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Item Number: 10

Addendum StartPage: 0

PROJECT NO. 48937

RULEMAKING TO AMEND § 24.44 RATE-CASE EXPENSES PURSUANT TO TEXAS WATER CODE § 13.187 AND § 13.1871	§ § § §	**PUBLIC UTILITY COMMISSION OF TEXAS**

JOINT REPLY COMMENTS OF AQUA TEXAS, CANYON LAKE WATER SERVICE COMPANY, SOUTHWEST WATER COMPANY, QUADVEST, AND CORIX UTILITIES (TEXAS) ON STRAWMAN AMENDMENTS TO § 24.44

These reply comments are jointly filed by the following investor-owned utilities which provide retail water/sewer utility service in Texas: Aqua Texas, Inc., Aqua Utilities, Inc., and Aqua Development, Inc. d/b/a Aqua Texas; SJWTX, Inc. d/b/a Canyon Lake Water Service Company; SouthWest Water Company; Quadvest, L.P., and Corix Utilities (Texas) Inc. (collectively, the "Water IOUs"). The Water IOUs hereby respectfully submit the following joint reply comments to the initial comments filed by Office of Public Utility Counsel ("OPUC") and Mr. Joe Freeland regarding the strawman amendments to 16 Texas Administrative Code ("TAC") § 24.44 (Rate-case Expenses Pursuant to Texas Water Code § 13.187 and § 13.1871) offered for public review and comment in Project No. 48937.

I. REPLY TO OPUC'S INITIAL COMMENTS

OPUC suggests that the 51% rule and settlement offer rule provisions currently included in 16 TAC § 24.44 are a justifiably necessary "check" on recovery of rate case expenses by water/sewer utilities. Respectfully, the Water IOUs disagree. OPUC's contentions are undermined by the fact that these provisions do not exist for electric utilities in 16 TAC §25.245. The reasonableness and necessity of rate case expenses are assessed based on uniform criteria in 16 TAC § 25.245, leaving disallowance possible, but: (1) the chance of 100% disallowance is appropriately remote; and (2) any disallowance is assessed based on case-specific facts.[1] Currently, if the 51% rule or settlement offer rule is found to apply, 100% disallowance automatically results without any case specific considerations. That is unfair and inconsistent with the Commission's electric utility regulations. There is simply no supportable justification for the 51% and settlement offer rules.

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[1] 16 TAC §25.245(a)-(d).

Further, and importantly, in 2013 the Third District Court of Appeals of Texas in Austin issued an opinion addressing rate case expense recovery under PURA which was issued seven years after the Texas Commission on Environmental Quality ("TCEQ") adopted the 51% rule and settlement offer rule in 2006. In *Oncor Elec. Delivery Co. LLC v. PUC of Texas* ("*Oncor*"), the court held the Commission acted arbitrarily and capriciously by precluding Oncor's recovery of reasonable and necessary rate-case expenses.[2] In reaching its conclusion, the court relied in part on a 1983 Texas Supreme Court water utility case decided under the older version of PURA called *Suburban Utility Corp. v. PUC of Texas*.[3] As discussed in *Oncor*, the Texas Supreme Court found in *Suburban*:

> (1) the effect of disallowing expenses is to charge those expenses to the utility's stockholders instead of to the ratepayers, meaning that disallowance of expenses results in reducing the return the utility earns on the rate base;
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> (2) a utility must be allowed to recover its operating expenses together with a reasonable return on its invested capital;
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> (3) this requirement is met only if the return is sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital;
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> (4) it is important that regulatory agencies do not arbitrarily disallow expenditures; and
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> (5) if the expense can be shown to be actual, necessary and reasonable it should be allowed.[4]

Oncor specifically holds that reasonable and necessary operating expenses to be included in electric utility rates may include rate case expenses under PURA § 36.061(b)(2) and cites *Suburban* repeatedly throughout the opinion as additional support.[5] The same concepts hold true with respect to Texas Water Code ("TWC"), Chapter 13 water/sewer utility ratemaking with the only difference being that reasonable and necessary rate case expense recovery is addressed by

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[2] *Oncor Elec. Delivery Co. LLC v. Public Util. Comm'n of Tex.*, 406 S.W.3d 253, 263-72 (Tex. App—Austin 2013, no pet.) (citing *Suburban Util. Corp. v. Public Util. Comm'n of Tex.*, 652 S.W.2d 358, 362-63 (Tex. 1983), a water utility rate case); TEX. UTIL. CODE §§ 11.001-66.016 ("PURA").

