate service and the financial stability of the applicant, including, if applicable, the adequacy of the applicant's debt-equity ratio;
- (7) environmental integrity;
- (8) the probable improvement of service or lowering of cost to consumers in that area resulting from the granting of the certificate or amendment; and
- (9) the effect on the land to be included in the certificated area.⁵

Approval of the sale and transfer of a certificate of convenience and necessity expires one year after the date of approval.⁶

III. Staff's Recommendation

Staff recommends that the Commission approve the application and approve the sale and transfer transaction between J&S Water and Utilities Investment. Utilities Investment has the financial, managerial, and technical capability to provide continuous and adequate service to the certificated area under water CCN No. 12085 and sewer CCN No. 20658. Thus, Utilities Investment's application meets the requirements of 16 Tex. Admin. Code §§ 24.109 and 24.112. Staff's recommendation on the application is based on the attached memoranda of Debi Loockerman and Mary Lupo of the Water Utilities Division.

⁵ Tex. Water Code § 13.246(c).

⁶ 16 Tex. Admin. Code § 24.112(e).

A. Utilities Investment has adequate financial, managerial, and technical capability

Staff has determined that Utilities Investment has adequate financial, managerial, and technical capability to provide continuous and adequate service to the certificated area under water CCN No. 12085 and sewer CCN No. 20658 and its other certificated areas. With regard to financial capability, as of December 31, 2013, the total debt to net position ratio is 0.68:1 (\$756,821 to \$1,120,786). A ratio of less than 1:1 is preferred. Net operating income prior to depreciation was \$472,828, and total debt service was \$145,783. The debt service coverage ratio is 3.24:1 (\$472,828 to \$145,783). A ratio of at least 1.25:1 is preferred. With regard to managerial and technical capability, Utilities Investment owns and operates a number of water and sewer systems. Utilities Investment has two licensed water and sewer operators on staff. Utilities Investment has no pending violations at the Commission, and the pending violations at the Texas Commission on Environmental Quality (TCEQ) have been addressed.

B. Utilities Investment is capable of providing adequate and continuous service

Staff has determined that Utilities Investment is capable to provide continuous and adequate service to the certificated area under water CCN No. 12085 and sewer CCN No. 20658. Staff's determination is based on the following factors listed in Tex. Water Code § 13.246(c):

1. Adequacy of service currently provided to the certificated area under water CCN No. 12085 and sewer CCN No. 20658. Based on its review of TCEQ records, Staff has determined that adequate service is currently being provided to the service area. There are no outstanding violations with the TCEQ, and the systems have adequate capacity to serve the service area.

2. Need for service in the certificated area under water CCN No. 12085 and sewer CCN No. 20658. There is a need for service because there are existing customers that are currently being served

3. The effect of granting an amendment to water CCN No. 12085 and sewer CCN No. 20658. Only J&S Water's current customers in the service area will be affected. There will be no change in the quality of service because Utilities Investment has already been operating the water and sewer systems of the service area.

4. The ability of Utilities Investment to provide adequate service. Utilities Investment has two certified operators on its staff that will be responsible for maintaining and operating the water

and sewer systems. Utilities Investment has experience in water and sewer systems because it owns and operates a number of water and sewer systems close to the service area.

5. The feasibility of obtaining water service from an adjacent retail public utility. Staff did not evaluate this factor.

6. The financial ability Utilities Investment to pay for facilities necessary to provide continuous and adequate service. As previously discussed, Utilities Investment has the financial capability to ensure that there are sufficient funds for repairs and maintenance.

7. Impact on environmental integrity. There will be no impact on environmental integrity because there are pre-existing water and sewer systems in place.

8. Improvement of service or lower of cost to customers. There will be no change in rates. However, there has been an improvement of service because issues with radionuclide have been addressed.

9. Effect on land. There will be no effect on the land in the certificated area under water CCN No. 12085 and sewer CCN No. 20658 because there are pre-existing water and sewer systems in place.

IV. Conclusion

Staff recommends that the Commission approve the application and approve the sale and transfer transaction between J&S Water and Utilities Investment. Utilities Investment has the financial, managerial, and technical capability to provide continuous and adequate service in the service area.

