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**APPLICATION OF CSWR-TEXAS § BEFORE THE STATE OFFICE
UTILITY OPERATING COMPANY, LLC § OF
FOR AUTHORITY TO CHANGE RATES § ADMINISTRATIVE HEARINGS**

**CSWR-TEXAS UTILITY OPERATING COMPANY, LLC
REPLY TO EXCEPTIONS
TO THE PROPOSAL FOR DECISION**

Respectfully submitted,

L. Russell Mitten
General Counsel
Central States Water Resources, Inc.
1630 Des Peres Rd., Suite 140
Des Peres, MO 63131
(314) 380-8595
(314) 763-4743 (Fax)

Evan D. Johnson
State Bar No. 24065498
Kate Norman
State Bar No. 24051121
C. Glenn Adkins
State Bar No. 24103097
Coffin Renner LLP
1011 W. 31st Street
Austin, Texas 78705
(512) 879-0900
(512) 879-0912 (fax)
evan.johnson@crtxlaw.com
kate.norman@crtxlaw.com
glenn.adkins@crtxlaw.com

**ATTORNEYS FOR CSWR-TEXAS
UTILITY OPERATING COMPANY, LLC**

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CSWR-Texas Utility Operating Company, LLC (“CSWR-Texas” or the “Company”), timely files this its Reply to the Exceptions to the Proposal for Decision (“PFD”).

I. INTRODUCTION

As the PFD explains,¹ this proceeding presents the Public Utility Commission of Texas (“Commission”) with an opportunity to address the unique challenges facing the water and wastewater utility industry in Texas. Since CSWR-Texas entered the Texas market in 2019, CSWR-Texas has acquired over 100 water or wastewater systems in Texas, 74 of which (62 water and 12 wastewater) are included in this proceeding.² Most of these systems were small, distressed, community-based systems located in rural areas,³ were out of compliance at the time of acquisition, historically lacked access to adequate capital to make necessary improvements, and had not performed consistent or adequate maintenance for years.⁴ All of the systems served small, primarily residential customer bases, making it difficult to spread the costs of critical improvements without significant increases in rates. Further, the books and records of these

¹ PFD at 6.

² Statement of Intent, CSWR-Texas Ex. 1 at 2.

³ *Id.* at 1, 13.

⁴ PFD at 6-7

systems have not been well maintained, and in some cases, historical, financial or operational data is not available, or is too inaccurate to be considered reliable.⁵

In each Sale Transfer Merger (“STM”) proceeding filed to acquire these systems, the Company promised to rehabilitate and operate the systems at a loss until it could seek implementation of fully compensatory rates.⁶ It has now invested approximately \$40 million in the water systems serving these communities.⁷ It has also incurred almost \$5 million in operating losses while it awaits Commission approval of compensatory rates.⁸

The PFD admirably recognizes the costs, risks, and challenges facing utilities that seek to invest in the rehabilitation of systems that serve smaller rural communities, and the Company supports adoption of its primary conclusions—including the consolidation of all systems, the inclusion of a business risk premium in the recommended return on equity (“ROE”), and the approval of rates that captures, without further delay, the Company’s investment in its 74 water and wastewater systems and a more current operating expense. The Company disagrees with the PFD that a 10.03% ROE sufficiently recognizes the challenges of bringing new investment to distressed, rural communities, as explained further below, but it credits the ALJs for rejecting the more extreme positions taken by other parties.

Staff of the Public Utility Commission of Texas (“Staff”) and the Office of Public Utility Counsel (“OPUC”) take positions that will not only significantly delay consolidation of numerous small systems and recovery of necessary investments and increased operational expense, but also exacerbate the level of operating losses already being incurred by the Company to operate its

⁵ PFD at 7.

⁶ *See, e.g.*, Tr. at 196:6-197:7 (Cox Cross) (Sept. 7, 2023).

⁷ Rebuttal Testimony of Josiah Cox, CSWR-Texas Ex. 11 at 4:21-23.

⁸ Tr. at 190:2-7 (Confidential Cox Cross) (Sept. 7, 2023).

systems. First, Staff opposes consolidation of 29 of the 74 systems—some of which were approved under Texas Water Code (“TWC”) § 13.305, the Fair Market Value statute—and recommends disallowing any rate changes for 36 of the 74 systems.⁹ Second, Staff recommends an 8.2% ROE based on the argument that CSWR-Texas operational and business risks are no different from those of larger, more centralized utilities. These recommendations result in a \$2.6 million disallowance to the Company’s total \$9.6 million revenue requirement—over half of the entire proposed increase in this case. Finally, while OPUC agrees with CSWR-Texas that consolidation benefits customers of smaller systems and supports consolidation as a means to mitigate rate increases to smaller systems,¹⁰ it requests that rate increases be phased-in over 7 or 8 years,¹¹ resulting in approximately \$8 million more in unrecoverable operating losses in the interim.¹² OPUC would also prohibit CSWR-Texas from filing a future rate proceeding in the interim, further delaying reasonable and necessary cost recovery for these systems and likely resulting in approximately \$8 million in additional operating losses until full rates are implemented.¹³

These positions would significantly handicap the Company’s viability. But also, more importantly, it would handicap this Commission’s ability to encourage new investment in the hundreds of smaller, distressed water and wastewater systems located in rural areas throughout Texas. CSWR-Texas respectfully requests that the Commission reject these proposals and instead adopt the PFD, subject to the Company’s exceptions.

⁹ Errata Testimony of Kathryn Eiland, Staff Ex. 3 at 9, 10 (Table KE-3).

¹⁰ Direct Testimony of Mark Garrett, OPUC Ex. 1 at 26:3-5.

¹¹ CSWR-Texas Ex. 11 at 21:4-5.

¹² *Id.* at 28:7-10.

¹³ OPUC Ex. 1 at 31:10-11; OPUC’s Exceptions to the Proposal for Decision at 2-3 (Jan. 11, 2024) (“OPUC’s Exceptions”); CSWR-Texas Ex. 11 at 28:15-17.

