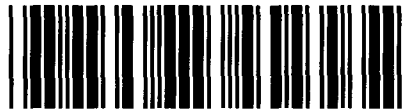


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RULEMAKING TO AMEND 24.44
RATE-CASE EXPENSES PURSUANT TO
TEXAS WATER CODE 13.187 AND
13.871

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PUBLIC UTILITY COMMISSION
OF TEXAS

APR 11: 14
FILING CLERK

**OFFICE OF PUBLIC UTILITY COUNSEL'S
COMMENTS ON STAFF'S STRAWMAN RULE**

The Office of Public Utility Counsel (OPUC) respectfully submits the following comments on Commission Staff's strawman rule proposing amendments to 16 Texas Administrative Code (TAC) § 24.44 regarding recovery of rate-case expenses for water and wastewater utilities. OPUC appreciates the opportunity to offer comment. The Texas Water Code (TWC) does not expressly authorize recovery of rate-case expenses. Consequently, the Commission's rule plays a critical role in the ratemaking process as the primary regulatory guidance on the issue.

Staff's strawman rule proposes replacing key provisions of the existing rate-case expense rule for water utilities with a portion of the Commission's rate-case expense rule for electric utilities. OPUC recommends that the Commission retain the existing rule at this time. The current rule offers a streamlined methodology to determine the reasonableness of rate-case expenses that is consistent with longstanding practice at the Texas Commission on Environmental Quality (TCEQ), and for the reasons discussed below, it is premature to replace it.

I. GENERAL COMMENTS ON STAFF'S STRAWMAN RULE

The current version of 16 TAC § 24.44 provides important protections for water and wastewater customers.

In its current form, 16 TAC § 24.44 protects customers by serving as a check on the recovery of rate-case expenses in two different ways. Subsection (b) prevents a utility from recovering rate-case expenses 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

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the rates proposed in the utility's application (51% rule).¹ Subsection (c) limits the recovery of rate-case expenses if a 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 approved by the Commission (settlement rule).² Both of these provisions were originally adopted by the TCEQ in response to ratepayer concerns "that utilities may have an incentive to overreach their rate applications if utilities believe that customers ultimately will bear all rate case expenses."³ The TCEQ drafted its 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."⁴

The ratepayer concerns that prompted the TCEQ's adoption of the 51% and settlement rules are still valid today. Water utilities do not bear the expense of proving up their rate applications and therefore have little incentive to behave like self-funded litigants. As it currently exists, the 51% rule preserves a utility's ability to pursue an issue while ensuring that ratepayers do not bear the costs should the utility overreach by making especially aggressive arguments or pursuing "longshot" issues. Moreover, leaving the 51% rule as-is will encourage utilities to focus their resources on preparing an application that requests a reasonable rate increase and is supported by detailed documentation. A rate filing package with these characteristics is likely to result in a rate that recovers at least 51% of the requested increase in revenues thereby nullifying the barrier to recovery of rate-case expenses.

Ensuring adequate customer protection against excessive rate-case expenses is particularly important for water and wastewater utility customers. In the electric industry, a *small* utility has upwards of 50,000 customers, while the benchmark for a *large* water utility is only 10,000 customers.⁵ Accordingly, the financial burden of rate-case expenses is heavier in water proceedings because it is spread over a relatively small customer base. Using an example based on a recent case, a utility that serves 296 connections and incurs \$46,080 in rate-case expenses would need to charge \$7.14 per connection per month for 24 months in order to recover its expenses. If the utility charges a flat rate of \$65 per month, this rate-case expense surcharge

¹ 16 TAC § 24.44(b).

² 16 TAC § 24.44(c).

³ 31 Tex. Reg. 8106, 8107 (Sep. 22, 2006) (former 30 TAC § 291.28(7) – (9)).

⁴ *Id.*

⁵ TWC § 13.002(4-a).

is the equivalent of a 10.98% increase per month for two years, which is in addition to any base rate increase authorized in the proceeding.⁶ Given this reality, it is of paramount importance to have a rule like the 51% rule that dis-incentivizes a utility from overreaching and receiving an increase that is only a fraction of the increase requested, and potentially recovering rate-case expenses in an amount that eclipses the increase.