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Date: October 19, 2015

Respectfully Submitted,

Margaret Uhlig Pemberton
Division Director
Legal Division

Stephen Mack
Managing Attorney
Legal Division



Sam Chang
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CERTIFICATE OF SERVICE

I certify that a copy of this document will be served on all parties of record on October 19, 2015, in accordance with 16 Tex. Admin. Code § 22.74.



Sam Chang

PUC Interoffice Memorandum

To: Sam Chang, Attorney
Legal Division

From: Debi Loockerman, Rates Team Lead
Water Utilities Division

Thru: Tammy Benter, Director
Water Utilities Division

Date: October 13, 2015

Subject: **Docket 43074; Application of J&S Water Company, LLC and Utilities Investment Company, Inc. for Sale, Transfer, or Merger of Facilities and Certificate Rights in Harris County**

Financial review

In my opinion, Utilities Investment Company, Inc. (UIC) has demonstrated adequate financial and managerial capability to provide service to the area subject to this application. These conclusions are based on information provided by UIC prior to this date and may not reflect any changes in UIC's status subsequent to this review.

The application requests approval for UIC to purchase service areas that include the following subdivisions Aldine Village Subdivision, Azalea Estates Mobile Home Community, Cotton Park Water System, and Cypress Hill Subdivision from J&S Water Company, LLC. The sale document indicates that UIC will assume 42% of a promissory note dated December 4, 2006, in the original principal amount of \$1,518,950. The net original cost of the assets transferred at December 31, 2014, (\$440,436) was supplied by UIC in a letter dated April 29, 2015. The new area includes 328 customers and 43 acres in Aldine Village Subdivision; 19 acres and 23 customers in Azalea Estates Mobile Home Community; 34 acres and 56 customers in Cottonwood Park Water System; and 85 acres and 37 customers in Cypress Hill Subdivision. No additional service area is being requested. The two entities involved are affiliated.

UIC provided a balance sheet, income statement and statement of cash flows for 2013. UIC's total debt to net position ratio at December 31, 2013 was \$756,821 to \$1,120,786, or 0.68 to 1.00. A ratio of less than 1 to 1 is preferred for analysis of financial capabilities. Net operating income prior to depreciation expense was reported as \$472,828 (net income of \$280,908 plus depreciation of \$191,920). Total debt service was reported in the notes payable section of the notes to the financial statements in the amount of \$145,783 per year. Therefore the debt service coverage ratio calculates to be \$472,828 to \$145,783 or 3.24 to 1.00. The coverage ratio appears sufficient to support the debt assumed as a result of the transaction. A ratio of at least 1.25:1 is preferred when reviewing financial capability to ensure that reserve funds for debt payment and repairs and maintenance are built up and maintained. The applicant meets both preferred financial ratios tests. Because applicant is a local company which owns and operates a number of water and sewer utilities in the region and currently has a CCN, the applicant will be more readily available to handle emergency situations if they arise with the systems.

Staff notes that the application does not provide a proper accounting entry for the acquisition. Because the parties to the transaction are affiliates, staff recommends that the original cost and accumulated depreciation for the transferred systems be maintained from the transferor entity to the acquiring entity and any acquisition adjustment be disallowed for future ratemaking purposes.

PUC Interoffice Memorandum

To: Sam Chang, Attorney
Legal Division

Through: Tammy Benter, Director
Water Utilities Division

From: Mary Lupo
Water Utilities Division

Date: October 13, 2015

Subject: **Docket No. 43074;** *Application of J&S Water Company, LLC and Utilities Investment Company, Inc. for Sale, Transfer, or Merger of Facilities and Certificate Rights in Harris County*

Background

On October 29, 2014, J&S Water Company, LLC (“J&S” or “Seller”) and Utilities Investment Company, Inc. (“UIC” or “Purchaser”) (collectively, “Applicants”) filed an application for approval of the sale, transfer, or merger of facilities and certificate rights for a portion of water Certificate of Convenience and Necessity (CCN) No. 12085 and sewer CCN 20658 currently held by the Seller in Harris County. As a result of the transaction, the Purchaser’s water CCN No. 12671 and sewer CCN No. 20765 would be expanded to increase the area. The application is being reviewed under Tex. Water Code Ann. § 13.301 (TWC) and 16 Tex. Admin. Code §§ 24.109 and 24.112(TAC).