[3] *Suburban*, S.W.2d 652 at 362-63.

[4] *Suburban*, S.W.2d 652 at 362-63; *see also Oncor*, 406 S.W.3d at 264 and 271.

[5] *Oncor*, 406 S.W.3d at 256, 264, and 271.

rule authorized via more general TWC statutory expense provisions.[6] The 51% and settlement offer rules result in arbitrary disallowances of otherwise actual, necessary, and reasonable rate case expenses, violating *Oncor*, *Suburban*, and the regulatory compact policy that drives TWC, Chapter 13 regulation.[7]

The Water IOUs respectfully submit that the ratepayer concerns OPUC advances are irrelevant and invalid. First, speculative concerns about what may or may not shape a rate filing have nothing to do with the fairness of a rate case expense recovery rule, and the notion that water and sewer utilities have no incentive to control rate case expenses is simply incorrect. Carrying costs for rate case expenses, the uncertainty of full recovery, political ramifications, customer relationships, and utility reputation, to name a few, are ample incentives to keep rate case expenses as low as possible. Second, the same ratepayer concerns would logically apply in the electric utility context if they were valid, but they are not. To the extent those identified ratepayer concerns (*i.e.,* the perceived incentive to "overreach," pursue "longshot" issues, or file applications that lack "detailed documentation") were ever valid in the TCEQ regulatory context, which they were not, the Commission has sufficiently addressed them already through revisions to the water/sewer utility regulatory program. Those revisions include routine suspension of rates, more detailed rate filing package requirements, and enhanced review of rate filings before deeming them administratively complete. The ratepayer concerns OPUC espouses are not persuasive.

Additionally, water and sewer utilities of all classes are now required to put on much more of their case before settlement negotiations with opponents even begins. Typically, this is not for lack of effort on the utility's part. But, unlike at TCEQ, this requires incurring more rate case expense before settlement possibilities can be explored. Meanwhile, water and sewer utilities must endure regulatory lag before receiving a requested rate change, in addition to the

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[6] TWC § 13.185(g)-(h) (stating that "[t]he regulatory authority may promulgate reasonable rules and regulations with respect to the allowance or disallowance of certain expenses for ratemaking purposes" and specifying certain items that the regulatory authority may not include for ratemaking purposes); 16 TAC § 24.33(a); *see also* 30 TAC § 291.28(7) (setting forth the TCEQ version of this rule). TWC § 13.185(h)(3) language stating that legal expenses found, unreasonable, unnecessary, or not in the public interest may be disallowed implies that legal expenses found reasonable, necessary, or in the public interest may be allowed (although other types of professional expenses are also ordinarily incurred in rate cases). Additionally, recovery of reasonable expenses incurred in appeal proceedings is specifically addressed in TWC § 13.043(a) which may apply to water/sewer utility appeals of municipal ratemaking decisions.

[7] *See* TWC § 13.001.

burden of rate case expense carrying costs, without knowing if they will receive all they seek on either front. It appears OPUC seeks to retain its ability to leverage the 51% and settlement offer rules against utilities in these settlement negotiations. OPUC takes that position without any reasonable justification for why the 51% and settlement offer rules are necessary on the water and wastewater utility side and not on the electric side. Interestingly, OPUC expresses concern about providing consistency across water/sewer regulation and electric regulation with respect to rate case expense evaluation criteria, but expresses no such concerns with respect to the 51% and settlement offer rules.[8]

The strawman rule provides appropriate criteria for evaluating the reasonableness and necessity of rate case expenses, broadly permits case specific arguments for any disallowances, and no more is needed. If additional criteria from 16 TAC § 25.245 is added to an amended 16 TAC § 24.44, it is important to note that some criteria from the electric rule, such as 16 TAC § 25.245(b)(6), would be overly burdensome for water/sewer utilities. That particular rule would require evidence verified by testimony or affidavit showing "the specific issue or issues in the rate case and the amount of rate-case expenses reasonably associated with each issue."[9] Most water/sewer utility rate case issues are worked on simultaneously by the same experts and attorneys. This is particularly true when it comes to rate filing package preparation prior to learning what specific contested rate case issues will require a more robust response. Regardless, the Water IOUs submit the strawman rule set of criteria is appropriately scaled for water/sewer utility cases.