II. SYSTEMWIDE CONSOLIDATION IS REASONABLE AND NECESSARY

The June 2, 2023 repeal of TWC § 13.145, which eliminated the “substantial similarity” consolidation standard, was intended to incentivize new investment in these communities by encouraging consolidation and more efficient regulation of the industry.¹⁴ This is the first fully contested comprehensive rate case before this Commission since § 13.145 was repealed, providing this Commission its first opportunity to give effect to this legislation. As explained in the Bill Analysis to that legislation:¹⁵

In its self-evaluation report to the Sunset Advisory Commission, the Public Utility Commission (PUC) identified improvements to statute to facilitate consolidation of water systems under a single tariff as an issue meriting of consideration by the legislature. Currently, Section 13.145, Water Code, requires that in order to approve such a consolidation, the PUC must find that the systems under the tariff are “substantially similar.” In practice, this requirement precludes most water utilities from consolidating systems within a tariff. The PUC noted in its report that “[eliminating] the substantial similarity determination to allow a utility to charge one rate to customers across all its water systems or sewer systems [would] eliminate confusion customers have when determining which part of a tariff applies to them. It would also treat water more like electric rate setting and encourage regionalization and consolidation. In addition, it would eliminate staff processing time required to produce multiple rates for one utility with several systems and would, in turn, eliminate testimony and rate case expenses.” **H.B. 2373 repeals the substantial similarity requirement found in Section 13.145, Water Code, in order to streamline ratemaking and facilitate regionalization and improvements to investor-owned water systems.**

In light of the repeal, the PFD appropriately approved consolidation of all water and wastewater systems affected by this proceeding. It recognized that repealed TWC § 13.145 does not apply to this proceeding even though the repeal did not take effect until two months after CSWR-Texas filed this case. It explains why the repeal must be recognized under the Code

¹⁴ See, e.g., TWC §§ 13.305 (effective Sept. 1, 2019), 13.183(c) (effective Sept. 1, 2019), and 13.3011 (effective Sept. 1, 2021).

¹⁵ Rebuttal Testimony of Chris Ekrut, CSWR-Texas Ex. 13 at Attachment CDE-R-1, House Bill 2373, Bill Analysis (emphasis added).

Construction Act¹⁶ and Commission precedent, and it correctly rules that consolidation is reasonable and necessary based on the facts of this proceeding and applicable law. Despite the ALJs' clear explanation of the law and this Commission's and the Legislature's clear direction with regards to consolidation, Staff demands that the Commission continue to apply the "substantial similarity" standard to preclude consolidation of 29 water and wastewater systems.¹⁷

Notably, OPUC did not support Staff's position. Rather, it agreed with the Company that consolidation provides significant benefits to customers of smaller systems.¹⁸ For this and the reasons explained below, consolidation of all systems should be approved, consistent with the PFD.

A. The repeal of TWC § 13.145 and the elimination of the "substantial similarity standard" applicable to consolidation requests is appropriate under the Code Construction Act.

The ALJs provide a thorough explanation of the applicability of TWC § 13.145 to this proceeding based on applicable provisions of the Code Construction Act. As explained therein, the bill that repealed TWC § 13.145, H.B. 2373, did not include a savings clause that would have required the statute to remain in effect upon its repeal. That said, the PFD notes that the effect of a repealed statute may be continued by the state's general savings clause under Texas Government Code § 311.031, which provides that the repeal should be given effect as long as the repeal does not affect the prior operation of the statute or any prior action taken under it.¹⁹ Here, the ALJs ruled it is appropriate to recognize the repeal of TWC § 13.145 because doing so does not affect the prior operation of the statute or any action taken under it.

¹⁶ Tex. Gov't Code § 311.030.

¹⁷ Importantly, Staff opposes consolidation of additional water and wastewater systems included in this filing also because, it claims, those systems lacked sufficient historical test year data. This issue is addressed in Section III related to annualization of historical test year cost to constitute a representative test year. PFD at 24.

¹⁸ OPUC's Post-Hearing Initial Brief at 5-6 (Sept. 22, 2023); OPUC's Exceptions at 2.

¹⁹ PFD at 15-16 (quoting Tex. Gov't Code 311.031(a)).

Staff rejects this interpretation, arguing that (1) the Preliminary Order constitutes prior action, (2) the ALJs' interpretation would constitute retroactive ratemaking and upset settled expectations of the law and that (3) the Commission was prohibited from giving effect to a statute before its June 2, 2023 effective date. Given this, Staff contends that the substantial similarity standard must continue to apply and exclude 29 water and wastewater systems from consolidation. And yet, despite this interpretation, Staff also recommends that the Abraxas, Laguna, and Quiet Village II sewer systems *should* be consolidated "even if they are not substantially similar,"²⁰ directly contradicting its rigid application of the substantial similarity standard to other systems.

As the ALJs aptly noted, Staff's analysis is inconsistent and unpersuasive. First, the ALJs ruled that "processing an application" is not "prior action" and that "[t]he issuance of the Preliminary Order . . . has no bearing on the prohibition against an agency taking administrative action prior to legislation taking effect."²¹ Similarly, they ruled that recognizing the repeal during this proceeding does not constitute "retroactive" application of the law because any consolidation approved in this proceeding will not occur until after the law has indisputably become effective. Further, they ruled that no "settled expectations" were upset by recognizing the repeal of TWC § 13.145 because the applicant, CSWR-Texas, expected consolidation to occur when it filed its request in its application.²² Further, Staff's concerns expressed in Exceptions that applying the repeal under these circumstances will create uncertainty is unfounded; the whole point of the Code Construction Act to interpret the effect of applicable law and rate cases and STMs already have strict deadlines; Staff does not have discretion to ignore the Coe Construction Act or these deadlines when it considers how to process applications.

²⁰ *Id.* at 20 (quoting Staff's Initial Brief at 17, 21, 41-42); Commission Staff's Exceptions and Corrections to the Proposal for Decision at 3-9 (Jan. 11, 2024) ("Staff's Exceptions").

²¹ PFD at 19.

²² *Id.* at 18-19.

Finally, to demonstrate the inanity of Staff's position, the ALJs noted that Staff applies the substantial similarity standard rigidly to certain systems but not to other systems that it believes would experience "extremely high rates" as standalone systems. "In short, Staff appears to advocate for consolidation for the value of subsidization while opposing it for the same reason."²³

B. Consolidation is in the public interest because it ultimately benefits all CSWR-Texas customers.

Consolidation promotes affordability among all customers by achieving economies of scale and spreading costs over larger customer bases. It also incentivizes the acquisition of smaller, distressed systems by allowing more larger utilities to invest in these systems with confidence they can timely recover their costs while maintaining affordable rates. Consolidation even benefits customers of systems that do not require immediate investment or increased costs.²⁴ As Company witness Chris Ekrut explained at the hearing:²⁵

What you have to take into account is the time impact. At various points in time, these systems will have capital cost, some systems at different times than others. So there's ebbs and flows, if you will, for that capital investment through consolidation. What you're doing is spreading that capital cost over more systems. So when the time comes for a system to have capital investment, that cost is spread over all customers instead of simply being applied to that system. So over time, as that capital cost gets spread, you are ultimately getting lower cost impacts to all customers.

