



Control Number: 48937



Item Number: 19

Addendum StartPage: 0

RULEMAKING TO AMEND 24.44 §  
 RATE-CASE EXPENSES PURSUANT §  
 TO TEXAS WATER CODE 13.187 AND §  
 13.871 §

PUBLIC UTILITY COMMISSION  
 2019 AUG 12 PM 2:02  
 PUBLIC UTILITY OF TEXAS  
 FILING CLERK

**OFFICE OF PUBLIC UTILITY COUNSEL'S  
INITIAL COMMENTS ON COMMISSION'S PROPOSAL FOR PUBLICATION**

The Office of Public Utility Counsel ("OPUC") respectfully submits these comments on the Proposal for Publication approved by the Public Utility Commission of Texas ("Commission") on June 27, 2019 that amends 16 Texas Administrative Code ("TAC") § 24.44 regarding recovery of rate-case expenses ("RCEs") for water and wastewater utilities.<sup>1</sup> As discussed below, OPUC recommends that the Commission study alternative streamlined mechanisms for recovery of RCEs for water utilities before adopting the proposed rule. However, if the Commission chooses to move forward with the proposed rule, OPUC recommends certain changes to the proposed rule.

**I. GENERAL COMMENTS ON PROPOSED RULE**

The Commission's proposed rule amendments would replace key provisions of the existing RCE rule for water utilities with the Commission's RCE rule for electric utilities. While efficiencies may be gained with applying the same RCE rule requirements to water utilities and electric utilities, OPUC notes that there are key differences between water utilities and electric utilities that the Commission should consider before adopting the same RCE rule for water utilities. The primary distinction is the much smaller size of water utilities in comparison to electric utilities. In the electric industry, a *small* electric utility has upwards of 50,000 customers, while the benchmark for a *large* water utility is only 10,000 customers.<sup>2</sup> Accordingly, the financial burden of RCEs for water utility rate proceedings is heavier for water utility consumers, because the RCEs are spread over a much smaller customer base.

Because RCEs can have a sizable impact on a water utility customer's bill, potential RCEs are more likely to impact whether and to what extent water utility customers participate in rate

<sup>1</sup> For brevity, OPUC hereafter refers to water and wastewater utilities collectively as "water utilities."

<sup>2</sup> Tex. Water Code ("TWC") § 13.002(4-a).

proceedings. Water utility customers must constantly balance their level of involvement in water utility rate cases to ensure that they participate enough to provide a meaningful review of the utility's request, but not so much as to drive up RCEs to the point that the cost outweighs the benefit obtained from their involvement in the rate case. The threat of significant RCEs can have a chilling effect on customers who may choose to settle an issue despite its merits if the cost of litigation will likely exceed its potential value. Notably, nearly all of the water utility rate cases filed at the Commission have settled.<sup>3</sup> Moreover, a survey of 27 settled water utility rate cases reveals that two-thirds of the time (i.e., 18 cases or 67%) the water utility agreed not to recover any RCEs associated with the rate proceeding.<sup>4</sup> The frequency of this type of agreement on RCEs indicates that the parties recognize the potential financial impact that RCEs can have on water utility customers and affirms the need to incentivize cost-conscious behavior.

The current form of the RCE rule for water utilities was adopted by the Texas Commission on Environmental Quality ("TCEQ"). During the rulemaking proceeding at the TCEQ, water utility customers raised concerns "that utilities may have an incentive to overreach their rate applications if utilities believe that customers ultimately will bear all rate case expenses."<sup>5</sup> In response, the TCEQ drafted the rule "to set out clearly certain instances when, as a matter of law, rate case expenses will be considered unreasonable, unnecessary, and against the public interest."<sup>6</sup> In particular, the TCEQ included two default provisions that limit a water utility's recovery of RCEs. First, a water utility may not recover RCEs if the rates approved by the Commission do not generate a revenue requirement that is at least 51% of the revenue requirement that would have been generated by the rates proposed in the utility's rate application (i.e., the "51% rule").<sup>7</sup> Second, if a water utility rejects a written settlement offer the terms of which generate a revenue requirement that is less than or equal to the revenue requirement generated by the rates ultimately

---

<sup>3</sup> Only three water utility rate cases have been fully litigated at the Commission. See *Application of Double Diamond Utility Company, Inc. for Water and Sewer Rate/Tariff Change*, Docket No. 46245, Order (Aug. 30, 2018); *Application of Rio Concho Aviation, Inc. for a Rate/Tariff Change*, Docket No. 45720, Order (June 29, 2017); *Water Rate/Tariff Change Application of Wiedenfeld Water Works, Inc. CCN No. 12052 in Kerr, Kendall, and Medina Counties*, Docket No. 42849, Order (Oct. 3, 2014).

