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PROJECT NO. 48937

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

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**PUBLIC UTILITY COMMISSION  
OF TEXAS**

PUBLIC UTILITY  
FILED OCT 15 2019

**ORDER ADOPTING AMENDMENTS TO 16 TAC §24.44  
FOR CONSIDERATION AT THE OCTOBER 11, 2019 OPEN MEETING**

The Public Utility Commission of Texas (commission) adopts amendments to 16 Texas Administrative Code (TAC) §24.44, relating to rate-case expenses under Texas Water Code (TWC) §§13.187 and 13.1871, without changes to the proposed text as published in the July 12, 2019 issue of the *Texas Register* (44 TexReg 3492). The amendments are based on the rate-case expense provisions applicable to electric utilities in 16 TAC §25.245. The amendments to 16 TAC §24.44 add titles to the existing subsections, amend 16 TAC §24.44(b) and (c), and insert a new subsection at 16 TAC §24.44(e), to mirror the structure of the electric rate-case expense rule. The amendment to 16 TAC §24.44(b) removes the provision that prohibited a utility from recovering rate-case expenses when the commission-approved rate following a contested case hearing generated less than 51% of the utility's requested revenue requirement (51% rule) and replaces it with the requirements for recovery or reimbursement of rate-case expenses. The amendment to 16 TAC §24.44(c) removes the provision that limits the recovery of rate-case expenses following a written settlement offer (settlement offer rule) and replaces it with criteria for the review and determination of the reasonableness of rate-case expenses. The addition of 16 TAC §24.44(e) details the method the commission will utilize in allowing or disallowing the recovery of rate-case expenses. The rule amendments are adopted under Project Number 48937.

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The commission received written comments on the amendments from the Office of Public Utility Counsel (OPUC), the law firm of Mathews & Freeland, LLP, and six Texas investor-owned utilities (IOUs) that jointly filed their written comments. The IOUs consisted of 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 (CLWSC); Southwest Water Company; Quadvest L.P.; Corix Utilities (Texas) Inc.; and Southern Utilities Company. There was no request for a public hearing.

Prior to publishing the proposed rule amendments in the *Texas Register* on July 12, 2019, the commission requested comments on a strawman rule that was published in the *Texas Register* on January 18, 2019. Similar to the amendments adopted herein, the strawman rule replaced the 51% rule and settlement offer rule provisions with general requirements for recovery of rate-case expenses. The strawman rule did not contain the more detailed criteria for the review and determination of reasonableness of rate-case expenses, as found in adopted 16 TAC §24.44(c). Additionally, the strawman rule did not contain the calculation for allowed or disallowed rate-case expenses, as found in adopted 16 TAC §24.44(e).

***Comments on the amendments to 16 TAC §24.44 generally***

The IOUs favored the strawman version of the rate-case expense rule. Specifically, the IOUs supported the removal of the 51% rule and settlement offer rule provisions that could act as a potential bar to any rate-case expense recovery. The IOUs stated that the strawman version provided a framework for evaluating the reasonableness and necessity of rate-case expenses, while broadly allowing case-specific arguments for any disallowances. The IOUs expressed

concern that the amendments primarily establish criteria for rate-case expense disallowances rather than maintaining focus on the recovery of reasonable and necessary expenses.

OPUC opposed the removal of the 51% rule and settlement offer rule. OPUC stated that a streamlined rate-case expense process, such as the 51% rule, provides protection for customers. OPUC argued that elimination of the existing provisions potentially exposes customers to additional rate-case expenses resulting from the litigation of rate-case expense issues. Further, OPUC argued that aligning the water and sewer rate-case expense rule with the electric rate-case expense rule may have other negative consequences. Specifically, OPUC stated that these increased rate-case expenses would often be spread over a smaller customer base than would be present in electric utility cases, meaning the individual water or sewer customers may encounter greater financial effects. OPUC also noted that parties must balance participation in rate-case proceedings to ensure meaningful review, but not to the extent that costs outweigh the benefit from involvement in the matter. OPUC expressed concern that the threat of significant rate-case expenses may have a chilling effect on customers' participation in rate cases, because they may be more likely to settle an issue despite its merits if the cost of potential rate-case expenses from continued litigation is too great. Finally, OPUC requested that the commission consider whether the method of recovering rate-case expenses should vary with the size of utility. Specifically, OPUC recommended that the amendments apply only to Class A water and sewer utilities, and that alternative rate-case expense options be considered for Class B, C, and D water and sewer utilities.