Picking "winners" or "losers" of consolidation based on the rate impacts at a single moment in time is misguided because there is likely *never* a moment when every system is experiencing the exact same cost of service relative to every other system, which demonstrates the challenge of applying the now-defunct substantial similarity standard to every system.

²³ *Id.* at 21.

²⁴ CSWR-Texas Ex. 11 at 25:15-26:9.

²⁵ Tr. at 94:9-23 (Ekrut Recross) (Sept. 7, 2023).

Finally, and importantly, consolidation reduces the need for more frequent, complicated, and expensive rate cases, thus reducing burdens and costs to customers, the Commission, Staff and OPUC, and the Company. This case encapsulates the challenges of rectifying a regulatory regime that discouraged consolidation: rate proceedings involving dozens of standalone systems and requiring review of dozens of rate filing packages, costs of services, rates, and tariffs in order to update rates. The time and energy it takes to produce and review 74 separate costs of service models is a significant burden on all parties and the Commission.²⁶ On that note, if consolidation is not approved, the Company will be required to immediately file another comprehensive rate case to consolidate the remaining standalone systems.²⁷ Further, CSWR-Texas has approximately 30 pending STMs that include dozens of additional systems, and the Company will be required to file one or more comprehensive rate proceedings to address those systems. In the meantime, the Company will experience more regulatory lag and carrying costs while it awaits Commission approval of consolidation and cost recovery in each proceeding.

C. Opposition to consolidation disproportionately affects rural communities.

Most of the systems CSWR-Texas serves that would benefit from consolidation are very small systems located in rural areas. As noted above, absent consolidation, those rural systems will see significant rate increases to keep up with the cost to serve these systems.²⁸ Customers in rural areas should not be required to pay seven- or eight-times what customers of larger systems pay for essentially the same product—reliable water.²⁹ Moreover, once the Company re-

²⁶ CSWR-Texas Ex. 11 at 22:13-23 (quoting Public Utility Commission Self-Evaluation Report). From this experience, CSWR-Texas can attest that cases involving fewer unconsolidated systems will be easier to produce, less costly to put together and, presumably, much easier to review by the Commission and intervenors. This is one of the goals the Commission sought to achieve with repeal of the “substantial similarity” standard.

²⁷ *Id.* at 4:9-13.

²⁸ *See* pages 6-8 (Section IIB) of this pleading.

²⁹ *Id.*

establishes safe, reliable water service in these areas, the communities are typically able to grow and the utility can expand safe service to more Texans.³⁰ Without consolidation, it will be more difficult to attract new investment to rehabilitate water and wastewater utilities in these communities.

D. Even if Section 13.145 is applied to this proceeding, consolidation is still reasonable for all systems because they are all “substantially similar.”

CSWR-Texas has shown that the 62 water and 12 wastewater systems it seeks to consolidate in this proceeding meet the substantial similarity standard. Although there may be some different technologies utilized within the different water or wastewater systems, all CSWR-Texas systems serve a similar customer base comprised almost entirely of rural residential or small commercial customers with similar types of water and wastewater usage.³¹ They share a substantially similar cost of service because they are managed to the same service quality and regulatory standards, and ultimately produce essentially the exact same product—safe drinking water.³² The systems all generally use groundwater, tanks for storage, system piping, disinfection equipment, power and control systems, including remote monitoring, and/or a distribution system to provide drinking water to residential and light commercial customers.³³ The wastewater systems are typically collection systems that routinely show signs of infiltration and inflow from past neglect.³⁴ They tend to experience overaccumulation of solids, overgrowth of vegetation, lack of system access, and absence of system security.³⁵ Once acquired, each system receives the same

³⁰ Direct Testimony of Josiah Cox, CSWR-Texas Ex. 3 at 8:3-22.

³¹ *See generally*, CSWR-Texas Ex. 11 at 21:10-28:11.

³² *Id.* at 8:17-20; Direct Testimony of Chris Ekrut, CSWR-Texas Ex. 8 at 37:17-38:7.

³³ Tr. at 48:22-49:1 (Freeman Redirect) (Sept. 7, 2023); Direct Testimony of Jacob Freeman, CSWR-Texas Ex. 5 at 15:7-29:11.

³⁴ *See generally*, CSWR-Texas Ex. 5 at 49:1-81:15.

³⁵ *Id.*

level of corporate services and customer service, including 24/7 availability to answer service and billing questions and respond to facilities and equipment problems.³⁶ The systems are common to a single owner, CSWR-Texas, and are served by the same third-party contractors providing substantially similar operations and maintenance practices.³⁷

III. ANNUALIZATION OF TEST YEAR COSTS TO CREATE REPRESENTATIVE TEST YEAR IS REASONABLE AND NECESSARY

This filing includes some systems the Company had acquired at the end of 2022 and for which a full year of operating expense was either entirely unavailable or based on unreliable books and records. CSWR-Texas annualized the historical test year operating expense for these systems over twelve months to create a complete and representative test year. The Company verified the accuracy of its annualizations against actual data through June 30, 2023 and, as explained by Company witness Brent Thies, the annualizations varied from actual costs by only 1.02%.³⁸

The PFD approved of the Company's annualization approach, finding that its annualizations were reasonable and accurate that Texas law allows a water and sewer utility to file a rate case with less than 12 months of historical data for recently acquired systems.³⁹ Nevertheless, Staff opposes any rate change for the systems for which the Company used annualized data because, it claims, annualized data cannot be used to satisfy the requirement that the Company provide 12 months of historical operating expenses for these 36 systems. For the same reason, Staff opposed consolidation of all 36 of these systems. The Commission should reject these arguments and adopt the PFD as explained in the PFD and below.

³⁶ *Id.*

³⁷ Similarly, all CSWR-Texas systems are provided customer service support by a single provider.

³⁸ Rebuttal Testimony of Brent Thies, CSWR-Texas Ex. 12 at 4:19-5:9.

³⁹ PFD at 27-28.