Additionally, the substantial impact that rate-case expenses can have on a customer's bill gives utilities significant bargaining power and 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.⁷ Moreover, a survey of twenty-five settled water rate cases reveals that two thirds of the time (seventeen cases or 68%) the utility agreed not to recover any rate-case expenses associated with the proceeding.⁸ The frequency of this type of agreement indicates that the parties recognize the potential impact of rate-case expenses on customers and affirms the need to incentivize cost-conscious behavior.

Lastly, by establishing clear instances in which rate-case expenses will be disallowed, the current rule reduces the costs associated with litigating the rate-case expense issue. Customers may be responsible for paying these costs as well, so having a streamlined process provides protection. Such a straightforward rule is also in harmony with the Commission's efforts to provide a simplified, less costly application process for smaller utilities. The policy reasons that support a less complex application process for smaller utilities also support a less complex process for proving up rate-case expenses.

The timing of this rule change is premature.

Along with the benefits provided by the existing rule, OPUC has identified three timing issues that support delaying the consideration of amendments to 16 TAC § 24.44. First, the

⁶ This example is based on numbers from a settlement that included an amount of rate-case expenses that was significantly lower than the amount claimed by the applicant in direct testimony. The parties in that case agreed to a \$30 increase in the utility's flat monthly base charge, a \$5 per month surcharge in year one of the rate-case expense rider, and a \$10 per month surcharge in year two. *Application of Forest Glen Utility Company for Authority to Change Rates*, Docket No. 47897, Unopposed Stipulation and Settlement Agreement at 2-3 (Nov. 12, 2018) (pending).

⁷ As discussed below, only three water rate cases have been litigated at the Commission.

⁸ A list of settled water rate cases is included as Attachment 1.

current ratemaking framework for smaller water utilities is in flux due to pending legislation and open Commission projects. Second, the 51% rule has been implicated in the only three contested cases that have gone to a Commission decision. Third, the electric rate-case expense rule that Staff's strawman is based on is also a new rule that does not yet have a body of Commission precedent applying it. Each of these issues is addressed below.

OPUC recommends waiting to address the water rate-case expense rule until after the Legislature and the Commission have had time to further develop the regulatory environment for water and wastewater utilities. There are already several pending proposals that may affect regulation of these utilities. This legislative session, Senate Bill 700 and House Bill 1587 have been filed to redefine the connection counts used to classify water and wastewater utilities as follows:⁹

	Current Law	S.B. 700/H.B.1587
Class A	over 10,000	over 10,000
Class B	501 – 10,000	2,301 – 10,000
Class C	500 or less	501 – 2,300
Class D	n/a	500 or less

This legislation also amends TWC § 13.183(c) to broaden the Commission's authority regarding the adoption of alternative ratemaking methodologies. Further, the Commission has opened Project No. 45757 to simplify the rate filing packages for class C and smaller class B utilities, and Project No. 47337 to amend the rule for alternative ratemaking methods for water utilities.¹⁰ Because the combined effect of the potential new classifications, ratemaking methodologies, and rate filing packages is as yet unknown, OPUC believes it is prudent to leave the current protections provided by 16 TAC § 24.44 in place until the new ratemaking framework is better defined. This approach would provide the Commission flexibility to determine if the rate-case expense rule should reflect any of these potential changes. For example, if the Commission adopts a more simplified version of the current class B application, then it may be appropriate to adopt a rate-case expense rule that reflects the varying levels of costs associated with preparing a class A, regular class B, or simplified class B application.

⁹ Tex. S.B. 700, 86th Leg., R.S. (2019); Tex. H.B. 1587, 86th Leg., R.S. (2019).

¹⁰ *Amendments to 16 TAC § 24.34, Alternative Rate Methods*, Project No. 47337 (pending); *Simplified Class B Water and Sewer Rate Filing Package Form, Notice and Instructions for Class C and Smaller Class B Utilities*, Project No. 47575 (pending).