Mathews & Freeland, LLP also opposed the removal of the 51% rule, for reasons similar to those stated by OPUC. Mathews & Freeland, LLP argued that the 51% rule provides incentive for utilities to file accurate rate change applications and protects against “gamesmanship.” Mathews & Freeland, LLP, advocated that rather than eliminate the 51% rule, the commission should raise the threshold from 51% to 75% because that would provide even stronger incentive for utilities to file adequately prepared rate change applications.

Both OPUC and Mathews & Freeland, LLP, stated that removing key rule provisions, specifically the 51% rule and the settlement offer rule, may encourage utilities to request inflated rates via unsupported or inadequately prepared applications.

In reply to OPUC’s initial comments, the IOUs argued that the utilities should not forfeit rate-case expenses via settlement, have their recovery curtailed based on their respective size, or be subject to the 51% rule, especially considering procedural changes the IOUs suggest have occurred since the transfer of the water and sewer oversight from the Texas Commission on Environmental Quality (TCEQ) to the commission. Specifically, the IOUs stated that utilities are now required to present a greater portion of their case before settlement negotiations can commence, meaning more rate-case expenses are incurred prior to those discussions. Additionally, the IOUs argued that they endure regulatory lag and bear the burden of rate-case expense carrying costs before receiving a requested rate change. The IOUs stated that these circumstances, along with political ramifications, customer relationships, and utility reputation are adequate incentive for utilities to keep rate-case expenses reasonable. The IOUs also stated that the commission rejected the 51% rule and the settlement offer rule for electric utilities in

enacting 16 TAC §25.245. The IOUs argued that the 51% rule and settlement offer rule are unfair and inconsistent because rather than assessing the reasonableness and necessity of rate-case expenses, it allows 100% disallowance without addressing specific case considerations. Further, the IOUs reasoned that policy revisions such as the routine suspension of rates and the requirement of a more detailed initial rate filing package are more impactful to customer protection than the 51% rule and settlement offer rule.

In reply to Mathews & Freeland, LLP's initial comments, the IOUs reiterated their support of the removal of the 51% rule and settlement offer rule. The IOUs restated that reasonable amounts of rate-case expenses should be recoverable even if the approved rate is less than the utilities request. As an example, the IOUs cited a case where a utility was denied any rate-case expense recovery due to operation of the 51% rule. According to the IOUs, the utility in that case was not granted any rate-case expense recovery despite the TCEQ's approval of a rate that generated a 48.5% annual revenue increase. Specifically, the IOUs stated that the 51% rule prohibited the utility from recovering any of the \$856,742.42 in rate-case expenses that may have been otherwise recoverable as reasonable, necessary, and in the public interest. The IOUs argued that rate-case expense disallowance in situations such as in that case presented conflicts with the commission's role in ensuring that a utility's revenue be fixed at a level that permits the utility a reasonable opportunity to earn a reasonable return on its invested capital, while preserving the utility's financial integrity.

*Commission response*

The commission declines to adopt all of the amendments originally proposed in the strawman rule as requested by the IOUs. Nonetheless, the commission agrees with the IOUs that reasonable and necessary rate-case expenses should be recoverable via the regulatory process for both water and sewer utilities and electric utilities. Therefore, the commission will employ a similar regulatory framework when determining a utility's rate-case expense for both water and sewer utilities and electric utilities.

The commission notes that the 51% rule and the settlement offer rule are not required by the TWC, nor do they exist under 16 TAC §25.245. The appropriate statutory standard for setting water or sewer utility rates includes establishing the reasonable and necessary operating expenses that will permit the utility a reasonable opportunity to earn a return on its invested capital that is used and useful in rendering service. The rule amendments result in a treatment of rate-case expenses in a manner that is more similar to the treatment of other types of utility expenses.