A. The PFD appropriately explains that CSWR-Texas' use of annualized costs is appropriate and consistent with the TWC and Commission rules and precedent.

As explained in the PFD, the TWC requires the Commission to: (1) “base a utility’s expenses on historic [sic] test-year information adjusted for known and measurable changes, as determined by utility commission rules,”⁴⁰ and (2) utilize a test year that is “the most recent 12-month period . . . *for which operating data for a retail public utility are available.*”⁴¹ However, Commission rules specifically allow a utility to file a rate case with less than 12 months of historical data for recently acquired systems. 16 TAC § 24.33(b)(2) allows a proposed rate change to be suspended “until a completed application to obtain or transfer a [CCN] is accepted by the commission.” As the ALJs explain,⁴² the rule clearly anticipates a utility may file a rate case proceeding while an STM application is pending and before a full year of historical test year data is available.⁴³ In addition, 16 TAC § 24.29(b)(2) allows a utility to file a rate case more than once in a 12-month period “to adjust the rates of a newly acquired utility system.” Thus, these two Commission rules flatly contradict Staff’s position that a utility must own a system for at least 12 months before it can file an STM.⁴⁴ Further, as explained in the PFD, this interpretation is entirely consistent with the water code.⁴⁵

Additionally, the PFD notes that although the terms “known and measurable” and “annualization” are defined in the Commission’s Class A Investor-Owned Utilities Water and/or

⁴⁰ *Id.* (quoting TWC § 13.185(d)(1)).

⁴¹ *Id.* at 28 (quoting TWC § 13.002(22)) (emphasis in original).

⁴² *Id.* at 28.

⁴³ CSWR-Texas Ex. 13 at 6:18-7:3.

⁴⁴ Staff’s Exceptions at 12.

⁴⁵ *Beldon Roofing & Remodeling Co. v. San Antonio Water Sys.*, 898 S.W.2d 351, 354 (Tex. App.—San Antonio 1995, writ denied); *Acker v. Texas Water Comm’n*, 790 S.W.2d 299, 301 (Tex. 1990).

Sewer Rate Filing Package (“RFP”), this Commission recently deleted those definitions from the Commission’s substantive rules:⁴⁶

By deleting the definition of “known and measurable” from the substantive water rules, the Commission signaled an intent to broaden the definition to suit the context of each case, which presumably could be broader than the definition set forth in the Class A RFP relied upon by Staff. By contrast, by deleting the definition of annualization, the Commission signaled a recognition that the term is so commonly understood that a definition was unnecessary.

The ALJs concluded that “known and measurable changes” are not just the narrowly interpreted changes that are “reasonably certain to occur within 12 months of the end of the test year” as defined in the Class A RFP, but are broad enough to include annualizations of available historical operating data for systems acquired during the test year.⁴⁷ Staff’s narrow definition of “known and measurable changes” would render Rule 24.33(b)(2) meaningless, which cannot be assumed under the circumstances here.

Further, this Commission *requires* utilities to calculate a test year that is most representative of current costs, which requires annualizing costs that are more representative of the costs to be incurred when rates are in effect.⁴⁸ Annualizing costs is necessary to capture in new rate costs incurred at the end of the test year that will be in effect when rates take effect. For instance, the Commission commonly requires a utility to update its customer counts to ensure that rates are not set too high or too low on a per-customer basis. The Company’s operating costs are clearly more indicative of current and future operating costs; the former owners’ historical costs

⁴⁶ The PFD notes that “known and measurable” was deleted because one definition may not be “appropriate for every context in which the term could be used;” and “annualization” was deleted because it is a “common ratemaking [term].” PFD at 28-29.

⁴⁷ PFD at 29.

⁴⁸ 16 TAC § 24.41(b).

are not.⁴⁹ And, it would be a considerable waste of time and resources to try to apply a former owner data that is already known to be unreliable.

B. Commission precedent dictates that a utility may use annualized costs to capture post-test year costs that represent the costs to provide service.

In Docket No. 52828, the Commission specifically recognized that a “post-test-year adjustment for transmission operator services expenses is based on known data that is annualized to show the future cost situation with reasonable certainty.”⁵⁰ Although this was an electric rate case, the PFD notes that Staff applied a similar approach in a recent water rate case, Docket No. 50200, *Application of Undine Texas, LLC and Undine Texas Environmental, LLC for Authority to Change Rates*.⁵¹

In that case, Staff supported the use of annualized test year data for recently acquired systems in order to calculate a revenue requirement.⁵² Staff witness Kathryn Eiland testified in that proceeding that she *supported* adjusting rates for systems that lacked a full 12 months of historical operating expense using annualized data.⁵³ In its Exceptions in this case, Staff tries to argue that Docket No. 50200 is not precedential because it was settled,⁵⁴ but Ms. Eiland unequivocally confirmed at the hearing in this case that she was ready to defend her recommendations regarding the annualizations in that case if it went to hearing.⁵⁵ The fact that

⁴⁹ CSWR-Texas Ex. 12:4:10-6:9.

⁵⁰ PFD at 29, citing *Application of Golden Spread Electric Cooperative, Inc. to Change Wholesale Transmission Service Rates*, Docket No. 52828, Final Order at Findings of Fact (“FoF”) Nos. 46, 108 (Mar. 9, 2023).

⁵¹ Tr. at 165:2-6 (Eiland Cross) (Sept. 7, 2023); Docket No. 50200 Direct Testimony of Kathryn Eiland, CSWR-Texas Ex. 16 at 7-18.

⁵² PFD 29-30, citing Docket No. 50200, *Application of Undine Texas, LLC and Undine Environmental, LLC for Authority to Change Rates*, Order (Nov. 5, 2020).

⁵³ Tr. at 172:8-16 (Eiland Cross) (Sept. 7, 2023); Docket No. 50200 Direct Testimony of Kathryn Eiland, CSWR-Texas Ex. 16 at 7-18; PFD at 25-26.

⁵⁴ Staff’s Exceptions at 16.

⁵⁵ Tr. at 172:2-10 (Eiland Recross) (Sept. 7, 2023).

Docket No. 50200 was settled does not change the fact that Staff took a diametrically opposite position on the law in that proceeding compared to what it has here.

C. Staff’s attempt to analogize “annualized costs” to “projected costs”⁵⁶ misconstrues the Company’s test year costs and misinterprets Commission precedent recognizing annualizations as appropriate.

