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**SOAH DOCKET NO. 473-25-00480.WS
PUC DOCKET NO. 56665**

APPLICATION OF TEXAS WATER	§	BEFORE THE STATE OFFICE
UTILITIES, L.P. FOR AUTHORITY TO	§	OF
CHANGE RATES	§	ADMINISTRATIVE HEARINGS

**INITIAL POST-HEARING BRIEF
OF
TEXAS WATER UTILITIES, L.P.**

MARCH 7, 2025

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APPLICATION OF TEXAS WATER UTILITIES, L.P. FOR AUTHORITY TO CHANGE RATES	§ § §	BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS
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TEXAS WATER UTILITIES, L.P.'S INITIAL BRIEF

Texas Water Utilities, L.P. (TWU) files this Initial Brief. Pursuant to State Office of Administrative Hearings (SOAH) Order No. 12, this Initial Brief is timely filed on or before March 7, 2025.¹

**I. INTRODUCTION AND SUMMARY [PO Issues 1, 2, 3, 4, 5, 6, 7, 8]
[UNCONTESTED]**

On June 24, 2024, TWU filed a class A application under Texas Water Code (TWC) § 13.187 to change its water and wastewater rates based on a test year ending on December 31, 2023 adjusted for known and measurable changes. TWU provides water service within the service area of its water certificate of convenience and necessity (CCN) number 12983 and provides wastewater service within the service area of its sewer CCN number 20899. TWU filed its 2023 annual report on July 31, 2024, in accordance with 16 Tex. Administrative Code (TAC) § 24.129. TWU also filed proof of notice of the proposed rate change on June 24, 2024 and July 11, 2024, which was declared sufficient by the Commission Administrative Law Judge. TWU's requested revenue requirement of \$55,730,016 for water and \$13,475,874 for wastewater, including TWU's requested Operations and Maintenance (O&M) expenses, depreciation expense, and executive compensation costs, should be approved by the Public Utility Commission of Texas (Commission). The revenue requirement will give TWU a reasonable opportunity to earn a reasonable return on its invested capital used and useful in

¹ SOAH Order No. 12 Post-Hearing Schedule; Guidelines at 2 (Jan. 31, 2025). The hearing on the merits was held on January 27–28, 2025. TWU objected to these dates at the prehearing conference as beginning more than 30 days after the December 26, 2024 effective date pursuant to Texas Water Code (TWC) § 13.187(f). TWU's agreement to these hearing dates was solely for the purpose of accommodating the schedule of the presiding officer and should not be construed as: a waiver of its objection; agreement that 16 Texas Administrative Code (TAC) § 24.35(b) is consistent with TWC § 13.187(f); an express or implied extension of the effective date; or express or implied agreement that the Commission does not lose jurisdiction over this proceeding if a hearing to determine the propriety of the change is not begun before the 30th day after the effective date of the change, which is January 24, 2025. *See* TWC § 13.187(f).

providing service to the public in excess of its reasonable and necessary operating expenses while preserving the utility's financial integrity as required by TWC § 13.183(a)(1) and (2) and 16 TAC § 24.43(a)

The Commission should reject the Office of Public Utility Counsel's (OPUC) recommendations to disallow certain shared services O&M expenses. The O&M expenses are recurring and necessary, benefit ratepayers through shared costs, and provide TWU, and its affiliates, with necessary corporate level support. Additionally, OPUC's recommendation regarding TWU's depreciation expenses to move assets from one National Association of Regulatory Commissioners (NARUC) account to another should be ignored by the Commission because it changes the depreciable lives without performing a thorough review of assets classification and without compelling justification.

TWU's proposed use of its actual capital structure, which consists of 43.75% long-term debt at an embedded cost rate of 5.70% and 56.25% common equity at the common equity cost rate of 10.55% should be approved by the Commission. The use of an actual capital structure over a hypothetical capital structure is superior in terms of established financial principles. Additionally, TWU's requested 10.55% return on equity (ROE) should be approved by the Commission over Commission Staff's recommended ROE of 8.55%, which uses a flawed analysis, fails to apply the Capital Asset Pricing Model (CAPM), and inappropriately applies the Discounted Cash Flow (DCF) model. The Commission should also approve the use of TWU's actual effective cost of debt of 5.70% as it is consistent with Commission Rules.

TWU's requested rate base of \$251,193,238 should be approved by the Commission. The capital investment included in TWU's rate base was prudently incurred, useful, reasonable and necessary. TWU has met its burden of proof for its requested rate base by filing an application that includes the required schedules and is consistent with multiple previous applications filed by TWU with the Commission. TWU also undergoes regular financial audits of its books and records and has provided an affidavit supporting the original cost of its assets included in rate base. As a result, OPUC's asset by asset review should be disregarded. TWU has provided information addressing the original cost of 200 assets OPUC alleged were not fully supported and the record contains evidence sufficient to support TWU's claimed original cost of \$301,006,790 for water and \$83,076,269 for wastewater. Regarding original cost of assets transferred to TWU from SWWC Utilities, Inc. dba Hornsby Bend Utility Company, Inc.

(Hornsby Bend), any assets included in Hornsby Bend's most recent rate case are barred by res judicata from being reviewed in this proceeding. Lastly, TWU's requested \$4,435,974 in Construction Work in Progress should be approved since these assets have already been in service for up to a year and TWU would experience significant regulatory lag in having to wait until its next System Improvement Charge (SIC) application to seek recovery of these capital outlays.

TWU's request for uniform water and sewer rate schedules were not challenged and should be approved by the Commission. Furthermore, TWU's deduction of wholesale contract revenues from the revenue requirement used to set rates should be approved by the Commission as the Commission lacks jurisdiction to set wholesale cost of service or approved allocation factors for wholesale service to set retail rates. Regarding billing determinants used in rate design, OPUC's recommendation to adjust billing determinants because of drought restrictions should be disregarded because drought restrictions have routinely been in place over the last fourteen years and continue today. These drought restrictions are used as a method of spreading demand for non-essential water usage over non-peak periods rather than necessarily reducing usage. Overall, TWU's proposed water and sewer rates should be approved by the Commission.

Overall, TWU seeks approval of the following:

- TWU's requested revenue requirement of \$55,730,016 for water and \$13,475,874 for sewer;
- TWU's proposed use of its actual capital structure consisting of 43.75% long-term debt and 56.25% common equity;
- TWU's requested ROE of 10.55%;
- TWU's requested actual effective cost of debt of 5.70%;
- TWU's requested rate base of \$251,193,238;
- TWU's requested water and sewer rate schedules; and
- TWU's requested uniform tap fees and single water passthrough rate of \$2.47 per 1,000 gallons and single sewer passthrough rate of \$0.38 per 1,000 gallons.

TWU will provide its proposed findings of fact and conclusions of law with its Reply Brief per SOAH Order No. 12.

II. REVENUE REQUIREMENT [PO Issues 9, 10, 11, 12, 13, 14, 15]

TWU's requested combined revenue requirement of \$69,205,890 should be approved by the Commission.²

A. Cost of Service [PO Issues 13–15] [PO Issue 16 - UNCONTESTED]

TWU's total adjusted test year cost of service is \$55,730,016 for water and \$13,475,874 for wastewater. TWU has addressed OPUC's and Commission Staff's proposed adjustments under 16 TAC § 24.41(b) below. TWU has adjusted for other revenue items in the amount of (\$378,986) under 16 TAC § 24.41(c)(5). TWU has not included any water or sewer systems in this proceeding where the application to transfer the system to TWU has not yet been approved.

B. Allowable Expenses [PO Issues 17–28]

1. Operations and Maintenance Expenses (O&M) [PO Issue 18]

TWU's requested water O&M expense of \$26,711,882 and sewer O&M expense of \$5,122,073 are comprised of reasonable expenses that are necessary to provide service and should be approved.³

i. Corporate Development

The allocated O&M portion of corporate development costs that TWU incurred during the test year—\$324,000—is a recurring expense that is properly included in the revenue requirement as an allocated cost from TWU's corporate parent, SouthWest Water Company (Southwest). As detailed by TWU witness, Mujeeb Hafeez, the "Corporate Development (CD) function is responsible for promoting the growth of SouthWest . . . this continued growth allows customers to benefit from greater economies of scale as the costs of Southwest's corporate functions are spread over a larger base of utilities and customers."⁴ The adjusted recorded test year cost attributable to the CD Team is approximately \$1.288 million, of which TWU's portion is approximately \$324,000.⁵

OPUC witness, Nelissa Heddin, challenges the inclusion of these costs on the grounds that these costs are not "used and useful in operating the utility plant," and are not "reasonable

² TWU Ex. 1A (Application Schedules WPs) at Schedule II-A Cost of Service Summary (Bates 070).

³ 16 TAC § 24.41(b).

⁴ See generally TWU Ex. 5 (Hafeez Dir.) at 26–27 (Bates 27–28).

⁵ *Id.* at 27 (Bates 28).

and necessary to provide service to rate payers,” as the CD Team costs are “entirely associated with growing TWU and serves the interest of the stockholders of the company, not the ratepayers.”⁶ Ms. Heddin does not challenge the prudence of these costs, only that on a philosophical level they should not be allowed, all while citing to no precedent by the Commission that would support such a policy conclusion. Adopting such a narrow approach would minimize the financial benefit of the CD Team to TWU’s ratepayers and does not support a finding to disallow these costs.