<sup>4</sup> A list of settled water utility rate cases is included as Attachment 1.

<sup>5</sup> 31 Tex. Reg. 8106, 8107 (Sep. 22, 2006) (former 30 TAC § 291.28(7) – (9)).

<sup>6</sup> *Id.*

<sup>7</sup> 16 TAC § 24.44(b).

approved by the Commission, the water utility may not recover the RCEs incurred after the date of the written settlement offer (i.e., the “settlement rule”).<sup>8</sup> The Commission’s proposed rule would eliminate both the 51% rule and settlement rule.

While the 51% rule and settlement rule do not result in disallowances that are tied to specific issues in a water utility’s rate case, the rules establish clear instances where RCEs will be disallowed, and therefore, reduce the costs associated with litigating the RCE issue. Since water utility customers will be responsible for paying the RCEs, these streamlined processes for RCE recovery provide additional protection for consumers. The fact that customers could potentially be responsible for a significant amount of additional RCEs resulting from the litigation of RCE issues compounds the already significant impact that RCEs can have on water utility customer bills. Notably, while the electric utility RCE rule that the Commission is proposing to adopt for water utilities is still relatively new, thus far, the rule has resulted in some electric utilities incurring hundreds of thousands of dollars to litigate RCEs. The same outcome for water utilities could have a devastating effect on water utility customers because the RCEs would be spread over a much smaller customer base. As a result, if the Commission adopts the proposed rule without the 51% rule and settlement rule, OPUC recommends that the Commission evaluate whether there are alternative streamlined mechanisms for recovery of RCEs by water utilities that are appropriate to protect customers before adopting the proposed rule.

Further, the Commission may want to consider whether the method for recovering RCEs should differ depending on the size of the water utility. While water utilities, as a whole, are significantly smaller than electric utilities, water utilities also vary substantially in size, which impacts the nature of their participation in rate-making proceedings. The experience and resources of a water utility with 10,000-plus customers will vary greatly from a water utility with only a few hundred customers. The Legislature has recognized this distinction by creating different classes of water utilities based on the utility’s size.<sup>9</sup> In fact, the Legislature further refined the classification system for water utilities this past legislative session by establishing four classes of water utilities, instead of the original three classes of water utilities:<sup>10</sup>

---

<sup>8</sup> 16 TAC § 24.44(c).

<sup>9</sup> TWC §§ 13.187-.1872.

<sup>10</sup> Tex. S.B. 700, 86th Leg., R.S. (2019).

<b>Class A</b>	over 10,000
<b>Class B</b>	2,301 – 10,000
<b>Class C</b>	501 – 2,300
<b>Class D</b>	500 or less

While the Commission has not yet had an opportunity to implement this new classification system, it is clear that the Legislature intends for the rate-making process to be less onerous for each successively smaller class of water utilities. The policy reasons that support a less complex rate-making process for smaller water utilities also support a less complex RCE recovery process for smaller water utilities. Thus, even if the Commission adopts the electric utility RCE rule for water utilities, OPUC recommends that the Commission consider limiting the RCE rule’s application to the largest water utilities in Class A and consider other RCE recovery options for the smaller water utilities.