The PFD appropriately recognizes that annualizations are appropriate and are distinct from “projected” costs, which are typically not allowed to calculate rates at this Commission. The PFD followed Mr. Ekrut’s reasoning and description of the process for annualizing data for newly acquired systems that did not have 12 months of data.⁵⁷ For fixed costs, Mr. Ekrut explained at the hearing:⁵⁸

[R]elative to these fixed cost components[,] [w]e looked at those elements and we took the known cost. We either had a contract or a future contract value for these operators. We know what that is by system on a monthly basis, we took that monthly amount multiplied by twelve. We knew what the insurance bill was going to be for the year [sic] we took that amount.

For variable costs, such as electric and chemical expenses, he explains:⁵⁹

What we’ve done there is we have used known data where we have it to calculate an effective cost for electricity and chemical expense. We then applied that known cost to the anticipated volumes by the system, the annualized volumes for the system. Those are the same annualized volumes that we used in coming in to annualize revenues. At the same time, we have to make sure that the period is matched.

Thus, annualizations are not speculative, future test year data, projected test year data, or “multiple test year” data, as Staff asserts. Rather, as the PFD explains, CSWR-Texas provided “robust support for its annualization” based on “actual operational data, which was then spread over 12

⁵⁶ Staff’s Exceptions at 11-14.

⁵⁷ PFD at 23.

⁵⁸ Tr. at 88:17-25 (Ekrut Redirect) (Sept. 7, 2023).

⁵⁹ Tr at 89:2-9 (Ekrut Redirect) (Sept. 7, 2023).

months.”⁶⁰ As also explained in the PFD, CSWR-Texas benchmarked the annualized data with an additional six months of actual data, and “no party challenged the accuracy of the annualized data or the Company’s subsequent analysis showing that its annualization was within 1% accuracy of its actual costs.”⁶¹ For these reasons, as in Docket Nos. 52828 and 50020, CSWR-Texas’ post-test-year adjustment for systems acquired during the test year is based on known data that is annualized to show the future cost situation with reasonable certainty.

D. The American Water Works Association Manual M1 (“M1 Manual”) explicitly supports annualization as known and measurable adjustments and is instructive in this proceeding.

The M1 Manual provides further support for the ALJs’ position. It states that a “test year may represent a specific 12-month period of time or it may be an annualization of a rate-design period of more or less than one year.”⁶² Staff expends considerable effort arguing that the M1 Manual should *not* be instructive in this proceeding,⁶³ but this effort is misplaced because the PFD does not rely on the M1 Manual. Instead the ALJs’ analysis is based solely on the TWC and this Commission’s rules, precedent, and practice.⁶⁴ However, it is worth noting that the Company’s annualization approach is consistent with a common industry-recognized guide to ratemaking⁶⁵—Staff’s argument that the M1 Manual is not “instructive” to utilities or rate regulators is like arguing that Generally Accepted Accounting Principles are not “instructive” to accountants.

⁶⁰ PFD at 30.

⁶¹ *Id.*

⁶² American Water Works Association, Manual M1 – Principles of Water Rates, Fees, and Charges at 11 (7th ed.).

⁶³ PFD 18.

⁶⁴ *Id.* at 27-30.

⁶⁵ Tr. at 210:17-22 (Ekrut Redirect) (Sept. 7, 2023) (“We informally refer to the M1 Manual as the bible of ratemaking. It is published and produced by the American Waterworks Association. Rate consultants all throughout the country participate in the development of the manual. It is the guiding document within our industry as to how rates should be developed.”).

E. Staff's reliance on the Public Utility Regulatory Act ("PURA") § 36.112(b)(2) to oppose annualization of test year costs is misplaced.⁶⁶

PURA § 36.112(b)(2) allows non-ERCOT electric utilities to provide 45-day updates to their estimated test years in a rate case. Staff argues that CSWR-Texas' annualization approach is akin to a test year update under PURA § 36.112(b)(2) and, because PURA is not applicable to water utilities, it should be inferred that a water utility may not update its test year during a rate case. However, as the PFD correctly explains, CSWR-Texas appropriately used annualization to address the limited circumstances in which "it did not have 12 months of historical test-year data for [recently acquired] systems."⁶⁷ It is not akin to a non-ERCOT electric utility's 45-day update.⁶⁸ And regardless, annualizations are permitted as known and measurable adjustments under TWC § 13.002(22) and TWC § 13.185(d)(1).

F. Staff's position would require utilities to file more frequent and more complicated rate cases for small, recently acquired systems.

It is important to note that Staff's opposition to rate changes and consolidation would effectively require all water or wastewater utilities to file more frequent rate cases to capture the costs of a newly acquired system with inadequate rates. Because most larger utilities are regularly acquiring new systems, they would be required to regularly file rate cases after each of those acquisitions. In this case, Staff's position, if adopted, would compel CSWR-Texas to immediately file a new rate case proceeding based on a 2023 test year and then again in 2025 based on 2024 data. Ultimately, CSWR-Texas would have to pancake multiple rate cases on top of one another as long as it continues to acquire systems.

⁶⁶ Staff's Exceptions at 14-15.

⁶⁷ PFD at 24.

⁶⁸ See, e.g., *Application of Southwestern Public Service Company for Authority to Change Rates*, Docket No. 47527, Southwestern Public Service Company's Notice of: Case Update as Required by PURA § 36.112; and 45-Day Update as Required by the Rate Filing Package at 3-8.

IV. RATE OF RETURN

A. CSWR-Texas requires a ROE that is commensurate with the unique challenges inherent in the operation of its systems and its willingness to take on those challenges.

As explained in detail below, Staff's witness Emily Sears' ROE analysis in this proceeding was erroneous and without merit. In its Exceptions, Staff challenges the ALJs' conclusions regarding Ms. Sears' analysis by introducing new facts that are not in the record and of dubious credibility. For instance, Ms. Sears does not apply her proxy group criteria consistently, excluding proxy group systems that would result in higher ROEs and adding in systems that do not fit her criteria that result in lower ROEs. In fact, much like its position on consolidation, Staff's analyses appear to be primarily engineered to achieve the lowest possible ROE result possible—an 8.2% that is 150 basis points below that of an established transmission and distribution electric utility, despite the considerable and unique challenges CSWR-Texas has absorbed and faces every day in the operation of its systems. Contrary to Staff's assertions, rather than amending the PFD to lower its recommendation, the PFD should be amended in the opposite direction because, as explained in CSWR-Texas Exceptions to the PFD, a 12.15% approved ROE is justified by the record evidence in this proceeding.⁶⁹

As explained below and in the PFD, Staff's Exceptions should be disregarded outright. Instead, the Commissioners should consider the significant business risks faced by utilities like CSWR-Texas that have committed to rehabilitating distressed water and wastewater systems throughout rural Texas, many of which it acquired at the request of the State itself.⁷⁰ Although the PFD's recommended 10.03% ROE is clearly a step in the right direction compared to Staff's recommendation, it is only 28 basis points above that of an established Texas TDU—far below

⁶⁹ CSWR-Texas Exceptions to the Proposal for Decision at 1-5 (Jan. 11, 2024).