By taking a broad interpretation of 16 TAC § 24.41(b)(1)(A), as to “reasonable and necessary” costs, CD costs contribute to economies of scale that directly benefit ratepayers. The CD Team’s efforts result in more efficient delivery of “reasonable and necessary” services at a lower per-unit cost. “By expanding the customer base through acquisitions, SouthWest has been able to spread shared corporate services such as Human Resources and Legal across a larger pool of customers, reducing the overall cost to individual customers.”⁷ As outlined in the rebuttal testimony of Mr. Hafeez, the CD Team has led to a reduction in the corporate services allocation to TWU from SouthWest, from 31.01% to 25.15%, which equates to roughly \$667,000 in shared services costs that would otherwise be allocated to TWU but for CD efforts.⁸

Moreover, CD expands the resources available to TWU ratepayers so they are available when needed, “in 2021, Winter Storm Uri affected the entire state of Texas with deep freezing temperature and icy conditions. As power went out for millions of Texans, water service disruptions followed.” SouthWest’s broader footprint allowed TWU to leverage additional resources from other areas of the country to quickly restore service, benefiting customers who would otherwise have faced extended service disruptions.”⁹ The expanded footprint of SouthWest not only brings economies of scale but additional resources that can be leveraged when needed, all of which directly benefit ratepayers. The CD Team costs provide significant service to TWU and those allocated costs should remain in TWU’s cost of service.

⁶ OPUC Ex. 1 (Heddin Dir.) at 70.

⁷ TWU Ex. 16 (Hafeez Reb.) at 3 (Bates 05).

⁸ *Id.* at 4 (Bates 05).

⁹ *Id.*

ii. Hauled Water

The O&M portion of the hauled water costs that TWU incurred during the test year—\$429,861—is a recurring expense that is properly included in the revenue requirement. TWU’s O&M expense for hauled water in calendar year 2024 was \$819,686, which is almost double the test year expense,¹⁰ and many areas of the state still remain in a severe state of drought more than one full year after the end of the test year.¹¹ No party challenged TWU’s hauled water expenses on the grounds that they were not necessary to provide service nor did any party assert that these expenses are unreasonable. Accordingly, the record evidence supports including the full amount of hauled water O&M expense in TWU’s cost of service.

If the hauled water expenses are removed from the cost of service, then they should be amortized over a period of two years, which will balance the need for timely recovery with the cost impact on customers.¹²

iii. Temporary Labor

OPUC’s recommendation to disallow expenses incurred to hire temporary labor during the test year is moot because TWU removed these expenses from the cost of service. More specifically, the known and measurable adjustments to Salaries and Wages – Employees (line 2), Employee Pensions and Benefits (line 5), Contractual Services Other (line 11), and Miscellaneous Expenses (line 23) of Schedule II-D-1.2(SH) (in aggregate) removed these costs.¹³

iv. Bank Charges

The charges from Amegy, Vantiv, and Bank of America are properly included in TWU’s O&M expense because they are TWU’s allocated portion of bank charges incurred as part of the shared cash management practices utilized during the test year by TWU and its affiliates.¹⁴ That is why they were described as “Intercompany reimbursement/receipt for

¹⁰ TWU Ex. 14 (Bahr Reb.) at 13 (Bates 14).

¹¹ See *id.*; see also TWU Ex. 15 (Freitag Reb.) at 3 (Bates 04).

¹² TWU Ex. 14 (Bahr Reb.) at 13 (Bates 14).

¹³ TWU Ex. 17 (Chaudhry Reb.) at 10 (Bates 11); TWU Ex. 1A (Application, Schedules, WPs) at Schedule II-D-1.2(SH) (Bates 151).

¹⁴ TWU Ex. 17 (Chaudhry Reb.) at 10 (Bates 11).

TWU.”¹⁵ Payment processing, cash flow management, and the related transactions are all integral to TWU’s financial operations and are a necessary part of maintaining financial liquidity and efficiency.¹⁶ In addition, bank accounts and financial services such as lock box agreements¹⁷ are required for customer billing and to provide services customers want and expect such as electronic bill payment like ACH transfers or credit card payment options.¹⁸ Consequently, the \$71,119 bank charges identified by OPUC are a reasonable and necessary cost of providing service to customers.¹⁹

v. Water/Wastewater Transportation Expense

TWU is unopposed to OPUC’s recommendation to move \$156,000 of transportation expenses from water O&M expense to sewer O&M expense.²⁰

vi. Outside Legal Costs

Expenses for outside legal work are recurring and ongoing, reasonable, and necessary to provide utility service; therefore, they are properly included in TWU’s cost of service. As an initial matter, \$163,190 of the \$342,509 identified by OPUC²¹ was paid to Alan Plummer & Associates, Inc., which is an engineering consulting firm that assists TWU with normal utility operations such as permit renewals, master planning, and construction design work.²² For specific/specialized engineering needs, TWU routinely relies on outside engineering expertise when it is more cost efficient.²³ Similarly, TWU and its parent company rely on outside legal support for specialized or specific legal needs.²⁴ Examples of this from the test year include the following:

¹⁵ Staff Ex. 14 (TWU’s Response to Staff’s Fifth Request for Information (RFI)) at Attachment Staff 5-12 (Bates 000026–29).

¹⁶ TWU Ex. 17 (Chaudhry Reb.) at 10 (Bates 11).

¹⁷ See Confidential TWU Ex. 17A (Chaudhry Reb. Attachment AC-R-2) at 6 (Bates 6).

¹⁸ TWU Ex. 17 (Chaudhry Reb.) at 10 (Bates 11).

¹⁹ OPUC Ex. 1 (Heddin Dir.) at Exhibit NH-24 (Bates 766).

²⁰ TWU Ex. 17 (Chaudhry Reb.) at 11 (Bates 12).

²¹ OPUC Ex. 1 (Heddin Dir.) at 76; OPUC Ex. 30 (Attachment NH-27).

²² TWU Ex. 14 (Bahr Reb.) at 15 (Bates 16).

²³ *Id.*

²⁴ *Id.*

- Cogency Global is TWU's registered agent having a registered agent is required to conduct business in Texas;
- Terrill & Waldrop was hired in connection with regulatory matters to provide litigation services outside the realm of expertise of in-house or primary outside regulatory counsel; and
- Branscomb Law was hired in connection with business matters to provide litigation services outside the realm of expertise of in-house counsel.²⁵

As for the test year legal expenses for services provided by TWU's primary outside regulatory counsel, TWU utilizes Spencer Fane on a regular basis for regulatory matters such as rulemakings, certificate of convenience and necessity amendments, formal customer complaints, Commission investigations, compliance proceedings, etc.²⁶ Further, the test year amount of \$143,003 is exclusive of capitalized legal expenses or rate case expenses.²⁷ As these needs are a recurring part of normal operations, it is appropriate for TWU to include these as O&M expenses rather than capitalize them.²⁸

In short, the assumptions underlying OPUC's recommendation to disallow outside legal expenses are unrealistic and incorrect because: (1) the fact that TWU has in-house counsel does not mean that TWU does not need specialized legal support or ongoing, state-specific regulatory support in the course of its normal utility operations; and (2) TWU does regularly incur legal expenses that are properly recorded as O&M expenses rather than capitalized.²⁹ Therefore, TWU's cost of service should include the \$179,319 for outside legal expenses incurred during the test year.

2. Depreciation Expense [PO Issue 19]

TWU's depreciation expense of \$8,809,866³⁰ is reasonable and necessary and was calculated using the straight-line method and the services lives supported by the depreciation

²⁵ *Id.*

²⁶ TWU Ex. 14 (Bahr Reb.) at 15–16 (Bates 16–17).

²⁷ *Id.* at 16 (Bates 17).

²⁸ *Id.*

²⁹ OPUC Ex. 1 (Heddin Dir.) at 76; TWU Ex. 14 (Bahr Reb.) at 14–15 (Bates 15–16).

³⁰ This is comprised of \$5,293,670 for water, \$1,668,064 for wastewater, and \$1,429,156 for shared expenses.

study performed by TWU witness Dane Watson. This depreciation study results in uniform depreciation rates for each asset class included in the application.³¹ The study also results in an overall decrease of approximately \$418,000 when compared to TWUs' annualized depreciation expense at existing rates.³²

The goal of performing a depreciation study is to support recovery of the original investment, over the useful lives of the underlying assets.³³ No party challenged the process used by Mr. Watson to complete the depreciation study or the descriptions of the assets included in each NARUC account included in the study.³⁴ The useful lives recommended by Mr. Watson are based on operational experience from the TWU subject matter experts who work with the assets, future expectations and plans for the assets, and Mr. Watson's professional judgment in performing depreciation studies throughout his nearly 40-year career.³⁵

OPUC presents a laundry list of assets that should be moved from one NARUC account to another.³⁶ Although OPUC witness Nelisa Heddin, who is admittedly not a depreciation expert,³⁷ specifically states that she is not opining on the appropriateness of the depreciable lives assigned to each NARUC account, her recommended reclassifications often result in the change in service life for the affected asset.³⁸ While some of the recommended reclassifications appear to be to promote uniformity, they also appear to be based on assumptions made by Ms. Heddin. For example, she has recommended moving all assets with the word "generator" in the description to NARUC account 355 for consistency.³⁹ However, she neither asserts that the NARUC account to which each generator was originally booked was improper nor does she explain why NARUC account 355 is the more appropriate choice. In other words, she does not

³¹ TWU Ex. 10 (Watson Dir.) at 5 (Bates 06).