## **II. SPECIFIC RECOMMENDED CHANGES TO PROPOSED RULE**

If the Commission chooses to adopt the electric utility RCE rule for water utilities in its entirety, OPUC proposes the following changes to the proposed rule:

### **Proposed Changes to § 24.44(c)(1) & (2)**

Proposed Subsection (c) provides the “[c]riteria for review and determination of reasonableness” for RCEs and sets forth six evidentiary findings that the Commission must make in determining the reasonableness of RCEs. OPUC recommends revising the required evidentiary findings in Subsections (c)(1) and (2) to incorporate the appropriate standard of review. As currently proposed, the draft rule states that the Commission “must decide whether and the extent to which the evidence shows that: (1) the fees paid, tasks performed, or time spent on a task were *extreme or excessive*; (2) the expenses incurred for lodging, meals and beverages, transportation, or other services or materials were *extreme or excessive*; ...” (emphasis added). Both provisions look at whether particular operating expenses or actions were “extreme or excessive.” However, under TWC § 13.183(a)(1), the standard for recovery of operating expenses is whether the expenses are “reasonable and necessary.” Tying the determination of whether RCEs are reasonable to whether they are “extreme or excessive” inappropriately lowers the threshold for recovery of RCEs. A particular operating expense may not reach the level of being extreme or excessive, but should nevertheless be disallowed, because it is not reasonable and necessary.

Therefore, to appropriately reflect the statutory standard for recovery, OPUC recommends replacing the phrase “extreme or excessive” in Subsections (c)(1) and (2) with the phrase “reasonable and necessary.”<sup>11</sup>

### **Proposed Addition of § 24.44(f)**

OPUC also proposes that the Commission’s RCE rule for water utilities identify specific expenses that are *not* recoverable as RCEs. Setting clear boundaries on expenses that are not recoverable will limit controversy, and thus, reduce the cost of litigating RCEs. The Commission takes a similar approach in determining recoverable expenses as part of a utility’s overall cost of service. The Commission’s cost-of-service rules for both water and electric utilities include a subsection titled “Expenses not allowed.”<sup>12</sup>

OPUC recommends that the Commission add the following subsection to the proposed rule:

- (f) Expenses not allowed. Expenses not recoverable as rate-case expenses shall include:
  - (1) Expenses for matters handled by service providers that are typically performed by utility management and staff based on their experience, expertise, and availability;
  - (2) Expenses typically included in a utility’s test-year revenue requirement;
  - (3) Expenses for first class airfare, gifts, alcohol, or other luxury items;
  - (4) Expenses for lodging, meals and beverages, and transportation incurred in a person’s home city;
  - (5) Carrying charges on rate-case expenses;
  - (6) Any expense for which recovery is prohibited by other commission rule; and
  - (7) Other expenses that are not related or material to the preparation or presentation of a base rate case, as determined by the commission after its review.

---

<sup>11</sup> See, e.g., Project No. 48937, Memorandum by Chairman Walker at 1 (June 26, 2019) (stating that the standard for recovery of expenses for water utilities under TWC § 13.183(a) is whether they are “reasonable and necessary” and that the rule should comply with the statutory standards).

<sup>12</sup> 16 TAC §§ 24.41(b)(2) (water utilities’ cost-of-service rule), 25.231(b)(2) (electric utilities’ cost-of-service rule).

Subsection (f)(1) would encourage water utilities to use their in-house management and staff to the extent possible to reduce RCEs. Subsection (f)(2) would prevent water utilities from potentially over-recovering their expenses, for example, by recovering a test-year amount of legal expenses in base rates, but also recovering additional legal expenses as RCEs. Subsection (f)(3) would make explicit that the Commission does not allow recovery of certain luxury items as RCEs. Subsection (f)(4) would incorporate prior Commission precedent relating to the responsibility for certain personal expenses incurred in a person's home city.<sup>13</sup> Subsection (f)(5) would make explicit the Commission's current practice that RCEs do not incur carrying charges. Subsection (f)(6) would ensure that expenses that are prohibited by other Commission rules, such as 16 TAC § 24.41(b)(2), are not recovered as RCEs. Subsection (f)(7) would exclude recovery of expenses for proceedings other than base rate cases, because expenses for other types of proceedings are more properly considered in setting a utility's base rates using a historical test year.

### **III. CONCLUSION**

OPUC appreciates the opportunity to provide comments on the Commission's proposed rule and looks forward to continuing to work with Commission Staff and other interested parties in this project.