The Water IOUs disagree this rulemaking should be delayed to assess the outcome of the pending legislative efforts OPUC highlights, primarily because those bills have nothing to do with rate case expense recovery. Repeal of the 51% and settlement offer rules is long overdue, not premature, particularly because the Commission rejected the proposed 51% rule and the settlement offer rule language (some requested by OPUC) in crafting 16 TAC § 25.245.[10] For

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[8] OPUC Comments on Staff's Strawman Rule, at 7.

[9] 16 TAC § 25.245(b)(6).

[10] Project No. 41622, *Rulemaking to Propose New Subst. R. 25.245, Relating to Recovery of Expenses for Ratemaking Proceedings*; Order Adopting New § 25.245 as Approved at the July 10, 2014 Open Meeting, at 130-133, 138, and 143 (Aug. 6, 2014). In rejecting OPUC's suggested inclusion of settlement offer rule language (based on the similar TCEQ rule) in the electric utility rate case expense rulemaking project, the Commission stated, "The commission declines to adopt OPUC's proposed new subsection (e) that would limit a utility's recovery of rate-case expenses if the litigated outcome of a rate case is equal to or less than a written settlement offer. The commission

consistency and equity, these rule provisions should be repealed from 16 TAC § 24.44 as soon as possible.

II. REPLY TO MR. FREELAND'S INITIAL COMMENTS

Mr. Freeland expresses many of the same concerns as OPUC in support of keeping the 51% rule and advocating for revising the rule to raise "the threshold to at least 75%."[11] Mr. Freeland's proposal would simply replace the current arbitrary disallowance standard with another more egregious standard, fails to consider the current electric utility rate case expense rule at all, and gives zero consideration to the impact on water and sewer utilities caused by arbitrary rate case expense disallowances as rejected in *Oncor* and *Suburban*. While Mr. Freeland's comments seem primarily directed at Class B and C utilities, the current rule makes no such class distinctions, nor should it. The premise that all water/sewer utilities (or a particular class of water/sewer utilities) cannot "properly" prepare rate applications, prepare them "poorly," or invoke "gamesmanship" in Mr. Freeland's eyes does not justify keeping or amending current 16 TAC § 24.44 or the strawman rule as Mr. Freeland suggests; and, as previously discussed, Commission procedures implemented since receiving the water/sewer utility regulatory program from TCEQ address these concerns.[12]

As emphasized in *Oncor* and *Suburban*, the Commission's job in utility rate cases is to ensure a utility charges just and reasonable rates and, in fixing those rates, to "fix its overall revenues at a level that will: (1) permit the utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses; and (2) preserve the financial integrity of the utility."[13] The 51% and settlement offer rules undermine the Commission's ability to satisfy those requirements.

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agrees with the Joint [electric] Utilities that *this proposal is not practical to implement because there exist many components to a settlement proposal other than revenue requirement, which is the criterion that OPUC's proposal focuses on.* Joint [electric] Utilities commented that it would be overly complex to try to analyze the elements of the settlement proposal that do not relate to the revenue requirement in order to determine whether the final outcome was better or worse than the settlement proposal. Accordingly, the commission declines to adopt OPUC's proposal." *Id.* at 143 (emphasis added). OPUC's comments ignore this Commission response to its previous suggestion.

[11] Freeland Comments, at 1.

[12] The Water IOUs note that the 51% and settlement offer rules have invited "gamesmanship" by ratepayer advocates.

[13] TWC §§ 13.182(a) and 13.183(a)(1)-(2); *see also Application of Cypress Gardens Mobile Home Subdivision for Authority to Change Rates*, PUC Docket No. 46747, Order Remanding Proceeding to Docket Management (Feb. 28,

The Water IOUs offer one example where the 51% rule undermined those requirements—the water utility ratemaking case of SJWTX, Inc. d/b/a Canyon Lake Water Service Company ("*CLWSC*").[14] In *CLWSC*, TCEQ used the 51% Rule to prohibit *any* (*i.e.* $0.00) rate case expense recovery for CLWSC even though $856,742.42 of its rate case expenses would otherwise have been recoverable as reasonable, necessary, and in the public interest.[15] TCEQ's findings concerning the 51% Rule resulted in a calculation that CLWSC's approved rates would produce an annual revenue increase that was 48.5% of what CLWSC's proposed rates would have produced.[16] A substantial reason why final rates did not meet the 51% Rule threshold in that case was the outcome of novel ratemaking issues that had not previously been litigated and that were subject to significant dispute, including how to calculate the threshold under the 51% Rule. In the final analysis, the revenue generated by the approved rates was substantially lowered from that requested to just below 51%. By disallowing 100% of CLWSC's rate case expenses, the TCEQ failed in its requirement to "fix [CLWSC's] overall revenues at a level that will: (1) permit the utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses; and (2) preserve the financial integrity of the utility."[17]

Ratepayers have the right to advocate particular positions in a rate case hearing. That is understood, but it requires a contested case hearing under TWC, Chapter 13 with commensurate expenses regardless of outcome. Mr. Freeland also disregards the fact that the Commission must

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2019) (finding that a water utility's rates must be calculated commensurate with a utility's adopted revenue requirement).