⁷⁰ PFD at 6-7.

what is necessary to capture the risks to companies that invest in smaller, distressed community-based systems.

B. Staff's proxy group is based on a flawed and arbitrary application of its own proxy group criteria.

The PFD appropriately concludes that Artesian Water ("ARTNA") and York Water ("YORW") should have been removed from Staff's Proxy Group⁷¹ because ARTNA and YORW fail Ms. Sears' proxy group requirement that each included utility have a positive projected earnings growth from *Value Line*.⁷² It also concludes that Staff inappropriately excluded certain companies from its proxy group that fits its criteria.

Staff implores the Commission in its Exceptions to ignore Ms. Sears' direct testimony that it is necessary for all companies in its proxy group to have a *positive* growth rate.⁷³ Staff argues that the criteria was supposed to mean that each company in the proxy group does not have a "negative or less than 0% growth."⁷⁴ Staff should not be able to retroactively change its selection criteria to erase errors in Ms. Sears' proxy group.

Staff also contends in its Exceptions that ARTNA and YORW meet Ms. Sears' selection criteria because "there is no consensus on the 5-year earnings growth rate" for those companies so "it is inaccurate to conclude that ARTNA and YORW do not have a positive growth rate"⁷⁵ This is mere obfuscation. Assuming for the sake of argument that ARTNA and YORW had a previously unreported positive growth rate when Ms. Sears performed her analysis (which it did

⁷¹ *Id.* at 48-49.

⁷² Rebuttal Testimony of Dylan D'Ascendis, CSWR-Texas Ex. 14 at 7:8-10; Direct Testimony of Emily Scars, Staff Ex. 1A at 10:1-11:2.

⁷³ Staff Ex. 1A at 10:4-6 (Ms. Sear's second selection criteria for each water utility in her proxy group: "Have a positive (greater than 0%) long-term forecast of the earnings growth rate from Value Line and, if Zacks and Yahoo! Finance provide estimates for the long-term earnings growth rate, have a positive (greater than 0%) long-term forecast of the earnings growth rate;").

⁷⁴ Staff's Exceptions at 23.

⁷⁵ *Id.*

not based on the evidentiary record), those companies would still fail Ms. Sears' selection criteria because she required that each water utility have a positive projected growth rate "from *Value Line*," which they did not.⁷⁶ It is uncontested that *Value Line* did not publish a positive projected growth rate for ARTNA and YORW. In short, the Commissioners should not allow Staff to change its proxy group selection criteria after-the-fact to accommodate a different result.

In the opposite manner, the PFD correctly concluded that Global Water Resources, Inc. ("GWR")—which would have resulted in a higher ROE for CSWR-Texas—*should* have been included in Staff's Proxy Group because it met all of Ms. Sears' criteria.⁷⁷ In briefing,⁷⁸ Staff attempted to justify the exclusion of GWR because, it claims, it operates only in two metropolitan cities in Arizona unlike other companies in the proxy group that have wider service areas. However, as noted in the PFD, Ms. Sears' stated criteria "did not differentiate or exclude companies based on the communities they serve."⁷⁹ For support, Staff asserts numerous facts that are not included in the record in this proceeding—that GWR should be excluded because of "the unique climate of Arizona," or because "all other companies in the proxy group are spread among several states and climates," or because its projected growth rate is higher than other utilities in the proxy.⁸⁰ It is impossible to know whether any of these statements are credible because Staff did assert them until late in the proceeding. Indeed, the statements regarding the uniqueness of GWR's service area are directly contradicted by Ms. Sears' own exhibits, which are included in the proxy group American States Water ("AWR"), which operates in a single state, California, that

⁷⁶ Staff Ex. 1A at 10:4-6.

⁷⁷ PFD at 49.

⁷⁸ Staff's Initial Brief at 27; Staff's Exceptions at 24.

⁷⁹ PFD at 49.

⁸⁰ Staff Exceptions at 24.

has a similar climate to Arizona.⁸¹ The PFD appropriately disregarded Ms. Sears' analysis. This Commission should as well.

C. Staff's Multi-Stage DCF Model contains errors and should be disregarded entirely.

The PFD notes that Ms. Sears' Multi-Stage DCF Model contains an input error that calls into question the integrity of this analysis. Ms. Sears omitted from her historical Gross Domestic Product ("GDP") dataset, the years 1947-1950, a period of much higher growth rates, thereby superficially lowering the GDP growth calculation and understating her Multi-Stage DCF Model result.⁸² Staff never corrected this error during this proceeding. In its Exceptions, for the first time, Staff claims without any citation to the record that the years 1947-1950 were omitted *intentionally*: "[t]he exclusion of these years was a choice borne from experience and reflecting the fact that the post-war economy of 1947-1950 was a bit of an outlier and not representative of the economy after 1951."⁸³ Once again, Staff attempts to insert into this proceeding factual claims underlying Ms. Sears' opinions that have not been tested. What the record shows is that Ms. Sears' Multi-Stage DCF Model contains unchallenged, and uncorrected, errors that harm the Company. Again, Staff asserts post-hoc justification for previously unreported analysis that results in a lower recommendation. The PFD was correct in disregarding this model.

Staff also attempts to defend the Multi-Stage DCF Model by citing several electric rate cases.⁸⁴ However, the cited electric cases do not support a conclusion that the Commission can use a Multi-Stage DCF model that is flawed or contains unsupported and arbitrary analysis.

⁸¹ Confidential Workpapers to the Direct Testimony of Emily Sears, Staff Ex. 1B at bates page 3, *see* "Business" section.

⁸² CSWR-Texas Ex. 14 at 23:29-24:15.

⁸³ Staff's Exceptions at 26.