³² *Id.* at 6 (Bates 07).

³³ *Id.* at 10 (Bates 11).

³⁴ *See* TWU Ex. 10 (Watson Dir.) at 9 and Attachment DAW-2 at 14–31 (Bates 10 and 27–44).

³⁵ TWU Ex. 10 (Watson Dir.) at 10 (Bates 11).

³⁶ OPUC Ex. 1 (Heddin Dir.) at 43–47.

³⁷ Tr. at 21:6–8 (Heddin Cross) (Jan. 27, 2025).

³⁸ OPUC Ex. 1 (Heddin Dir.) at 43.

³⁹ OPUC Ex. 1 (Heddin Dir.) at 46; OPUC Ex. 8 (Attachment NH-5.1–NH. 5.43) at Attachment NH-5.11 (Bates 12).

present any compelling justification that the current classification was inaccurate or inconsistent with industry norms.⁴⁰

When placing an asset or project into service, TWU performs a thorough review of the associated costs and determines the appropriate classification(s) based on the supporting information (invoices, project plans, etc.).⁴¹ This review also takes into account TWU's operational history, industry standards, and specific service requirements—all of which TWU evaluates before booking an asset to a specific NARUC account.⁴² OPUC's recommendation to reclassify assets based solely on a review of the summary descriptions for those assets has the potential to lead to over-generalizations and unnecessary adjustments.⁴³ Changing NARUC accounts and the associated service life also runs the risk of disrupting established accounting consistency and introducing unintended discrepancies that could affect TWU's long term financial planning.⁴⁴

Ms. Heddin admitted at the hearing that she is not a depreciation expert. Yet, her recommended reclassifications would change TWU's depreciation expense due to the change in useful life attendant to these reclassifications. This lack of expertise combined with the lack of analysis supporting her recommended reclassifications does not sufficiently justify deviating from the depreciation study presented by TWU, which was performed by an expert with years and years of depreciation-specific experience and included information specific to TWU. Accordingly, OPUC's recommendation should be rejected and TWU's depreciation expense should not change due to the reclassification of assets from one NARUC account to another.

3. Taxes [PO Issues 20, 21, 22, 42]

TWU has included \$3,965,937 in calculated income tax in its revenue requirement.⁴⁵ For purposes of federal income taxes, TWU is considered a division of Monarch Utilities, Inc., which is a taxable corporation.⁴⁶ As a result, TWU's rates should be set in accordance with its

⁴⁰ TWU Ex. 17 (Chaudhry Reb.) at 6 (Bates 07).

⁴¹ *Id.* at 5 (Bates 06).

⁴² *Id.* at 5 (Bates 06).

⁴³ *Id.* at 5 (Bates 06).

⁴⁴ *Id.* at 5–6 (Bates 06–07).

⁴⁵ TWU Ex. 9 (Shupak Dir.) at 7 (Bates 08).

⁴⁶ *Id.* at 5 (Bates 06).

federal treatment as an income paying tax corporation, which is supported by prior Commission precedent.⁴⁷ Furthermore, TWU has complied with HB 2774, which requires income taxes related to intercompany profits on affiliated profits to be applied to reduce the cost of the property or service purchased.⁴⁸ Therefore, all transactions among affiliates are at costs and no intercompany profits are included in Southwest's allocated costs.⁴⁹

4. Professional or Trade Association Expense, Advertising Expense [PO Issue 23– 24] [UNCONTESTED]

TWU has no advertising expenses included in the cost of service.⁵⁰ For Professional and Trade Association Expenses, TWU requested the following in its application: \$73,751 for Industry Organization Membership Dues, \$10,192 for Business/Economic Membership Dues, and \$5,990 for Professional Membership Dues.⁵¹

5. Self-Insurance Plan [PO Issue 25] [UNCONTESTED]

TWU does not have a self-insurance plan approved by the Commission.⁵²

6. Affiliate Expenses [PO Issues 26–27] [UNCONTESTED]

The only challenges to affiliate expenses were addressed in Sections B.1.i. and B.7.i related to Corporate Development Costs and Executive Costs.

7. Not-Allowed Expenses [PO Issue 28]

Under 16 TAC § 24.41(b)(2), expenses that are not allowed by the Commission to be included in a utility's cost of service are any expenditures including executive salaries that are found by the Commission to be unreasonable, unnecessary, or not in the public interest. TWU's executive costs do not meet these criteria as these O&M costs provide a benefit to ratepayers and are in the public interest.

⁴⁷ *Id.* at 5–6 (Bates 06–07).

⁴⁸ *Id.* at 6 (Bates 07).

⁴⁹ *Id.*

⁵⁰ TWU Ex. 1A (Application, Schedules, WPs) at Schedule II-D-3.1 Advertising (Bates 153).

⁵¹ TWU Ex. 1A (Application, Schedules, WPs) at Schedule II-D-3.3 Industrial Organization Membership Dues (Bates 155); TWU Ex. 1A (Application, Schedules, WPs) at Schedule II-D-3.4 Business/Economic Membership Dues (Bates 156); TWU Ex. 1A (Application, Schedules, WPs) at Schedule II-D-3.5 Professional Membership Dues (Bates 157).

⁵² Staff Ex. 14 (TWU's Response to Staff's Fifth RFI) at Staff RFI No. 5-23 (Bates 000040).

i. Executive Costs

The O&M portion of executive costs that TWU incurred during the test year—roughly \$1,127,000⁵³—is a recurring expense that is properly included in the revenue requirement as an allocated cost from TWU’s corporate parent, SouthWest. The total test year cost incurred by SouthWest for the Executive function was \$4.481 million, which is then allocated to TWU via the process outlined in the Cost Allocation Manual (CAM).⁵⁴ The portion of this test year expense related to executive salaries and compensation was reviewed by TWU witness Robert Mustich for reasonableness and was not challenged by any party.⁵⁵ As TWU witness Mujeeb Hafeez testified: “All long-term incentive compensation has been excluded from the test year costs. Additionally, short-term incentive compensation for executive officers that is based on financial measures has been excluded from the test year costs.”⁵⁶

OPUC witness Ms. Heddin recommends disallowing Executive costs, arguing that they are not necessary for providing service to customers. Specifically, she suggests that Executive costs benefit shareholders rather than ratepayers and that these costs are not directly linked to the provision of utility services.⁵⁷ This proposal to eliminate Executive costs ignores their benefit to ratepayers and should be disregarded.

As discussed by TWU witness, Mujeeb Hafeez, SouthWest’s executives maintain a fiduciary duty to not only its shareholders, but also its entire customer base.⁵⁸ The record evidence from TWU establishes the robust benefits gleaned by TWU’s customers from SouthWest’s executive team, which oversee utility operations and ensure services are delivered efficiently.⁵⁹ Executive leadership is responsible for high-level decision-making in finance, operations, safety, and governance-functions that directly affect the quality and cost of service for customers.⁶⁰ The SouthWest executive functions are carried out by four executives (CEO, CFO, COO, and General Counsel) who are in charge of management and oversight of corporate

⁵³ See TWU Ex. 5 (Hafeez Dir.) at Attachments MSH-3 and MSH-4.

⁵⁴ TWU Ex. 5 (Hafeez Dir.) at 15 (Bates 15).

⁵⁵ See *generally* TWU Ex. 12 (Mustich Dir.).

⁵⁶ TWU Ex. 5 (Hafeez Dir.) at 15 (Bates 16).

⁵⁷ OPUC Ex. 1 (Heddin Dir.) at 71–73.

⁵⁸ TWU Ex. 16 (Hafeez Rcb.) at 5–6 (Bates 06–07).

⁵⁹ See *generally id.* at 5–8 (Bates 06–09).

⁶⁰ *Id.* at 6 (Bates 07).

services that are directly useful to TWU customers, as they directly manage and oversee services that benefit TWU customers.⁶¹ Moreover, the SouthWest Board of Directors, a portion of the costs of which is also allocated to TWU, benefit customers by ensuring safe, reliable, and cost-effective water services, through “prudent financial oversight,” “risk management,” “operation excellence and service reliability,” “talent and succession planning,” and “regulatory” compliance.⁶² These critical roles are necessary for the delivery of quality service to ratepayers, and are used and useful for the provision of service. Without such services being provided at the corporate level, TWU would have to incur substantial cost that would be directly borne by ratepayers to ensure they are addressed.

As the record evidence supports, SouthWest’s corporate shared services model provides necessary executive functions more effectively and efficiently than could be procured by the individual affiliates individually.⁶³ TWU customers benefit from economies of scale from the shared services model.⁶⁴ Additionally, the costs of SouthWest’s Corporate Shared Services are allocated to subsidiaries without any associated margin or mark-up.⁶⁵

C. Return on Rate Base [PO Issues 29-43]

1. Capital Structure [PO Issues 29, 30]

TWU proposes the use of its actual capital structure, which consists of 43.75% long-term debt at an embedded cost rate of 5.70% and 56.25% common equity at the common equity cost rate of 10.55% recommended by TWU witness Dylan W. D’Ascendis.⁶⁶

Commission Staff, through its witness Ms. Emily Sears, recommended the use of a hypothetical capital structure. Ms. Sears recommends a hypothetical capital structure of 52.00% common equity and 48.00% long-term debt, based on the average capital structure of her proxy group.⁶⁷ She believes that using the industry average capital structure is a “more stable and reliable indicator of the industry’s and market’s view of the appropriate capital structure for a

⁶¹ *Id.* at 7–8 (Bates 08–09).