On September 22, 2014, Commission Staff filed comments on the application stating that the application was deficient pursuant to 16 TAC § 24.109 because material deficiencies existed. On September 23, 2014, the administrative law judge (ALJ) issued Order No. 3 finding the application administratively incomplete and deficient. The Applicants filed additional information on September 23, 2014, October 23, 2014, February 17, 2015 and April 29, 2015. The ALJ issued Order No. 4 requiring a Staff response by June 30, 2015. Therefore, on June 30, 2015, Staff filed its recommendation that the application be deemed sufficient for filing and to provide notice.

On July 2, 2015, the ALJ issued Order No. 5 deeming the application sufficient for filing and ordered the Applicants to provide evidence of notice by July 13, 2015. On July 9, 2015, the Applicants filed a request for an extension to provide the notice documents until July 28, 2015. On July 15, 2015, the ALJ issued Order No. 6 granting the Applicant’s request to extend the deadline to provide notice documents. On July 27, 2015, Staff requested an extension because Order No. 6 gave the Applicants additional time to provide notice documents, and the Staff needed to review those documents before providing a supplemental procedural schedule. On July 28, 2015, the ALJ issued Order No. 7 extending the deadline for Staff to file a supplemental procedural schedule until August 10, 2015. On August 10, 2015, Staff filed the supplemental procedural schedule and the ALJ issued Order No. 8 establishing the procedural schedule on August 14, 2015.

On August 11, 2015, Staff submitted its first set of Requests for Information (RFIs) to the Applicants and the Applicants responded on August 28, 2015. The RFIs requested information regarding the technical capability of the Purchaser to provide continuous and adequate service, to request affidavits of notice provided, and to determine if outstanding enforcement violations with

the Texas Commission on Environmental Quality (TCEQ) had been addressed. On September 14, 2015, Staff filed a motion for an extension of the procedural schedule to allow more time to review the Applicants RFI responses. On September 15, 2015, the ALJ issued Order No. 9 granting the extension in the procedural schedule. On September 18, 2015, the Applicants filed additional information. On October 5, 2015, Staff requested another extension to allow time to review the additional documents provided by the Applicants. On October 7, 2015, the ALJ issued Order No. 10, which established October 12, 2015, as the deadline for Staff to request a hearing or file its recommendation. On October 9, 2015, Staff was made aware of additional, material information about the Purchaser and therefore, requested an extension to review the new information.

The Applicants provided the information and Staff provides this recommendation in response to CADM's Order No. 8.

Staff review

Pursuant to TWC § 13.301(e), before the expiration of the 120-day notification period, the Commission is required to notify all known parties to the transaction whether the Commission will hold a hearing to determine if transaction will serve the public interest. Staff believes the transaction will serve the public interest based on the review of the information in the application and the criteria listed below. Therefore, Staff has not recommended that a hearing be held. J&S demonstrates adequate financial, managerial and technical (FMT) capability to provide service to its existing service area plus the area subject to this application.

With respect to The Purchaser's managerial capability to provide continuous and adequate service to the area, the Purchaser is a local company which owns and operates a number of water and sewer systems and utilities in the region. The Purchaser will maintain the water and sewer systems in compliance with the rules and regulations of the TCEQ. The Purchaser has two licensed water and sewer operators on staff to maintain and operate the systems and has addressed all violations with the TCEQ and no violations exist with the PUC. Therefore, I opine that the Purchaser has the required managerial capability to provide service to the requested area plus any area already served by the Purchaser.

