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RATEPAYERS APPEAL OF THE	**§**	**BEFORE THE STATE OFFICE**
DECISION BY WINDERMERE	**§**	
OAKS WATER SUPPLY	**§**	**OF**
CORPORATION TO CHANGE	**§**	
WATER AND SEWER RATES	**§**	**ADMINISTRATIVE HEARINGS**

COMMISSION STAFF'S RESPONSE TO THE PROPOSAL FOR DECISION'S REQUEST FOR RATES BASED ON ITS PROPOSED REVENUE REQUIREMENT

On June 29, 2023, the administrative law judges (ALJs) issued a proposal for decision (PFD). In the PFD, the ALJs suggested that Commission Staff calculate, for the Commission's consideration, rates based on the revenue requirement of $527,714 that the ALJs adopt in their proposed final order.

Staff maintains its position that applying an offset of $48,478 to a revenue requirement of $576,192 is applying an "apples" offset to an "oranges" revenue requirement. A given offset is developed in coordination with a specific revenue requirement. It is inappropriate to apply the offset calculated relative to Staff's proposed revenue requirement to another, unrelated revenue requirement. This is further exacerbated by the fact that the PFD rejects Staff's volumetric rates, instead approving Windermere's existing volumetric rates while rejecting its base rates. The result is a cobbling together of a revenue requirement based on an unverified allocation factor, Windermere's existing water and wastewater volumetric rates, Staff's offset, and base rates that are reverse engineered to arrive at the PFD's desired revenue. The PFD simultaneously adopts Windermere's existing volumetric rates while also adopting the TRWA allocation factor, asking Staff to incorporate two mutually exclusive components when calculating rates based on the PFD's revenue requirement.[1] As shown below, this is impossible.

To illustrate the problematic nature of creating rates using Staff's offset and the PFD's revenue requirement, a brief summary of the math that flows from the PFD's revenue requirement is helpful.[2] Given Windermere's position that approximately 60% of its revenue comes from water

[1] *See* PFD at 53 (stating that Windermere's fixed versus variable allocation was reasonable and that Windermere should continue collecting rates in accordance with the rate design effective March 2020); *see* PFD at 5, stating that Windermere's volumetric charge is not part of this appeal.

[2] The calculations supporting the rates noted below are provided in the attachment to this filing.

and 40% of its revenue comes from wastewater, and given a revenue requirement of $527,714, Windermere would need to generate $316,628 in water revenue and $211,086 in wastewater revenue. Windermere further indicated through the TRWA rate analysis that it allocated 61.48% of its expenses to fixed costs, while allocating the remaining 38.53% to variable costs. These allocations are applied to each of the water and wastewater revenue requirements.

Calculating Windermere's water rates based on the allocation shown in the TRWA rate analysis, which is the same allocation factor approved by the PFD, some 61.48% of $316,628, or $193,143 should be recovered through base rates, and 38.53%, or $123,485, should be recovered from volumetric charges. Using the TRWA fixed and variable cost allocation, the monthly water base rate *should* be $59.86. However, based on the test year volumetric revenue provided by Windermere, its current volumetric water rates generate only $75,045 per year. Because the PFD also appears to approve Windermere's existing volumetric rates, this would necessitate recovery of $241,583 in water base rate revenue, requiring a monthly water base rate of $74.29. The resulting allocation of 76.30% to fixed costs and 23.70% to variable costs differs wildly from the allocation in the TRWA study and is not supported by evidence in the record.

The same disconnect occurs when calculating the wastewater base rates. Calculating Windermere's wastewater rates using the allocation shown in the TRWA rate analysis, which is the same allocation factor approved by the PFD, 61.48% of $211,086, or $128,762 should be recovered through base rates, and 38.53%, or $82,324, should be recovered from volumetric charges. Therefore, using the TRWA allocation, the monthly wastewater base rate *should* be approximately $44.14. However, based on the test year volumetric revenue provided by Windermere, its volumetric wastewater rate generates $33,011 per year. Because the PFD also appears to approve Windermere's existing volumetric rates, this would necessitate recovery of $178,075 from its wastewater base rate, requiring a monthly water base rate of $60.57. The resulting allocation of 84.36% to fixed costs and 15.64% to variable costs differs wildly from the allocation in the TRWA study and is not supported by evidence in the record.