⁶² *Id.* at 9–11 (Bates 10–12).

⁶³ TWU Ex. 5 (Hafeez Dir.) at 13 (Bates 14).

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ TWU Ex. 11 (D’Ascendis Dir.) at 5 (Bates 006).

⁶⁷ Staff Ex. 5 (Sears Dir.) at 22 (Bates 000022) and Attachment ES-4 (Attachment ES-4 was provided in the Microsoft Excel portion of Staff Ex. 5).

utility in the water utility industry” than TWU’s actual capital structure.⁶⁸ No other intervenor took a position as to TWU’s capital structure.

i. TWU’s actual capital structure is not substantially different from typical utility capital structures

At the hearing on the merits, Ms. Sears admitted that TWU’s actual capital structure is not “substantially different from the typical utility capital structure”.⁶⁹ Ms. Sears’s recommendation of a hypothetical capital structure in this instance is unsupported given the cited academic literature and capital structures maintained, and expected to be maintained, by the proxy groups used to derive the ROE in this proceeding. TWU’s actual capital structure, which consists of 43.75% long-term debt and 56.25% common equity, is appropriate for ratemaking purposes. This is significant as the factors typically considered relative to the use of a regulated subsidiary’s actual or expected capital structure, or a hypothetical capital structure, are provided by David C. Parcell in *The Cost of Capital – A Practitioner’s Guide* prepared for the Society of Regulatory Financial Analysts notes that there are circumstances where a hypothetical capital structure is used in favor of an actual or expected capital structure, which specifically includes a finding that “the utility’s capital structure is deemed to be substantially different from the typical or “proper” utility capital structure.”⁷⁰ Moreover, Ms. Sears admits that TWU’s actual capital structure for the test year is within the range of capital structures for Ms. Sears’s proxy group and that TWU’s test year capital structure is within the range of capital structures maintained and expected to be maintained by typical water utilities.⁷¹ It is also similar to capital structures previously approved for TWU.⁷² Therefore, Ms. Sears’s recommendation of a hypothetical capital structure for TWU is inappropriate.

ii. Use of a Hypothetical Capital Structure in this case violates basic financial principles

Basic financial principles consider that it is the use of capital funds invested that gives rise to the risk of the investment. TWU’s capital structure represents the actual capital financing

⁶⁸ *Id.* at 22 (Bates 000022).

⁶⁹ Tr. at 56:5–8 (Sears Cross) (Jan. 27, 2025).

⁷⁰ TWU Ex. 19 (D’Ascendis Reb.) at 8 (Bates 09).

⁷¹ Tr. at 56:5–8 and 20–24 (Sears Cross) (Jan. 27, 2025).

⁷² *Application of Monarch Utilities I L.P. for Authority to Change Rates*, Docket No. 50944, Order at Finding of Fact No. 84 (capital structure of 45% debt and 55% equity).

of its operations, to which the overall rate of return will be applied.⁷³ As described by reference to the financial literature in the Rebuttal Testimony of TWU witness Dylan D'Ascendis, it "is fundamental that individual investors expect a return commensurate with the risk associated with where their capital is invested. In this proceeding, that capital is invested in TWU's rate base for the provision of safe, reliable, and low-cost water distribution service. Hence, TWU's operations must be viewed on their own merits, including the actual capital structure financing TWU's rate base."⁷⁴ In short, "it is the total investment risk inherent in TWU's capital structure, which is presumed to finance the entirety of their operations, and relevant to the appropriate rate of return for TWU's rate base."⁷⁵ Based on the financial literature addressing the use of an actual versus a hypothetical capital structure, the use of TWU's actual capital structure is appropriate.

2. Overall Rate of Return [PO Issue 31]

Using TWU's recommended ROE and TWU's actual cost of debt and capital structure results in the below overall rate of return.

<u>Type of Capital</u>	<u>Ratios</u>	<u>Cost Rate</u>	<u>Weighted Cost Rate</u>
Long-Term Debt	43.75%	5.70%	2.49%
Common Equity	<u>56.25%</u>	10.55%	<u>5.93%</u>
Total	<u>100.00%</u>		<u>8.42%</u>

i. Return on Equity

TWU's 10.55% return on equity was supported by the Direct Testimony of Dylan W. D'Ascendis, and was based on the assessment of "market-based common equity cost rates of companies of relatively similar, but not necessarily identical, risk to TWU."⁷⁶ The evidence presented by TWU's witness establishes that the proposed 10.55% return on equity is consistent with water utility industry standards for expected investor returns on equity by applying the

⁷³ TWU Ex. 19 (D'Ascendis Reb.) at 9 (Bates 10).

⁷⁴ *Id.* at 10 (Bates 11).

⁷⁵ *Id.* at 11 (Bates 12).

⁷⁶ TWU Ex. 11 (D'Ascendis Dir.) at 6 (Bates 007).

Discounted Cash Flow (DCF) model, the Risk Premium Model (RPM), and the Capital Asset Pricing Model (CAPM), to available market data.⁷⁷ Moreover, the record evidence supports a finding that a 10.55% ROE provides TWU with the opportunity to earn a return that is: (1) adequate to attract capital at reasonable cost and terms; (2) sufficient to ensure its financial integrity; and (3) commensurate with returns on investments in enterprises having corresponding risks.⁷⁸

a. Commission Staff's proposed ROE is flawed

Commission Staff, via its witness Ms. Emily Sears, proposes the Commission adopt a ROE in a range of 7.82% to 9.90%, with a point estimate of 8.55%.⁷⁹ Ms. Sears's recommendation is flawed due to her: (1) misapplication of her proxy group selection criteria; (2) failure to apply the CAPM model; (3) application of a multi-stage DCF model for utility companies; (4) use of the multi-stage DCF model; (5) use of the RPM method; and (6) failure to reflect TWU's increased business risk as compared to her proxy group.

In her testimony Ms. Sears identifies her selection criteria for her proxy group⁸⁰ but fails to include Global Water Resources, Inc. (GWRS) as a company that meets those specific criteria.⁸¹ Moreover, she included two companies—ARTNA and YORW—that fail to meet her identified criteria.⁸² The end result of eliminating ARTNA and YORW from Ms. Sears's proxy group and adding GWRS raises the average single-stage DCF to 10.68% and multi-stage DCF to 8.14%, respectively.⁸³ This failure undercuts Ms. Sears's conclusions on ROE and supports an adjustment to her analysis.

Ms. Sears's conclusions are also flawed due to her overreliance and misapplication of the DCF model. As outlined in the record, primary reliance on the DCF model is generally problematic, as DCF models assume a market-to-book (M/B) ratio of 1.0 and therefore under or over state investors' required return when market value exceeds or is less than book value,

⁷⁷ *Id.* at 6–7 (Bates 007–08).

⁷⁸ *See id.*

⁷⁹ Staff Ex. 5 (Sears Dir.) at 20 (Bates 000020) and Attachment ES-10 (Attachment ES-10 was provided in the Microsoft Excel portion of Staff Ex. 5).

⁸⁰ Staff Ex. 5 (Sears Dir.) at 9 (Bates 000009).

⁸¹ TWU Ex. 19 (D'Ascendis Recb.) at 14 (Bates 15).

⁸² *Id.*

⁸³ *Id.* at 15 (Bates 16).

respectively.⁸⁴ Based on the literature and support cited by TWU's witness, it can be inferred that DCF model results have consistently and significantly understated the investor-required return over the last ten years.⁸⁵ Based on Mr. D'Ascendis's refined approach to using the DCF model results in an increase of 1.29% over Mr. Sears's indicated average DCF result of 8.19%.⁸⁶

Moreover, as outlined by Mr. D'Ascendis, the DCF model run by Ms. Sears has additional failings. Ms. Sears's direct testimony admittedly eliminated an indicated result of 14.16% as an outlier.⁸⁷ This resulted in a range and standard deviation in her DCF model results of 2.18%, a far cry from the standard deviation of 0.70% found in Mr. D'Ascendis's CAPM model results.⁸⁸ Such overreliance on a DCF model with a high standard deviation justifies the use of multiple cost of common equity models, as supported by the financial literature.⁸⁹ Ms. Sears relies on only two models (DCF average and RPM), and the absence of a third confirmatory model strains the value of her analysis, "especially when the DCF is shown to understate the investor required return when M/B ratios are over 1.0 times."⁹⁰

Ms. Sears's analysis also omits the CAPM methodology that she admittedly used in prior rate cases as a method to compare her DCF results.⁹¹ This is despite the fact that Ms. Sears has used the CAPM methodology in nine prior rate cases,⁹² and the Commission itself has relied on the RPM, DCF, and CAPM models as recently as June 2023 in approving an ROE in another utility rate case.⁹³ In lieu of Ms. Sears using this methodology in her own testimony, Mr. D'Ascendis was able to replicate her calculations in prior cases, resulting in a CAPM range of 9.28% and 9.66%, using her proxy group, and 9.39% and 9.80% using her updated proxy

⁸⁴ *Id.* at 16–21 (Bates 17–22).