The outcomes of the three water cases that have been decided by the Commission since jurisdiction over water rates was transferred in 2014 also suggest that it is practical to wait to amend 16 TAC § 24.44 until utilities have had more time to acclimate to the Commission's approach to ratemaking.¹¹ While this is a small sample of cases, it is significant that all three applicants ran afoul of the 51% threshold. In Docket No. 42849, the Commission denied recovery of rate-case expenses because the applicant failed to show that it qualified for any rate increase whatsoever.¹² The Commission also applied 16 TAC § 24.44(b) in Docket No. 45720 to deny recovery of rate-case expenses because the Commission approved a \$1,476 increase in the revenue requirement rather than the \$35,736 increase requested by the applicant.¹³ The rate-case expense issue is still pending in Docket No. 46245,¹⁴ but its resolution will likely entail a discussion of issues related to the 51% rule. In that case, the applicant requested water and wastewater rate increases for two subdivisions, but the Commission ordered a significant rate reduction for one subdivision and granted an increase that was less than the applicant's requested increase for the other subdivision.¹⁵

Finally, the Commission has not yet applied its rule on the recovery of *electric* rate-case expenses to a fully litigated case, which is yet another reason to proceed slowly with developing a new rule to govern water rate cases that is based on the electric rule.¹⁶ While 16 TAC § 25.245 is the result of the full formal rulemaking process, insufficient precedent exists to evaluate how the Commission will apply it. The lack of precedent also makes it difficult to gauge how well it will translate to water cases, which are often less expensive and involve fewer contested issues.

In short, leaving the water rate-case expense rule unchanged will ensure consistency regarding the recovery of rate-case expenses until the Commission has had more time to refine

¹¹ See *Application of Double Diamond Utility Company, Inc. for Water and Sewer Rate/Tariff Change*, Docket No. 46245, Final Order (Aug. 30, 2018); *Application of Rio Concho Aviation, Inc. for a Rate/Tariff Change*, Docket No. 45720, Order (Jun. 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).

¹² Docket No. 42849, Final Order at Finding of Fact No. 41, Conclusions of Law Nos. 30-31.

¹³ Docket No. 45720, Final Order at Findings of Fact Nos. 43C-43E, Conclusion of Law No. 11.

¹⁴ *Review of Rate Case Expenses Incurred by Double Diamond Utility Company, Inc. in Docket No. 46245*, Docket No. 47748 (pending).

¹⁵ Docket No. 46245, Final Order at 1.

¹⁶ The only litigated rate-case-expense proceeding under 16 TAC § 25.245 remains pending before the Commission. See *Review of Rate Case Expenses Incurred by Sharyland Utilities, L.P. Severed from Docket No. 45414*, Docket No. 45979 (pending).

the regulatory structure for water utilities, develop a more robust body of Commission-issued precedent, and test the efficacy of 16 TAC § 25.245 in the context in which it was designed to apply before applying it to water utilities.

II. SPECIFIC COMMENTS ON STAFF'S STRAWMAN RULE

Should the Commission determine that changes to 16 TAC § 24.44 are necessary, OPUC recommends that the new rule cultivate a process for reviewing rate-case expenses that takes into account features that are unique to water utilities and encourages evaluation of rate-case expenses based on policy considerations. In addition, OPUC offers the following comments related to each specific change proposed in Staff's strawman.

Staff's proposed deletion in § 24.44(a) of the "just" and "in the public interest" standards

Staff's strawman proposes deleting the requirement that rate-case expenses be "just" and "in the public interest" from 16 TAC § 24.44(a), which leaves reasonableness and necessity as the only criteria for assessing rate-case expenses. However, there may be some instances where a rate-case expense is both reasonable and necessary but not just and in the public interest. For example, rate-case expenses have been disallowed that were otherwise reasonable and necessary where "a substantial portion of the rate case expenses were incurred as a direct result of the confusion from the utility's [multiple] filings."¹⁷ In addition, as discussed above, water utilities have smaller customer bases, and the Commission should be able to consider whether there are public interest concerns, such as rate shock, in passing on rate-case expenses to customers. Accordingly, OPUC recommends keeping the reference to the public interest in 16 TAC § 24.44(a) to ensure utilities have notice that policy considerations are an inherent part of the evaluation of rate-case expenses.