Staff reviewed of the public interest factors and the FMT capability of UIC to acquire the proposed area pursuant to TWC § 13.246(c). Under this statute, the Commission shall consider the following nine criteria when amending a CCN:

- TWC § 13.426(c)(1) requires the Commission to consider the adequacy of service currently provided to the requested area. The requested transaction proposes to transfer a portion of the facilities and service area of CCN Nos. 12085 and 20658 currently held by the Seller to J&S. The systems and subdivisions involved include the following: Aldine Village Subdivision, served by Public Water System (PWS) No. 101931 and Water Quality (WQ) permit No. 12382-001; Azalea Estates Mobile Home Community, served by PWS No. 1011253; Cottonwood Park Water System, served by PWS 1010283; and Cypress Hill Subdivision, served by PWS 1011792. The systems being acquired have no outstanding violations with the TCEQ and have adequate capacity to serve the area.
- TWC § 13.246(c)(2) requires the Commission to consider the need for service in the requested area. This is a sale of existing systems serving current connections and therefore the need for service is already established and met.
- TWC § 13.246(c)(3) requires the Commission to consider the effect of granting an amendment on the recipient and on any other retail utility servicing the proximate area. Only the Applicants

and the current customers will be affected by this transaction. With respect to the quality of service, no change in the quality of service is anticipated by the proposed transaction because the Purchaser has been operating the systems for the proposed area for seven years prior to the filing of this application.

- TWC §13.246(c)(4) requires the Commission to consider the ability of the Purchaser to provide adequate water and sewer service. UIC is an existing water and sewer utility and will provide water and sewer service using the existing systems, pending the closure and approval of the transaction. UIC has two certified operators on staff that will be responsible for maintaining and operating the systems. The Purchaser is a local company which owns and operates a number of water and sewer systems in the proximate area. In addition, since the Purchaser is located in the area, the Purchaser will be more readily available and responsive to emergency situations.
- TWC §13.246(c)(5) requires the Commission to consider the feasibility of obtaining service from an adjacent retail public utility. In this case, the area is already receiving retail water and sewer service from the Seller; therefore, the feasibility of obtaining service from an adjacent retail public utility was not considered.
- TWC §13.246(c)(6) requires the Commission to consider the financial ability of the Purchaser to pay for facilities necessary to provide continuous and adequate service and financial stability. The sale document indicates that UIC will assume 42% of a promissory note dated December 4, 2006, in the original principal amount of \$1,518,950. The net original cost of the assets transferred at December 31, 2014, (\$440,436) was supplied by UIC in a letter dated April 29, 2015. The new area includes 328 customers and 43 acres in Aldine Village Subdivision; 19 acres and 23 customers in Azalea Estates Mobile Home Community; 34 acres and 56 customers in Cottonwood Park Water System; and 85 acres and 37 customers in Cypress Hill Subdivision. No additional service area is being requested. The two entities involved are affiliated. UIC provided a balance sheet, income statement and statement of cash flows for 2013. UIC's total debt to net position ratio at December 31, 2013 was \$756,821 to \$1,120,786, or 0.68 to 1.00. A ratio of less than 1 to 1 is preferred for analysis of financial capabilities. Net operating income prior to depreciation expense was reported as \$472,828 (net income of \$280,908 plus depreciation of \$191,920). Total debt service was reported in the notes payable section of the notes to the financial statements in the amount of \$145,783 per year. Therefore the debt service coverage ratio calculates to be \$472,828 to \$145,783 or 3.24 to 1.00. The coverage ratio appears sufficient to support the debt assumed as a result of the transaction. A ratio of at least 1.25:1 is preferred when reviewing financial capability to ensure that reserve funds for debt payment and repairs and maintenance are built up and maintained. The applicant meets both preferred financial ratios tests.
- TWC §§13.246(7) and (9) requires the Commission to consider the environmental integrity and the effect on the land to be included in the certificate. There will be minimal impact on the environment and the land because the systems are already in place.
- TWC § 13.246(8) required the Commission to consider the probable improvement in service or lowering of cost to consumers. At this time, the customers' rates will not be affected by this transaction as they will remain the same. The transaction has improved the water quality because the Applicants addressed the radionuclide issues while the transaction was occurring.

Recommendation on approval of sale

Pursuant to 16 TAC § 24.109(f), Staff recommends the Commission find that the transaction will serve the public interest and allow the Applicants to proceed with the proposed transaction. Staff further recommends that a public hearing is not necessary. Staff also recommends that the Applicants be ordered to file documentation as evidence that all assets have been transferred to the acquiring entity and that the disposition of any remaining deposits have been addressed as soon as possible pursuant to 16 TAC § 24.109(f).