⁸⁴ *Id.* at 25.

Regardless, Ms. Sears' Multi-Stage DCF Model is flawed and was correctly disregarded in the PFD for this proceeding.

D. The PFD appropriately adjusted Staff's risk premium model to reflect appropriate forward-looking financial data.

The PFD's adjustments to Ms. Sears' Risk Premium Model ("RPM") are correct and should be adopted.

As the PFD notes, "Staff did not respond to the criticisms regarding Ms. Sears' RPM approach."⁸⁵ Despite that, Staff again tries to raise new arguments based on factual claims in its Exceptions without any citations to the record—specifically that *historical* interest rates should be used in an RPM analysis instead of *projected* interest rates because, it argues, historical interest rates are more reliable.⁸⁶ Staff also argues, without any citation to the record, that an average of annual authorized returns are more accurate than projected rates for use in an RPM. However, these arguments disregard that regulated ratemaking and the calculation of ROE are a *forward-looking* process and that the use of projected interest rates and individual rate case decisions are better able to capture the economic conditions during the time of that decision. Company witness Dylan D'Ascendis adjusted Ms. Sears' RPM analysis to account for these errors. His analysis was adopted by the PFD and should be approved here.

E. Business Premium

The PFD's conclusion that the unique business risks of CSWR-Texas merit a 0.5% upward adjustment is correct. Staff misconstrues the PFD on this point by arguing that the 0.5% upward adjustment goes against the Commission's past disapproval of size adjustment premiums.⁸⁷

⁸⁵ PFD at 59.

⁸⁶ Staff's Exceptions at 27.

⁸⁷ *Id.* at 28-29.

However, the PFD was clear that it declined to adopt a size-related premium.⁸⁸ Instead, the upward adjustment was based on the Company's acquisition of "numerous troubled systems and bringing them into compliance" and not the Company's size.⁸⁹ The acquisition of troubled systems and the unique business risks of CSWR-Texas were exceedingly supported by the record.⁹⁰ The PFD was therefore justified in its recommendation for an 0.5% upward adjustment related to the Company's business risk.

F. Cost of Debt

Recognizing that CSWR-Texas does not have any debt, the PFD recommended that a 5.60% hypothetical cost of debt be used for CSWR-Texas based on the most current data for Baa-rated utilities.⁹¹ Staff disagrees with this recommendation by citing that a "change in rates must be based on a test year."⁹² However, it is undisputed that CSWR-Texas' capital structure was comprised of 100% equity during the test year.⁹³ Thus, taken to its logical conclusion, Staff's argument supports awarding CSWR-Texas an overall rate of return based solely on its ROE. However, that is not realistic. Thus, a hypothetical cost of debt must be selected. The PFD reasonably concluded that when selecting a hypothetical cost of debt, the most current and accurate barometers of utility debt must be used and rejected Staff's proposed cost of debt as outdated.⁹⁴ Alternatively, if the ALJs were to base the hypothetical cost of debt on information that is tied to the test year, as Staff proposes, the best option available is the Company's proposal to set the cost

⁸⁸ PFD at 71.

⁸⁹ *Id.* at 71-72.

⁹⁰ Direct Testimony of Dylan D'Ascendis, CSWR-Texas Ex. 10 at 8:5-8; Tr. at 120:6-10 (D'Ascendis Redirect) (Sept. 7, 2023); CSWR-Texas Ex. 3 at 14:1-6; Tr. at 192:16-193:5 (Confidential Cox Redirect) (Sept. 7, 2023); CSWR-Texas Ex. 5 at 13:13-81:15.

⁹¹ PFD at 76-77.

⁹² Staff's Exceptions at 30.

⁹³ CSWR-Texas Ex. 10 at 20.

⁹⁴ PFD at 76-77.

of debt based at the weighted average of CSWR-Texas' regulated sister companies, which is 6.52%.⁹⁵

V. PHASED-IN RATES

OPUC supports consolidation, as well as the utilization of cost annualizations, for the same reasons expressed in the PFD. CSWR-Texas agrees with OPUC on this issue. However, OPUC argues that rate increases that reflect the Company's cost of service would be "untenable" for some customers and should be mitigated through rate phase-ins over several years.⁹⁶

OPUC disregards the fact that certain customers have benefited from "rate mitigation" through inadequate rates for many years and, thus, it may be necessary for certain customers to experience larger increases relative to their existing rates. Allowing these customers to perpetually pay less than their cost of service is untenable and ultimately requires other customers to subsidize them. OPUC also appears to disregard the fact that, as explained below, proposed rates are within recognized measures of affordability, like the Medium Household Income ("MHI"), and that average bills are in line with other utility customers in Texas.

A. CSWR-Texas' proposed rates accurately reflect the Company's cost of service.

As a threshold matter, it is important to note that OPUC does not challenge the Company's cost of service. It just challenges when the Company can start recovering its full cost of service from these customers through rates. However, it offers no empirical evidence that the consolidated rates are unaffordable or are otherwise unreasonable. It merely points to the percentage size of certain rate increases, which it concedes are inflated by the fact that existing rates were superficially low when the Company acquired these systems.

⁹⁵ CSWR-Texas Ex. 10 at 21:1-6, Schedule DWD-2.

⁹⁶ OPUC initially proposed a 7- to 8-year phase-in and rate case "stay out" but amended its recommendation throughout this proceeding. Notably, the PFD admonished OPUC for attempting to argue for alternative phase-in approaches. *See generally*, PFD at 95-99.

B. CSWR-Texas’ proposed rates are within a range of reasonableness and consistent with the average bills of customers of other utilities whose rates have been reviewed by the Commission.

To ensure customers were not experiencing rate impacts dissimilar to customers of other utilities in Texas, CSWR-Texas performed an empirical analysis to determine whether its proposed rates were affordable for all customers. As explained by Mr. Ekrut in his direct testimony, a common and traditional approach to measuring affordability of water and wastewater service measures “a community’s average cost of water and sewer service as a percentage of that community’s median household income.” He explains that service under a singular function (e.g., water or wastewater) is considered affordable if the average customer bill does not exceed 2% to 2.5% of MHI. His Exhibit CDE-16 demonstrates that, on a consolidated basis, the average monthly water bill based on 5,000 gallons of usage was below 2.5% for all customers.