---

<sup>13</sup> *Petition of Public Utility Commission of Texas (Staff) to Inquire into the Reasonableness of the Rates and Services of Cap Rock Energy Corporation*, Docket No. 28813, Order at Finding of Fact 154(e) (Aug. 5, 2005) ("\$4,457 in expenses for meals and other personal expenses were for Cap Rock employees in Midland while they remained in Midland; such expenses are not reasonable and necessary, and are properly disallowed."); *see also* Docket No. 28813, Proposal for Decision at 177 (Mar. 17, 2005) ("These meals were all taken in Midland by employees who work in Midland at Cap Rock. The ALJs agree that those meal expenses should be disallowed. While working in Midland, those employees should be responsible for the costs of their own meals whether they are working on the rate case or on other Cap Rock business.").

Dated: August 12, 2019

Respectfully submitted,

Lori Cobos  
Chief Executive & Public Counsel  
State Bar No. 24042276



Cassandra Quinn  
Assistant Public Counsel  
State Bar No. 24053435  
1701 N. Congress Avenue, Suite 9-180  
P.O. Box 12397  
Austin, Texas 78711-2397  
512-936-7500 (Telephone)  
512-936-7525 (Facsimile)  
[cassandra.quinn@opuc.texas.gov](mailto:cassandra.quinn@opuc.texas.gov)  
[opuc\\_eservice@opuc.texas.gov](mailto:opuc_eservice@opuc.texas.gov) (Service)

ATTORNEYS FOR THE  
OFFICE OF PUBLIC UTILITY COUNSEL



## ATTACHMENT 1

- 42864 Application of Farmers Transport. Inc. dba Enchanted Harbor Utility for Authority to Change Rates
- 42919 Application of Double Diamond Utilities Company for a Water and Sewer Rate/Tariff Change
- 42942 Application of Castle Water, Inc. dba Horseshoe Bend Water System for a Rate/Tariff Change
- 43069 Application of Inline Development LLC for a Rate/Tariff Change
- 43076 Application of Consumers Water, Inc. for a Rate/Tariff Change in Harris and Montgomery Counties
- 44809 Application of Quadvest, LP for a Rate/Tariff Change
- 44844 Application of Sunset Water LLC for a Rate/Tariff Change
- 44898 Application of Lindsay Pure Water Company for a Rate/Tariff Change
- 45418\* Application of Corix Utilities Texas Inc. for a Rate/Tariff Change
- 45570 Application of Monarch Utilities I, LP for Authority to Change Rates
- 46069\* Application of Nitsch & Son Utility Company, Inc. for a Rate/Tariff Change
- 46104 Application of Shore Tech, Inc. dba L&M Water Development Company for a Rate/Tariff Change
- 46123\* Application of Rio Brazos Water System for a Rate/Tariff Change
- 46247 Application of Double Diamond Properties Construction Co. dba Rock Creek for a Water Rate/Tariff Change
- 46256\* Application of Liberty Utilities (Woodmark Sewer) Corp. and Liberty Utilities (Tall Timbers Sewer) Corp. for a Rate/Tariff Change
- 46438 Application of J&S Water Company, LLC for a Rate/Tariff Change
- 46556 Application of River Side Wastewater Treatment Plant for Authority to Change Rates
- 46637 Application of Hilco United Services, Inc. dba Hilco H2O for Authority to Change Rates
- 46670\* Application of Custom Water Company, LLC for Authority to Change Rates
- 46991 Application of Waring Knoll Subdivision Well Water for Authority to Change Rates

- 47161      Application of Kerr County Water Systems, LLC for Authority to Change Rates  
(stipulation and settlement pending Commission approval)
- 47736\*      Application of SWWC Utilities, Inc. DBA Water Services, Inc. for Authority to  
Change Rates  
(stipulation and settlement pending Commission approval)
- 47424      Application of Legend Bank dba Oreal, Inc. for Authority to Change Rates
- 47626\*      Application of Southwest Liquids, Inc. for Authority to Change Rates
- 47680      Application of Bolivar Utility Services, LLC for Authority to Change Sewer  
Rates
- 47897\*      Application of Forest Glen Utility Company for Authority to Change Rates
- 47976\*      Application of Liberty Utilities (Silverleaf Water) LLC for Authority to Change  
Water and Sewer Rates  
(stipulation and settlement pending Commission approval)

\* Denotes a case where the utility recovered some portion of its rate-case expenses