⁸⁵ *Id.* at 17–19 (Bates 18–20).

⁸⁶ *Id.* at 19–21 (Bates 20–22).

⁸⁷ Staff Ex. 5 (Sears Dir.) at 17 (Bates 000017).

⁸⁸ TWU Ex. 19 (D'Ascendis Rcb.) at 21–22 (Bates 22–23).

⁸⁹ *Id.* at 22–24 (Bates 23–25).

⁹⁰ *Id.* at 25 (Bates 26).

⁹¹ Tr. at 54:15–21 (Sears Cross) (Jan. 27, 2025).

⁹² TWU Ex. 19 (D'Ascendis Rcb.) at 25 (Bates 26) (citing to Commission Docket Nos. 43076, 44809, 45570, 45418, 46247, 46256, 46245, 47976, and 48640).

⁹³ *Application of Oncor Electric Delivery Company LLC for Authority to Change Rates*, Docket No. 53601, Order On Rehearing at Finding of Fact No. 86 (Jun. 30, 2023).

group.⁹⁴ The CAPM methodology employed by Ms. Sears in prior cases is in line with her own RPM result of 9.90%, providing a confirmation as to its validity.⁹⁵ As explained by Mr. D'Ascendis, a CAPM model would have confirmed Staff's ROE recommendation was unreasonable.⁹⁶

While TWU takes no issue with Ms. Sears's constant growth DCF model, it does take issue with her application of the multi-stage DCF model. As outlined in the record, the economics of the public utility business indicate that the industry is in the steady-state, or constant-growth stage of a multi-stage DCF, which would mean that the three- to five-year projected growth rates for each company would be the "steady-state" or terminal growth rate appropriate for the DCF model for utility companies, not the GDP growth rate, which is not a company-specific growth rate, nor is it an upward bound for growth.⁹⁷

TWU requested in its application a 0.15% upward adjustment to ROE related to business risk.⁹⁸ Ms. Sears failed to reflect any company specific risk adjustment, which is more than justified in this proceeding.⁹⁹ As presented by Mr. D'Ascendis the financial literature relied on for Ms. Sears's rejection of the proposed adjustment is flawed and has been rebutted, supporting a finding that smaller utilities, like TWU, are riskier than larger ones.¹⁰⁰

Based on the record evidence, Ms. Sears's ROE analyses are flawed and should be appropriately adjusted as presented by Mr. D'Ascendis.¹⁰¹

⁹⁴ TWU Ex. 19 (D'Ascendis Rcb.) at 26 (Bates 27).

⁹⁵ *Id.*

⁹⁶ *Id.* at 26–27 (Bates 27–28).

⁹⁷ *Id.* at 29–34 (Bates 30–35).

⁹⁸ TWU Ex. 11 (D'Ascendis Dir.) at 58 (Bates 059).

⁹⁹ Staff Ex. 5 (Sears Dir.) at 23 (Bates 000023).

¹⁰⁰ TWU Ex. 19 (D'Ascendis Rcb.) at 36–39 (Bates 37–40).

¹⁰¹ *Id.* at 40 (Bates 41).

Table 5: Summary of Ms. Sears's Corrected Results

Model	Range	Point Estimate	Point Estimate with business risk adjustment
Single-stage DCF	7.00% - 17.87%	10.68%	10.83%
Multi-stage DCF	7.37% – 10.12%	8.39%	8.54%
RPM	N/A	9.90%	10.05%
CAPM	9.39% – 9.80%	9.59%	9.74%
Average	N/A	9.64%	9.79%

As shown in Table 5, Ms. Sears's corrected models show an updated range of ROEs of 8.39% to 10.68%, with an overall average of 9.64% (unadjusted). After adjusting for TWU-specific risk, her updated average is 9.79%. Lastly, disregarding the results of the multi-stage DCF, which Mr. D'Ascendis identified is not applicable to utilities, her average result is 10.21%, illustrating that her recommended 8.55% ROE is inappropriate for TWU, and is more in line with TWU's proposed 10.55%.

b. Ms. Sears agrees that the cost of common equity has risen

Commission Staff witness, Ms. Sears advised in her hearing testimony that she had provided ROE testimony in two recent water utility rate cases in which she recommended overall ROEs of 8.2%; those cases were filed in 2022 and 2023 respectively.¹⁰² In her direct testimony, Ms. Sears recommends an overall ROE for TWU of 8.55%, and she admitted on the stand that this 35 basis point difference resulted from the fact that the cost of common equity has increased for water utilities since those prior rate proceedings.¹⁰³ As presented in his rebuttal testimony, Mr. D'Ascendis established a "9.48% indicated cost of common equity

¹⁰² Tr. at 48:4-25 (Sears Cross) (Jan. 27, 2025) (referencing *Application of CSWR-Texas Utility Operating Company, LLC for Authority to Change Rates*, Docket No. 54565, Order (Jun. 13, 2024); *Application of Corix Utilities (Texas) Inc. for Authority to Change Rates*, Docket No. 50557, Order (Sept. 29, 2021)).

¹⁰³ Tr. 55:2-11.

relative to the book value of the proxy group . . . an increase of 1.29% over Ms. Sears's indicated average DCF result of 8.19%.”¹⁰⁴ Ms. Sears's statements support a finding by the Commission of an increase in cost of common equity as compared to recent ROE determinations.¹⁰⁵

Mr. D'Ascendis presented the only ROE analysis supported by an appropriate range of methodologies that recognizes TWU's unique risks. His recommended 10.55% ROE is reasonable, supported by the evidence, and should be approved.

ii. Cost of Debt

TWU requested in its application the use of its actual effective cost of debt of 5.70%.¹⁰⁶ TWU's effective cost of debt is the actual cost of debt, adjusted for net proceeds, which is consistent with the Commission's rules.¹⁰⁷ No party contested TWU's calculation of the actual effective cost of debt, or the validity of transaction costs for issuance.

a. Commission Staff's recommendation to use TWU's actual cost of debt unadjusted for net proceeds is inconsistent with Commission rules

Ms. Sears recommends in her direct testimony that the Commission use TWU's actual weighted cost of debt, unadjusted for net proceeds, equaling 5.68%.¹⁰⁸ Her recommendation hinges on the Commission adopting her recommendation to use a hypothetical capital structure, which is inappropriate, as presented above. She argues, that her 5.68% cost of long term debt still allows for full recovery of TWU's issuance costs because the hypothetical capital structure overstates the amount of debt capital of TWU, and thus still allows TWU to recover its full interest expense.¹⁰⁹ Ms. Sears's recommendation on cost of debt presumes the use of a hypothetical capital structure in order to avoid non-compliance with 16 TAC § 24.41(c)(1)(B)(i), but the end result would unfairly penalize the equity return approved for TWU under such a hypothetical structure. Ms. Sears does not challenge the calculation of TWU's actual weighted effective cost of debt of 5.70%, which as outlined in Commission Rules

¹⁰⁴ TWU Ex. 19 (D'Ascendis Reb.) at 19:4–21:3.

¹⁰⁵ Docket No. 54565, Order at Finding of Fact No. 75; Docket No. 50557, Order at Finding of Fact No. 91.

¹⁰⁶ TWU Ex. 11 (D'Ascendis Dir.) at 22 (Bates 023); TWU Ex. 1A (Application, Schedules, WPs) at Schedule II-C-4 (Bates 139).

¹⁰⁷ 16 TAC § 24.41(c)(1)(B)(i) (“[t]he cost of debt capital is the actual cost of debt, plus adjustments for premiums, discounts, and refunding and issuance costs.”).

¹⁰⁸ Staff Ex. 5 (Sears Dir.) at 21 (Bates 000021).

¹⁰⁹ *Id.*

must include adjustments for issuance costs, and therefore no adjustment should be made regardless of the capital structure employed.

3. Rate Base [PO Issues 32–43]

TWU is requesting total rate base of \$251,193,248 comprised of the following:¹¹⁰

Gross Plant in Service	\$384,083,059
Accumulated Depreciation	(\$113,601,566)
CWIP in Service	\$4,435,974
Parent Company Rate Base	\$1,999,495
ADFIT (including excess ADFIT)	(\$2,857,024)
Materials & Supplies	\$3,044,377
Prepayments	\$207,214
Cash Working Capital	\$2,196,034
Regulatory Assets	\$1,382,015
Other Rate Base Items	(\$29,696,330)
TOTAL RATE BASE	\$251,193,248

No party challenged TWU's requested amounts for Materials & Supplies and Prepayments, and no party challenged TWU's requested regulatory assets.

Several of the challenges to elements of TWU's rate base implicate the legal question of what constitutes a prima facie case. The Commission has addressed this question in the context of the showing of changed circumstances needed to support a prudence finding.¹¹¹ Although the contested issues in this proceeding are not specific to whether TWU's capital investment was prudently incurred, the Commission's decision is instructive. Citing to *Black's Law Dictionary*, the Commission identified two meanings of prima facie case: "1) evidence sufficient to allow the case to go to the jury; or 2) evidence compelling a conclusion that the plaintiff wins if the defendant produces no evidence to rebut plaintiff's evidence."¹¹²

The former meaning of prima facie case is most apposite when ruling on a Motion for Summary Decision because the finder of fact must determine if a genuine issue of material fact exists such that summary decision is not appropriate.¹¹³ At this stage in the case, i.e.,

¹¹⁰ TWU Ex. 3 (Bahr Dir.) at 9 (Bates 09).