*Comments on the amendments to 16 TAC §24.44(b)*

The IOUs were concerned that the amendment of 16 TAC §24.44(b)(6) that requires the submittal of information detailing rate-case expenses with a specific issue in the rate case and the amount of rate-case expenses reasonably associated with each issue will be overly burdensome to implement. Furthermore, the IOUs were concerned that this may lead to disallowance disputes under amended 16 TAC §24.44(c) and newly added 16 TAC §24.44(e). The IOUs argued that the provisions could increase overall rate-case expenses.

*Commission response:*

**The commission declines to remove 16 TAC §24.44(b)(6), as the commission intends to align the water and sewer utility rate-case expense rule with the corresponding electric utility rate-case rule in its entirety. Additionally, with the removal of the 51% rule, the need to consider the novelty and complexity of the issues and the amount of money spent on each issue is of heightened importance.**

*Comments on the amendments to 16 TAC §24.44(c)*

The IOUs were concerned that the amendment of 16 TAC §24.44(c) regarding the criteria for reviewing requested rate-case expenses will be overly burdensome to implement and lead to additional disallowance disputes. Specifically, the IOUs requested the removal of the second sentence of the subsection, which includes subsections (c)(1) through (c)(6), stating that the criteria are duplicative and unnecessary considering the items listed in subsection (b).

OPUC recommended replacing the phrase "extreme or excessive" in subsections (c)(1) and (c)(2) with the phrase "reasonable and necessary" to appropriately reflect the statutory standard for recovery.

*Commission response:*

**The commission declines to remove 16 TAC §24.44(c). The commission does not agree that subsections (c)(1) through (c)(6) are duplicative and unnecessary. The use of the phrase "extreme or excessive" provides guidance to the commission for application of the "reasonable and necessary" statutory standard.**



***Comments on the amendments to 16 TAC §24.44(d)***

The IOUs questioned the incorporation of this subsection that states unamortized rate-case expenses may not be a component of invested capital for the calculation of rate-of-return. The IOUs noted that it is not found in the electric utility rate-case expense rule, 16 TAC § 25.245.

***Commission response:***

**The commission recognizes that the corresponding electric rate-case expense rule does not include a provision stating that unamortized rate-case expenses may not be a component of invested capital for the calculation of rate-of-return. However, in the past, except in limited situations, the commission has not authorized recovery of carrying charges on the unpaid balance of rate-case expenses. See *Application of Reliant Energy for Approval of Unbundled Cost of Service Rate Pursuant to PURA § 39.201 and Public Utility Commission Substantive Rule § 25.344*, Docket No. 22355, Finding of Fact No. 98G (Oct. 4, 2001). Therefore, the incorporation of this existing subsection is consistent with commission precedent.**

***Comments on the amendments to 16 TAC §24.44(e)***

The IOUs requested that the amendment to subsection (e)(3) not be adopted. The IOUs argued that the provision specifically provides for rate-case disallowances that are tied to the result of the rate case if evidence of rate-case expenses associated with an issue is not viewed as sufficient under subsection (b)(6). Further, the IOUs argued that this provision is similar to the 51% rule and the settlement offer rule that were eliminated as a part of the rule amendments. The IOUs argued that it was unfair that subsection (e)(3) requires evidence of actual cost incurrence for rate-case expense recovery yet permits cost estimates for disallowances.

*Commission response:*

The commission declines to remove 16 TAC §24.44(e)(3), because the provision allows an alternative method for determining the appropriate disallowance of rate-case expenses when the utility fails to provide the required evidence under subsection (b). If the utility is unable to provide the information necessary to make a determination on a rate-case expense issue with certainty and specificity, the calculation described in subsection (e)(3) provides a method that is fair to both the utility and its customers.

*Additional Comments on the amendments to 16 TAC §24.44*

OPUC recommended 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.

The IOUs disagreed with OPUC's recommendation to add subsection (f). Rather, the IOUs supported a rate-case expense recovery rule that limits disallowances to case-specific arguments.

***Commission response:***

**The commission declines to adopt OPUCs proposed subsection (f), because subsection (c) provides sufficient guidance for the determination of the reasonableness of the utility's rate-case expenses.**

All comments, including any not specifically referenced herein, were fully considered by the commission.

These amendments are adopted under §14.002 of the Public Utility Regulatory Act, Tex. Util. Code and Texas Water Code §13.041(b), which provide the commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction.