[14] *SJWTX, Inc. d/b/a Canyon Lake Water Service Co. v. Zachary Covar, Executive Director of the Texas Commission on Environmental Quality, the Texas Commission on Environmental Quality, and its Commissioners Bryan Shaw, Carlos Rubenstein, and Toby Baker*, Cause No. D-1-GN-13-003915 (419th Dist. Ct., Travis County, Tex.) ("CLWSC Appeal"); *Application of SJWTX, Inc. d/b/a Canyon Lake Water Service Co. to Change Water Rates; CCN No. 10692; in Comal and Blanco Counties*, SOAH Docket No. 582-11-1468, TCEQ Docket No. 2010-1841-UCR ("CLWSC TCEQ Hearing"). The Water IOUs note that Mr. Freeland represented a ratepayer group in this TCEQ water utility rate case, but only references PUC water/sewer utility rate cases in the introduction to his comments.

[15] *CLWSC Appeal*, Plaintiff's Original Petition, at 9-13 (Nov. 15, 2013); CLWSC TCEQ Hearing, Final Order, at 14-17, 19-20 (Aug. 28, 2013); SOAH ALJs' Proposal for Decision, at 118-123 (Dec. 3, 2012).

[16] CLWSC TCEQ Hearing, Final Order, at 16-17, FoF 131-137 (Aug. 28, 2013).

[17] TWC §§ 13.182(a) and 13.183(a)(1)-(2); *see also Application of Cypress Gardens Mobile Home Subdivision for Authority to Change Rates*, PUC Docket No. 46747, Order Remanding Proceeding to Docket Management (Feb. 28, 2019) (finding that a water utility's rates must be calculated commensurate with a utility's adopted revenue requirement).

now automatically refer Class A Utility rate cases for a contested case hearing regardless of who may protest it and that the Commission has the option to refer a Class B Utility rate case for a contested case hearing on its own motion regardless of whether 10% of the ratepayers protest it.[18] Reasonable amounts of rate case expenses should be recoverable even if the outcome is less than requested.

With respect to Mr. Freeland's request to include additional criteria from 16 TAC § 25.245, the Water IOUs incorporate their discussion of OPUC's similar suggestions in response. With respect to Mr. Freeland's additional suggestion to include a clarification to the 51% rule related to application amendments, it is not necessary because the 51% rule should be eliminated entirely. Again, case specific facts should determine whether any rate case expense disallowance is warranted, rather than a universal complete disallowance rule. In fact, disallowances should be the exception and not the rule. But $0 in rate case expense recovery is an extreme result 100% of the time under the current 51% rule and should not be continued as a codified Commission rule.

III. CONCLUSION

In sum, repealing the 51% and settlement offer rule provisions from 16 TAC § 24.44 will add fairness and consistency to Commission rate regulation of water and sewer utilities. That is not the case under the current rule. The Water IOUs respectfully request the Commission officially propose and adopt a revised 16 TAC § 24.44 in line with the strawman rule and reject the recommended changes offered by OPUC and Mr. Freeland. The Water IOUs remain hopeful that the final rule that results from this process will improve the ratemaking process for Texas water and sewer utilities and remove unjust prohibitions on recovery of rate case expenses.

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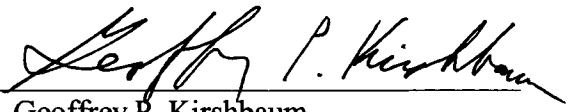
[18] TWC §§ 13.187(f) and 13.1871(k).

Respectfully submitted,

By: 

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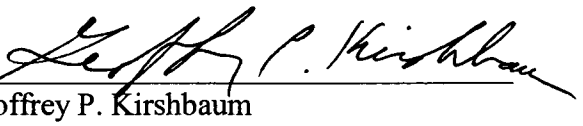
CERTIFICATE OF SERVICE

I certify that a copy of this document will be served on the Public Utility Commission of Texas on March 12, 2019 in accordance with P.U.C. Procedural Rule 22.74.



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