¹¹¹ *Application of Texas-New Mexico Power Company for Authority to Change Rates and Application of Texas-New Mexico Power Company for Deferred Accounting Treatment for TNP One-Unit Two*, Docket Nos. 10200 and 10034, 19 P.U.C. Bull. 89, Examiner's Report at 22 (Mar. 18, 1993).

¹¹² *Id.*

¹¹³ 16 TAC § 22.182(a).

post-hearing, the second meaning of prima facie is the central inquiry. As discussed in more detail below, and in Section III.A, TWU has presented evidence sufficient to make a prima facie case regarding several issues. Once that showing is made, the burden of production shifts to the other parties.¹¹⁴

i. Affiliated Interest [PO Issue 33]

Prior to the issuance of the final order in Docket No. 55304, Hornsby Bend was an affiliate of TWU. However, no party has challenged the Hornsby Bend assets included in the application on the grounds that they do not meet the affiliate standard in TWC § 13.185 or for any other reason related to the fact that Hornsby Bend and TWU were affiliates.

ii. Original Cost [PO Issue 34]

The capital investment included in TWU's rate base was prudently incurred, used and useful, and reasonable and necessary. TWU's rate base is comprised of the following categories of gross plant in service:¹¹⁵

Prior Commission Determination (Docket No. 50944)	\$180,936,554
Invoices, Contracts, Work Orders, or Other	\$104,459,960
Hornsby Bend STM (Docket No. 55304)	\$57,751,890
Fair Market Valuations of Acquisitions	\$39,823,667
Non-Fair Market Valuations of Acquisitions	\$1,110,988
TOTAL	\$384,083,059

Of the \$57.7 million in gross plant transferred from SWWC Utilities, Inc. dba Hornsby Bend Utility Company, Inc. (Hornsby Bend), \$42,777,636 was included in the application to change rates filed with the TCEQ in Docket No. 2014-0539-UCR.¹¹⁶

No party disputes that, under TWC § 13.184(c), the applicant bears the burden of proving that the proposed rate change is just and reasonable. With regard to rate base (and many other elements of the cost of service), the application TWU filed in this proceeding is consistent with the application it has filed in its previous two rate cases adjudicated by the

¹¹⁴ Docket Nos. 10200 and 10034, 19 P.U.C. Bull. 89, Examiner's Report at 22 (Mar. 18, 1993).

¹¹⁵ TWU Ex. 3 (Bahr Dir.) at 9 (Bates 10).

¹¹⁶ Staff Ex. 9 (TWU's Response to Staff 1-1) at Attachment Staff 1-1 (sorting for HBU assets with an in-service date of 2012 or earlier); TWU Ex. 3 (Bahr Dir.) at 8-9 (Bates 09-10).

Commission, Docket Nos. 45570 and 50944.¹¹⁷ TWU's application provided the rate base schedules required by Section II-B of the Instructions for Rate/Tariff Change for Class A, including Schedule II-B-1 Original Cost of Utility Plant for Water/Sewer.¹¹⁸ Also included in the application was the affidavit of a licensed engineer attesting that the non-retired assets for which original costs are claimed as part of rate base are currently used and useful in providing utility service.¹¹⁹ As part of a larger corporate organization, TWU is subject to internal financial, tax, and regulatory audits of its books and records.¹²⁰ TWU is also audited annually by PricewaterhouseCoopers LLP, which is a globally respected accounting firm.¹²¹

In response to discovery, TWU provided an itemized depreciation schedule for water, wastewater, and shared assets showing original cost, date of installation, service lives, depreciation expense, accumulated depreciation, and net plant.¹²² TWU also provided the information in Schedule II-B-1.1 separated by water and wastewater system.¹²³ TWU prevailed in a discovery dispute regarding what were ultimately deemed unduly burdensome requests¹²⁴ to produce documentation underlying the thousands of assets presented in the 119 attachments that were prepared by OPUC's witness using an asset list provided by TWU.¹²⁵ In the form of supplemental rebuttal testimonies, TWU provided information addressing the original cost of 200 assets OPUC alleged were not fully supported.¹²⁶

¹¹⁷ See TWU Ex. 14B (Bahr Second Supp. Reb.) at 11–12 (Bates 012–13); Docket No. 50944, Order (Feb. 23, 2022); *Application of Monarch Utilities I.L.P. for Authority to Change Rates*, Docket No. 45570, Final Order (Aug. 21, 2017).

¹¹⁸ TWU Ex. 1A (Application, Schedules, WPs) at Schedules II-B-1, II-B-1(W), II-B-1-(S), II-B-1(SH) (Bates 100–03); TWU Ex. 1B (Conf. Application, Schedules, WPs) at Schedule II-B-1.1 (no Bates numbering).

¹¹⁹ TWU Ex. 1A (Application, Schedules, WPs) at WP/II-B-1.5 (Bates 537).

¹²⁰ TWU Ex. 14B (Bahr Second Supp. Reb.) at 11 (Bates 012).

¹²¹ *Id.*

¹²² Staff Ex. 9 (TWU's Response to Staff 1-1) at Attachment Staff 1-1 (Bates 000003) (Staff's exhibit includes the Microsoft Excel file that comprised Attachment Staff 1-1).

¹²³ Staff Ex. 10 (TWU's Response to Staff's Second RFI) at Staff 2-3 (Bates 000005–06); Staff Ex. 10A (Conf. Attachment Staff 2-3) (Staff's exhibit is the Microsoft Excel file that comprised Attachment Staff 2-3).

¹²⁴ SOAH Order No. 5 Notice of Prehearing Conference on Motions to Compel; Striking Nonparticipating Intervenor (Dec. 5, 2024) (SOAH Order No. 5); SOAH Order No. 9 Modifying Order No. 7 (Dec. 27, 2024); see also TWU Ex. 14B (Bahr Supp. Reb.) at Attachment BDB-SR-1 (Bates 12–45).

¹²⁵ See OPUC Ex. 1 (Heddin Dir.) at 21–22; see also OPUC Ex. 6 (Attachments NH-4.1 through NH-4.76) and OPUC Ex. 8 (Attachments NH-5.1 through NH-5.43).

¹²⁶ See TWU Ex. 17B (Chaudhry Supp. Reb.) (48 assets); TWU Ex. 15A (Freitag Supp. Reb.) (51 assets); TWU Ex. 31 (Chaudhry Second Supp. Reb.) (43 assets); TWU Ex. 30 (Bahr Second Supp. Reb.) (58 assets).

Based on the foregoing, the record contains evidence sufficient to support TWU's claimed original cost of \$301,006,790 for water and \$83,076,269 for sewer.¹²⁷ The level of production required for the audit style, asset-by-asset review championed by OPUC has the potential to greatly increase the amount of rate case expenses incurred by an applicant utility, and it was rejected by the SOAH administrative law judge in favor of a reasonable sample.¹²⁸ After taking the time to sort assets into numerous attachments, OPUC could have employed a targeted approach that focused on assets with an original cost that looked unreasonable given the asset description or investments that raised questions about prudence given available information and alternatives.¹²⁹ Another option would have been to focus on assets with an original cost greater than a certain dollar amount. Further, OPUC's approach resulted in parties devoting time and resources to *de minimis* discrepancies.¹³⁰ When asked about her experience advising clients on rate base issues, OPUC witness Ms. Heddin could only recall one investor-owned utility client she advised regarding claimed original cost, but she could not recall how many assets were included in the client's rate change application.¹³¹ The majority of her clients were municipalities that do not use "the same method of setting rate base and a return on rate base" as an investor-owned utility.¹³²

In short, establishing a blanket challenge to every asset (including assets with an original cost that is reasonable and necessary on its face) that can only be overcome through a level of production that is unduly burdensome, is a wholly unreasonable approach to reviewing original cost and should be rejected. Therefore, TWU's original cost should be approved.

a. The capitalized labor, overhead, and interest included in the original costs of TWU's assets are reasonable and necessary costs

Generally, the original cost of an asset may include any of the following components: amounts paid to third parties, direct labor, overhead, interest accrued during construction—

¹²⁷ TWU Ex. 1A (Application, Schedules, WPs) at Schedules II-B-1 (Bates 100).

¹²⁸ TWU Ex. 14 (Bahr Supp. Reb.) at 5 (Bates 06); SOAH Order No. 5 at 2 ("OPUC in particular is strongly encouraged to propose a reasonable limitation on the information requested.").

¹²⁹ *Gulf States Util. Co. v. Pub. Util. Comm'n of Tex.*, 41 S.W.2d 459, 475 (Tex. App.—Austin 1992, writ denied).

¹³⁰ See, e.g., OPUC Ex. 74 (Attachment NH-61) (Seven of the 11 assets listed had a discrepancy of less than \$500 or a negative discrepancy).

¹³¹ Tr. at 23:1–12 (Heddin Cross) (Jan. 27, 2025).