It is unclear to Staff whether it should rely on the TRWA allocation to calculate base rates, or if it should rely on the volumetric revenue from Windermere's test year. To rely on the volumetric revenue from the test year is to create an allocation between fixed and variable costs that has been neither evaluated nor approved. Further, an allocation factor should drive rates; it is not appropriate for rates to drive an allocation, which is exactly what the PFD would require. If

Staff properly calculates Windermere's rates, using the PFD's revenue requirement and the allocation adopted in the TRWA study, the allocation that has been evaluated and approved, then Staff *must* redesign Windermere's volumetric rates. Staff is providing, for the Commission's consideration, both rate designs: one using an allocation factor that Staff has no way to know is valid, the other using volumetric rates that are not approved. As Staff has repeatedly noted, this is the problem with adjusting only one piece of a rate design: revenue requirement, allocation, offsets volumetric rates, and base rates are all interdependent. Changing one element affects all others, and each element must be re-evaluated in turn.

There are two major issues with crafting base rates in the manner suggested by the PFD. First, such calculations would ignore standard Commission policy, which is to review and evaluate whether costs of service are properly allocated before setting rates. When submitting a rate filing package, utilities are directed to "[p]rovide a detailed cost analysis that supports the utility's fixed rate customer charges included in the utility's general rate, by meter size, showing all direct and indirect costs included." To adopt rates in the method suggested by the PFD is to disregard information that is explicitly required in the Commission's rate filing package. If utilities must provide support for allocations between fixed and variable costs, but then may subsequently ignore those allocations, it renders a significant portion of the rate filing package toothless. While this is a rate appeal involving a water supply corporation, and investor-owned utilities are required to use the rate filing package, proper allocation is a necessary component of any valid rate design. As noted in *Bear Creek*, "[b]efore the Commission can design new rates, it must first determine a reasonable revenue requirement".[3] Rate setting follows a process: revenue requirement, then allocation, then rates.

In terms of practical application, the PFD's approach has negative real-world implications. Cost causation principles try to align a rate with drivers for the changes in the underlying rate components. The PFD would have Staff ignore those principles. Reduced voluntary water conservation could be one such negative consequence. If a utility's gallonage rate is too low, ratepayers will not try to conserve. A given ratepayer would pay close to the same monthly rate regardless of usage and would therefore have no incentive to conserve water. Conversely, in times

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3 *Ratepayers Appeal of the Decision by Bear Creek Special Utility District to Change Rates*, Docket No. 49351, Order on Rehearing at 4 (Nov. 19, 2021).

of high usage, the utility might not recover enough costs for variable items, such as chemicals or purchased power, that are more expensive due to the increased usage.

As directed, Staff has performed number running as suggested by the PFD, though Staff notes that it is mathematically impossible to submit "number running consistent with the [PFD's] recommendations."[4] Because there is a lack of clarity as to whether Staff should use: (1) an allocation factor that is not consistent with the PFD and the approved volumetric rates to calculate base rates; or (2) the approved allocation factor and volumetric rates that are not consistent with the PFD to calculate base rates, Staff has provided both options for the Commission's review. In closing, Staff once again cautions against the piecemeal approach that the PFD adopts and reiterates that it does not support either of the attached rate designs.

Dated: September 1, 2023

Respectfully submitted,

PUBLIC UTILITY COMMISSION OF TEXAS
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[4] PFD at 57.

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I certify that unless otherwise ordered by the presiding officer, notice of the filing of this document was provided to all parties of record via electronic mail on September 1, 2023 in accordance with the Second Order Suspending Rules, issued in Project No. 50664.

/s/ Merritt Lander
Merritt Lander

The following files are not convertible:

50788 rates from PFD (comparison).xlsx

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