Staff's proposed § 24.44(b)

The new subsection (b) proposed in Staff's strawman is similar to 16 TAC § 25.245(b), which addresses rate-case expenses for electric utilities. However, the strawman omits the language found in 16 TAC § 25.245(b)(5)(C) and (b)(6). The former specifies that evidence on

¹⁷ *City of Port Neches v. R.R. Comm'n of Tex.*, 212 S.W.3d 565, 579 (Tex. App.—Austin 2006, no pet.) (brackets in original).

“the novelty and complexity of the issues addressed” is evidence related to the nature and scope of a rate case.¹⁸ The latter requires a utility to file sufficient evidence that details and itemizes the amount of expenses associated with the specific issues in the rate case.¹⁹ The electric rate-case expense rule was adopted in Project No. 41622, and a review of the Commission’s order adopting the rule confirms that it is inadvisable to both delete the 51% bar on recovery from the current version of 16 TAC § 24.44(b) and omit the language from subsections (b)(5)(C) and (b)(6) from the proposed replacement provision.

As initially proposed, 16 TAC § 25.245(d)(4) included a methodology for calculating rate-case expenses that was nearly identical to the 51% rule Staff’s strawman proposes to delete.²⁰ The Commission explained its rationale for removing this methodology from the final version of the rule as follows: “...adoption of the requirement that rate-case expenses be associated with the rate case’s issues decreases the need to adopt the 51% Allowance Method. Accordingly, the commission finds at this time that it is not necessary to adopt subsection (d)(4) of the published rule.”²¹ Applying this reasoning, OPUC recommends adding a provision to the proposed 16 TAC § 24.44(b) that links an amount of rate-case expenses to each issue in the rate case.

In addition, Staff’s strawman would create inconsistencies between the water and electric rate-case expense rules without explanation and may cause confusion regarding its interpretation. As discussed above, the electric rate-case expense rule has not been considered by the Commission in a fully litigated proceeding; thus, there is not a body of Commission precedent interpreting and applying the rule. If the Commission chooses to adopt a similar rule for water utilities, any deviations from the electric rule should be fully explained. In this case, Staff has not provided an explanation for excluding (b)(5)(C) and (b)(6) of 16 TAC § 25.245, and these provisions appear to be particularly important in the context of water utilities. Without the 51% rule, the need for consideration of the novelty and complexity of the issues that the utility pursues, as well as the amount spent on each issue, becomes more important. Accordingly,

¹⁸ 16 TAC § 25.245(b)(5)(C).

¹⁹ 16 TAC § 25.245(b)(6).

²⁰ 39 Tex. Reg. 570, 572 (Feb. 7, 2014).

²¹ *Rulemaking to Proposed New Subst. R. §25.245, Relating to Recovery of Expenses for Ratemaking Proceedings*, Project No. 41622, Order Adopting New § 25.245 as Approved at the July 10, 2014 Open Meeting at 131 (Aug. 6, 2014).

OPUC recommends that if the Commission plans to replace the existing rate-case expense rule for water utilities with subsection (b) of the rule for electric utilities that it do so in its entirety.

Moreover, the provisions of the electric rate-case-expense rule are interdependent and should not be adopted piecemeal. Staff's proposed strawman would only adopt portions of the list of evidence a utility is required to file under 16 TAC § 25.245(b), and would exclude subsection (c) regarding the criteria for review and determination of reasonableness, as well as subsection (d), which provides methods for calculating allowed or disallowed rate-case expenses when the utility fails to provide sufficient information. These provisions were adopted as part of a comprehensive rulemaking for electric utility rate-case expenses. Without their inclusion, the rule is incomplete. Thus, OPUC recommends that if the Commission chooses to adopt subsection (b) of the electric rate-case expense rule, then subsections (c) and (d) of the rule also be included.

III. CONCLUSION

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

Respectfully submitted,



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ATTORNEY FOR THE
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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 (stipulation and settlement pending Commission approval)
- 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)
- 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
(stipulation and settlement pending Commission approval)

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