¹³² Tr. at 23:13–24:6 (Heddin Cross) (Jan. 27, 2025); Tr. at 40:18–41:16 (Heddin Redir.) (Jan. 27, 2025).

referred to as allowance for funds used during construction (AFUDC), and materials and supplies from inventory.¹³³ Capitalized direct labor represents the cost of exempt TWU employees who complete and submit weekly time sheets that include time charged to capital service orders or projects.¹³⁴ For each category of field personnel utilizing time sheets, TWU assigns an average hourly wage (inclusive of a loading rate for other wages/benefits) in SAP.¹³⁵ These field personnel enter time spent on service notifications to the corresponding service order.¹³⁶ SAP then multiplies the assigned hourly wage by the number of hours entered and this resulting amount is automatically recorded to the service order to capture the capitalizable time.¹³⁷ Entries on TWU's books for capitalized direct labor indicate the employee category and the number of hours worked.¹³⁸

Capitalized overhead typically represents the cost of non-exempt (salaried) employees who spend time working on capital projects.¹³⁹ Non-exempt employees include employees in engineering, operations, accounting, customer care, legal, and regulatory.¹⁴⁰ The NARUC accounting instructions addressing overhead construction costs for utility plant state:

All overhead construction costs, such as engineering, supervision, general office salaries and expenses, construction engineering and supervision by others than the accounting utility, legal expenses, insurance, injuries and damages, relief and pensions, taxes and allowance for funds used during construction, shall be charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto, so that each job or unit shall bear its equitable proportion of such costs.¹⁴¹

Historically, TWU calculated capitalized overhead using percentages based on industry experience.¹⁴² TWU witness Alhaj Chaudhry presented an example of this calculation that used

¹³³ TWU Ex. 17B (Chaudhry Supp. Recb.) at 12 (Bates 013).

¹³⁴ *Id.* at 14 (Bates 015).

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ *Id.* at 15 (Bates 016).

¹³⁹ *Id.* at 16 (Bates 017).

¹⁴⁰ *Id.*

¹⁴¹ *Id.* at 16 and fn. 9 (Bates 017).

¹⁴² *Id.* at 17 (Bates 018).

6.77%.¹⁴³ The actual percentage varied depending on the amount of capitalized project costs for the month as well as the method used to determine the proper amount to be capitalized.¹⁴⁴ The method used was consistently based on TWU's best efforts to assign capitalized amounts properly and based on industry experience.¹⁴⁵ Therefore, it is not unreasonable that the resulting percentages changed as TWU sought to continually improve the precision of the allocation of overhead.¹⁴⁶

Despite these ongoing best efforts, TWU determined that it had been understating the amount of time non-exempt personnel were spending on capital projects.¹⁴⁷ As a result, TWU updated its overhead methodology in October 2023.¹⁴⁸ Since that time, TWU has used the documented salaries (inclusive of a loading percentage for benefits and taxes) for non-exempt employees and performed a review across all business units to determine the percentage of time spent on capital projects.¹⁴⁹ The amount of overhead to be capitalized is then determined based compensation and time spent and allocated across capitalized costs for each month.¹⁵⁰ Below is an example of the current methodology:

Person	Annual Salary	Percent of Time Spent on Capex	Overhead to Apply to Projects for the Year
Jane	\$59,500	80%	\$47,600
Doe	\$45,000	50%	\$22,500
John	\$49,900	100%	\$49,900
		Total	\$120,000
		Divided by months	12
		Amount to Allocate (per month)	\$10,000

	Jan-25
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¹⁴³ *Id.*

¹⁴⁴ TWU Ex. 31 (Chaudhry Second Supp. Reb.) at 12–13 (Bates 013-014).

¹⁴⁵ *Id.*

¹⁴⁶ *Id.* at 13 (Bates 014).

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

¹⁴⁹ *Id.* at 18 (Bates 019).

¹⁵⁰ *Id.*

Project	Project Cost	Percent Allocation	Capitalized Overhead Applied
P-000200	\$10,000	20%	\$2,000
P-000201	-	0%	-
P-000202	\$40,000	80%	\$8,000
Total	\$50,000		\$10,000

TWU records AFUDC to engineering projects, which typically take multiple months to construct, and generally does not record AFUDC to operational projects, which are typically placed into service after only a short time.¹⁵¹ The NARUC accounting instruction addressing AFUDC states: “Allowance for funds used during construction, includes the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used.”¹⁵² TWU currently uses the weighted cost of capital percentages approved in Docket No. 50944 (2.78% for debt and 4.95% for equity) to calculate monthly AFUDC accrued on engineering projects not yet in service.¹⁵³ Historically, due to previous settlements, TWU capitalized interest at its actual cost of interest.¹⁵⁴

Projects that accrue AFUDC are flagged in SAP, and SAP calculates and records AFUDC on a monthly basis.¹⁵⁵ When a project is placed into service, TWU’s Engineering Department notifies the Accounting Department and the flag is removed from SAP.¹⁵⁶ Once the flag is removed, SAP automatically stops calculating and recording AFUDC.¹⁵⁷ Mr. Chaudhry provided an example of how the monthly AFUDC calculation works.¹⁵⁸

No party asserts that capitalized labor, overhead, and interest are not necessary costs of providing service, and no party asserts that the methodologies used by TWU result in an unreasonable amount of capitalized labor, overhead, or interest. In other words, there has been no challenge to whether these costs were prudently incurred. Instead, OPUC contends that TWU did not provide information sufficient to allow OPUC to confirm the calculation of the

¹⁵¹ *Id.* at 19 (Bates 020).

¹⁵² *Id.* at 18–19 (Bates 019–20).

¹⁵³ *Id.* at 19 (Bates 020).

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

labor, overhead, and interest capitalized for each specific asset OPUC reviewed.¹⁵⁹ If OPUC's arguments are accepted, it will create an unnecessarily and unreasonably high burden a utility must satisfy to establish a prima facie case that capitalized intangibles like AFUDC are reasonable and necessary.

OPUC's view of the level of information a utility must produce to establish a prima facie case would increase the cost for the utility to prepare and present an application to change rates. Accordingly, the amount of information required must be weighed against the benefit as well as the other alternatives such as reviewing the utility's capitalization methodologies. In a case like this where the utility's policies addressing capitalized labor, overhead, or interest are not challenged on the grounds of prudence, reasonableness, or necessity, then there is no rational reason to require the production of information needed to confirm each and every capitalized amount included in original cost. Accordingly, TWU has shown that its capitalized labor, overhead, and interest are appropriately included in original cost, and no evidence has been presented by any party to rebut the prudence, reasonableness, or necessity.

b. The amounts for supplies pulled from inventory that TWU included in original cost of assets are reasonable and necessary

The methodology TWU uses to calculate the cost of an item pulled from inventory and capitalized results in a reasonable cost for the item. In order to obtain optimal pricing and purchasing efficiency, TWU purchases its supply inventory in multiple quantities.¹⁶⁰ This supply inventory is booked to NARUC account 151, which is described as follows: "This account shall include the cost of fuel on hand and materials purchased for use in the utility business for construction and maintenance purposes."¹⁶¹ Because supplies kept on hand as inventory are purchased at varying times and at varying prices, TWU uses the "moving average" method to calculate the average cost for each category of supplies.¹⁶² As the name suggests, the moving average method updates the average cost of the inventory on hand after each stock movement.¹⁶³ This ensures that at the time an item is pulled from inventory and

¹⁵⁹ OPUC Ex. 90 (Heddin Second Supp. Dir.) at 16–17.

¹⁶⁰ TWU Ex. 17B (Chaudhry Supp. Reb.) at 12 (Bates 013).

¹⁶¹ *Id.* at 12–13 (Bates 013–14).

¹⁶² *Id.* at 13 (Bates 014).

¹⁶³ *Id.*

added to the original cost of an asset, the cost of that item reflects an average of the actual, historical prices at which the item was purchased.¹⁶⁴ Supplies pulled from inventory are reflected on TWU's books as "Supplies—Field" or with a document type labeled "WA."¹⁶⁵

No party challenged TWU's use of the moving average method or identified any of the supplies booked to NARUC account 151 as unnecessary for the provision of utility service. The only complaint was that TWU did not provide the information needed to verify its calculation of the moving average.¹⁶⁶ Demanding that TWU to provide the invoices underlying the average cost for each type of supply maintained as inventory such that opposing parties may recreate the calculation of the average cost of an item at the time it is pulled from inventory is once again an extreme exaggeration of the showing a utility must make to establish a prima facie case regarding capitalized inventory. If the methodology used to calculate the average is reasonable, and the item is necessary for the provision of service, then the record is sufficient to support a finding that the portion of original cost attributable to an item pulled from inventory is reasonable and necessary.

c. It was proper for TWU to capitalize leak repairs

Leak repairs are part of larger capital projects, and therefore, should be capitalized.¹⁶⁷ TWU approaches leak repairs as a two-step process.¹⁶⁸ Initially, the leak is isolated using main line valves and then excavated.¹⁶⁹ Depending on the type of line failure, if possible, a clamp is installed to allow immediate restoration of service to customers.¹⁷⁰ Then, a TWU repair crew is scheduled to install a new section of water main.¹⁷¹ TWU's practice is to avoid leaving repair clamps in place long-term because a main that has failed to the point of resulting in a leak tends to fail again in other areas and repair clamps are less reliable than a properly installed section of pipe.¹⁷²

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ OPUC Ex. 90 (Heddin Second Supp. Dir.) at 18.

¹⁶⁷ TWU Ex. 18 (Sabolsice Reb.) at 3 (Bates 04).