**§24.44. Rate-case Expenses**

- (a) **Recovery of rate-case expenses.** A utility may recover rate-case expenses, including attorney fees, incurred as a result of filing a rate-change application pursuant to TWC §13.187 or TWC §13.1871, only if the expenses are reasonable and necessary.
- (b) **Requirements for claiming recovery of or reimbursement for rate-case expenses.** A utility requesting recovery of its rate-case expenses has the burden to prove the reasonableness of such rate-case expenses by a preponderance of the evidence. A utility seeking recovery of rate-case expenses must submit information that sufficiently details and itemizes all rate-case expenses, including, but not limited to, evidence verified by testimony or affidavit, showing:
- (1) the nature, extent, and difficulty of the work done by the attorney or other professional in the rate case;
  - (2) the time and labor expended by the attorney or other professional;
  - (3) the fees or other consideration paid to the attorney or other professional for the services rendered;
  - (4) the expenses incurred for lodging, meals and beverages, transportation, or other services or materials;
  - (5) the nature and scope of the rate case, including:
    - (A) the size of the utility and number and type of consumers served;
    - (B) the amount of money or value of property or interest at stake;
    - (C) the novelty or complexity of the issues addressed;
    - (D) the amount and complexity of discovery;

(E) the occurrence and length of a hearing; and

(6) the specific issue or issues in the rate case and the amount of rate-case expenses reasonably associated with each issue.

(c) **Criteria for review and determination of reasonableness.** In determining the reasonableness of the rate-case expenses, the commission must consider the relevant factors listed in subsection (b) of this section and any other factor shown to be relevant to the specific case. 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;
- (3) there was duplication of services or testimony;
- (4) the utility's proposal on an issue in the rate case had no reasonable basis in law, policy, or fact and was not warranted by any reasonable argument for the extension, modification, or reversal of commission precedent;
- (5) rate-case expenses as a whole were disproportionate, excessive, or unwarranted in relation to the nature and scope of the rate case addressed by the evidence pursuant to subsection (b)(5) of this section; or
- (6) the utility failed to comply with the requirements for providing sufficient information pursuant to subsection (b) of this section.

(d) **Unamortized rate-case expenses.** Unamortized rate-case expenses may not be a component of invested capital for calculation of rate-of-return purposes.

(e) **Calculation of allowed or disallowed rate-case expenses.**

(1) Based on the factors and criteria in subsections (b) and (c) of this section, the commission must allow recovery of rate-case expenses equal to the amount shown in the evidentiary record to have been actually and reasonably incurred by the requesting utility. The commission must disallow recovery of rate-case expenses equal to the amount shown to have been not reasonably incurred under the criteria in subsection (c) of this section. A disallowance may be based on cost estimates in lieu of actual costs if reasonably accurate and supported by the evidence.

(2) A disallowance pursuant to subsection (c)(5) of this section may be calculated as a proportion of a utility's requested rate-case expenses using the following ratio or an appropriate methodology:

(A) the amount of the increase in revenue requirement requested by the utility that was denied, to

(B) the total amount of the increase in revenue requirement requested in a proceeding by the utility.

(3) If the evidence presented pursuant to subsection (b)(6) of this section does not enable the commission to determine the appropriate disallowance of rate-case expenses reasonably associated with an issue with certainty and specificity, then the commission may disallow or deny recovery of a proportion of a utility's

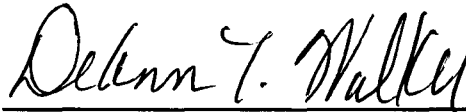
requested rate-case expenses using the following ratio or an appropriate methodology:

- (A) the amount of the increase in revenue requirement requested by the utility in the rate case related to the issues not reasonably supported by evidence of certainty and specificity, to
- (B) the total amount of the increase in revenue requirement requested in a proceeding by the utility.

This agency certifies that the adoption has been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority. It is therefore ordered by the Public Utility Commission of Texas that amendments to 16 TAC §24.44, relating to rate-case expenses under Texas Water Code (TWC) §§13.187 and 13.1871, are hereby adopted with no changes to the text as proposed.

Signed at Austin, Texas the 14<sup>th</sup> day of October 2019.

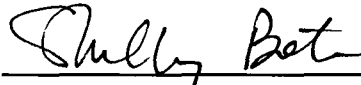
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