Further, based on the final orders in recent rate cases approved at this Commission, bills for customers in many systems are similar to those of CSWR-Texas’ proposed rates:

Docket No.	Utility/Subdivision	Bill at 5,000 gallons⁹⁷
50200	Undine/Pioneer Trails	\$129.88
50200	Undine/Greengate Acres	\$96.28
50200	Undine/Springmont	\$92.88
50557	Corix Utilities (Texas) Hill Country Region ⁹⁸	\$110.48
54565	CSWR-Texas	\$ 81.73

The Commission should disregard OPUC’s fixation on percentage increases and instead recognize that actual bills will in fact be lower than those previously approved by the Commission for other utilities, especially to subsidize customers that have long benefited from superficially low rates.

⁹⁷ See *Application of Corix Utilities (Texas) Inc. for Authority to Change Rates*, Docket No. 50557, Clean Tariffs (Oct. 11, 2021); *Application of Undine Texas, LLC for a Pass-Through Rate Change*, Docket No. 54326, Stamped Approved Tariff (Jun. 21, 2023). This calculation is based on the approved rates included in each utility’s tariffs with 5,000 gallons of usage.

⁹⁸ *Application of Corix Utilities (Texas) Inc. for Authority to Change Rates*, Docket No. 53815, Corix Letter to PUCT re Compliance Tariff (May 26, 2023).

C. Phased-in rates will result in the disallowance of millions of dollars in reasonable and necessary costs.

OPUC argues that it is “unrealistic” for the Company to expect its customers to pay for their cost of service and points to the “massive rehabilitation costs” incurred by the Company.⁹⁹ However, it is unreasonable to require investor-owned utilities who are already struggling to capture in rates fully compensatory costs of providing service to make significant investments in water quality and safety while forcing them to indefinitely operate at a loss. Further, OPUC’s implication that the Company failed to offer a “viable alternative” to proposed rates is unfounded. CSWR-Texas explained at the hearing that phased-in rates were untenable in Texas due to the degree to which many of these customers’ rates *already* currently under-recover their cost of service. The Company made clear that it cannot operate at a loss *and* subsidize customers while also investing in these systems to improve service.

In fact, consolidation already acts as a form of rate mitigation for the most affected customers because it allows those customers to share costs with a much larger customer base. OPUC’s proposed “phase-ins” for certain systems would require the Company to also absorb approximately \$8 million in operating losses until rates are fully phased-in.¹⁰⁰

VI. RATE CASE EXPENSES

The only contested issue related to the Company’s requested rate case expenses is Staff’s opposition to the Company’s request for recovery of a \$25,000 flat fee rate case expense charged for the provision of direct testimony by witness Mr. D’Ascendis. Staff has argued that flat fee arrangements are, by definition, not reasonable. The ALJs rejected Staff’s position, finding that that flat fee charges are recoverable; however, they rejected recovery of the specific fee in this case

⁹⁹ OPUC’s Post-Hearing Initial Brief at 12.

¹⁰⁰ CSWR-Texas Ex. 11 at 28:2-11.

because, they claim, the Company failed to provide a more specific breakdown of the underlying costs in response to Staff's position.

In fact, a \$25,000 charge for provision of a complex piece of expert testimony on cost of capital, including discovery responses and appearances at an evidentiary hearing, is reasonable. Compared to similar testimony provided at hourly rates, a flat fee arrangement places caps on these expenses and allows the utility and its customers predictability. CSWR-Texas agrees with the ALJs that flat fee arrangements may represent a lower cost option for provision of rate case support and are recoverable, and it urges the Commission to find that a \$25,000 fee is reasonable here.

VII. CORRECTION TO THE PROPOSED ORDER RELATED TO CERTAIN PASS-THROUGH CHARGES

The PFD recommends the Commission deny the Company's proposed pass-through provisions to be charged by the Guadalupe County GCD; North Alamo WSC; Upper Trinity GCD to WaterCo; the City of Rockport to Copano Cove and Copano Ridge; and Bi-County WSC because the Company did not present 12 months of historical line-loss data for these systems.¹⁰¹ However, for these systems, the ALJs also recommend that, as presented by Staff, the Company be authorized to collect the gallonage charge by the pass-through entity or source supplier until it files an application for a minor tariff change to update those provisions when it has sufficient line-loss data for the systems.¹⁰² The proposed order contains ordering language recognizing the denial of the proposed pass-through charges¹⁰³ but does not contain ordering language authorizing CSWR-Texas to collect the gallonage charge charged by the pass-through entity or source supplier until it files an application for a minor tariff change to update those provisions when it has sufficient line-loss data for the systems. To the extent necessary and in order to avoid confusion

¹⁰¹ PFD at 89.

¹⁰² *Id.*

¹⁰³ *Id.* at FoF 96.

as to the appropriate pass-throughs to be applied, the Company requests the addition of clarifying language in the final order as follows:

- XX. CSWR-Texas should be authorized to collect the proposed gallonage charge by the pass-through entity or source supplier until it files an application for a minor tariff change to update those provisions when it has sufficient line-loss data for the systems.

VIII. CONCLUSION

For these reasons, the Company requests that the Commission approve rates and tariffs consistent with the PFD, subject to its Exceptions and these Replies to Exceptions, and provide such other relief to which it has shown itself to be justly entitled.

Respectfully submitted,

L. Russell Mitten
General Counsel
Central States Water Resources, Inc.
1630 Des Peres Rd., Suite 140
Des Peres, MO 63131
(314) 380-8595
(314) 763-4743 (Fax)

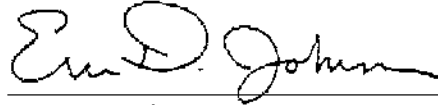


Evan D. Johnson
State Bar No. 24065498
Kate Norman
State Bar No. 24051121
C. Glenn Adkins
State Bar No. 24103097
Coffin Renner LLP
1011 W. 31st Street
Austin, Texas 78705
(512) 879-0900
(512) 879-0912 (fax)
evan.johnson@crtxlaw.com
kate.norman@crtxlaw.com
glenn.adkins@crtxlaw.com

**ATTORNEYS FOR CSWR-TEXAS
UTILITY OPERATING COMPANY, LLC**

CERTIFICATE OF SERVICE

I hereby certify that on this 25th day of January 2024, notice of the filing of this document was provided to all parties of record via electronic mail in accordance with the Second Order Suspending Rules, issued in Project No. 50664.

A handwritten signature in black ink, appearing to read "Evan D. Johnson", written over a horizontal line.

Evan D. Johnson