¹⁶⁸ *Id.*

¹⁶⁹ *Id.*

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.* at 4 (Bates 05).

Capitalizing the entire project represents a prudent approach to managing TWU's buried infrastructure.¹⁷³ The service life assigned to these assets is reasonable because it is consistent with TWU's depreciation study.¹⁷⁴ Overall, leak repairs are a reasonable and necessary cost of providing service and constitute projects that are appropriately capitalized.

1) Res judicata bars a Commission decision that adjusts the original cost of the Hornsby Bend Assets that were included in the application filed in Texas Commission on Environmental Quality (TCEQ) Docket No. 2014-0539-UCR

TWU has provided evidence identifying all assets included in the application filed in Hornsby Bend's last comprehensive rate case.¹⁷⁵ That case was resolved via a unanimous settlement among the parties, which included OPUC.¹⁷⁶ A final order approving the settled rates was filed on August 7, 2014, and approved Hornsby Bend's requested rates.¹⁷⁷ The order found that the rate structure for Hornsby Bend was "just, reasonable, and adequate to allow the utility to recover its cost of providing service, as required by sections 13.182 and 13.183 of the Code."¹⁷⁸ Under TWC § 13.183(a), the Commission must "fix overall revenues at a level that will[] permit the utility a reasonable opportunity to earn a reasonable return on its invested capital used and useful in rendering service to the public over and above its reasonable and necessary operating expenses[.]" Because a final order was rendered, the Commission should not re-review the assets installed prior to the end of the December 31, 2012 test year¹⁷⁹ used in that proceeding.

The doctrine of res judicata states that when a matter is judicially determined, the retrial of claims pertaining to the same cause is barred.¹⁸⁰ The Texas Supreme Court has held that "whenever possible the courts should support the finality of administrative orders in keeping with the public policy favoring an end to litigation, whether it be in the administrative or judicial

¹⁷³ *Id.*

¹⁷⁴ *Id.*

¹⁷⁵ TWU Ex. 17B (Chaudhry Supp. Reb.) at Attachment AC-SR-5 (Bates 283-306).

¹⁷⁶ TWU Ex. 15A (Freitag Supp. Reb.), Attachment GF-SR-1 at 7 (Bates 13).

¹⁷⁷ *Id.* at 6–8 (Bates 12–14).

¹⁷⁸ *Id.* at 8 (Bates 14).

¹⁷⁹ *Id.* at 3 (Bates 04).

¹⁸⁰ *Coal. of Cities for Affordable Util. Rates v. Public. Util. Comm'n of Tex.*, 798 S.W.2d 560, 563 (Tex. 1990).

process. Continued litigation of issues or piecemeal litigation should be discouraged.”¹⁸¹ Specific to ratemaking, the Texas Supreme Court has evaluated the application of res judicata by asking whether the issue to be revisited is an issue that can change over time (e.g., rate of return or operating expenses).¹⁸² Further, an order must be considered final unless the PUC is granted statutory authority to defer and reconsider an issue.¹⁸³ The Court noted that the Public Utility Regulatory Act¹⁸⁴ expressly grants the Commission the authority to revoke or amend a certificate of convenience and necessity but that no such authority is granted for ratemaking.¹⁸⁵

The original cost of an asset, once all trailing costs are recorded, is a historical amount that does not change over time. Similar to PURA, Chapter 13 of the TWC grants the Commission the authority to amend or revoke a CCN,¹⁸⁶ but includes no similar grant of authority to revisit a ratemaking decision. Moreover, a decision to revisit assets that were submitted for review in a prior general rate case filed with and decided by the TCEQ will have implications for any utility that has not filed a rate case since jurisdiction over rates was transferred from TCEQ to the Commission or for a utility that acquires a utility that has not filed a general rate case since jurisdiction over rates was transferred from TCEQ.¹⁸⁷ Permitting a second review of assets also has the potential to expand the number of contested issues in a proceeding, which in turn drives up rate case expenses.¹⁸⁸ The foregoing legal and policy considerations supporting the application of res judicata to a ratemaking determination have been satisfied in this proceeding. Accordingly, any assets included in Hornsby Bend’s most recent rate case (i.e., installed before January 1, 2013) should not be reexamined here.

iii. Accumulated Depreciation [PO Issue 35]

No party challenged the useful lives presented in the depreciation study conducted by Dane Watson and used to calculate accumulated depreciation. OPUC’s recommendation to

¹⁸¹ *Westheimer Indep. Sch. Dist. v. Brockette*, 567 S.W.2d 780, 787 (Tex. 1978).

¹⁸² *Cities for Affordable Util. Rates*, 798 S.W.2d at 563.

¹⁸³ *Id.* at 564.

¹⁸⁴ Public Utility Regulatory Act, Tex. Util. Code Ann. §§ 11.001–66.016 (PURA).

¹⁸⁵ *Cities for Affordable Util. Rates*, 798 S.W.2d at 564.

¹⁸⁶ TWC §§ 13.241(a) and 13.254.

¹⁸⁷ TWU Ex. 15A (Freitag Supp. Rec.) at 4 (Bates 05).

¹⁸⁸ *Id.*

reclassify certain assets to a different NARUC account would have flow through effects on accumulated depreciation. The recommendation to reclassify is addressed in Section II.B.2 – Depreciation Expense and should be rejected. The only other adjustment to accumulated depreciation was recommended by OPUC and is addressed below.

TWU is following the NARUC instructions addressing retirement units and removal of assets. These instructions state: “If the retirement unit is of a depreciable class, the book cost of the unit retired and credited to utility plant shall be charged to the accumulated depreciation applicable to such property.”¹⁸⁹ As shown in the example below, charging the cost basis of a retired asset to accumulated depreciation does not result in a change to rate base because rate base will still include accumulated depreciation.¹⁹⁰ Stated another way, it does not matter if rate base includes gross plant of \$1,500 for an asset or accumulated depreciation of positive \$1,500 because it is still considered rate base that continues to depreciate per the remaining useful life.¹⁹¹

	Book Cost	Accumulated Depreciation	Book Value
Asset Prior to Retirement	5,000	(3,500)	1,500
Adjustment to Retire (as per NARUC)	(5,000)	5,000	-
Asset Post Retirement	-	1,500	1,500

TWU is permitted to recover a return of and on its capital investment, and the concept illustrated above ensures that will happen when an asset is retired before it has fully depreciated.¹⁹² Below is an application of the same concept that was prepared by Mr. Chaudhry and applied to the adjustments recommended in Columns G, H, Y, and Z of Attachment NH-9.¹⁹³ Per these calculations, the net effect on rate base is zero.

¹⁸⁹ TWU Ex. 17 (Chaudhry Recb.) at 6 and 8–9 (Bates 07 and 08–10).

¹⁹⁰ *Id.* at 6–7 (Bates 07–08).

¹⁹¹ *Id.* at 7 (Bates 08).

¹⁹² *Id.*

¹⁹³ *Id.*

<i>As presented in Attachment NH-9</i>	Retirements		Adjustment for Items That Were Replaced (13)	
	TWU Legacy (4)	HB	TWU Legacy	HB
Original Cost	\$ 221,971	\$ -	\$ 25,656,427	\$ 6,840,281
Accumulated Depreciation	(6,906)	-	(18,940,789)	(5,113,501)
Theoretical Depreciation Reserve Surplus	-	-	-	-
Net Plant in Service	\$ 215,065	\$ -	\$ 6,715,638	\$ 1,726,780
Other Rate Base Items	-	-	-	-
Total Rate Base	\$ 215,065	\$ -	\$ 6,715,638	\$ 1,726,780
Annual Depreciation Expense	\$ 4,439	\$ -	\$ 1,626,160	\$ 266,008

<i>If Retirement Transactions Occurred as proposed by NH-9</i>	Retirements		Adjustment for Items That Were Replaced (13)	
	TWU Legacy (4)	HB	TWU Legacy	HB
Original Cost	\$ -	\$ -	\$ -	\$ -
Accumulated Depreciation	215,065	-	6,715,638	1,726,780
Theoretical Depreciation Reserve Surplus	-	-	-	-
Net Plant in Service	\$ 215,065	\$ -	\$ 6,715,638	\$ 1,726,780
Other Rate Base Items	-	-	-	-
Total Rate Base	\$ 215,065	\$ -	\$ 6,715,638	\$ 1,726,780
Annual Depreciation Expense	\$ 4,439	\$ -	\$ 1,626,160	\$ 266,008

OPUC's witness, Ms. Heddin, devoted several pages of testimony to a discussion of which assets she had identified as either minor items of property or replacement units.¹⁹⁴ She also opines as to whether she believes TWU has made credit adjustments for items retired from service.¹⁹⁵ Finally, she identified projects for the removal of assets such as well houses.¹⁹⁶ Not only does this testimony include unsupported assumptions,¹⁹⁷ it is moot given the explanation provided above because the credits to rate base she claims are missing result in an overall net zero impact to rate base.¹⁹⁸ Because there is no effect on rate base, and therefore, no corresponding effect on rates, OPUC's recommendation amounts to little more than an exercise

¹⁹⁴ OPUC Ex. 1 (Heddin Dir.) at 48–52 and 56–58.

¹⁹⁵ *Id.* at 58–60.

¹⁹⁶ *Id.* at 31–34.

¹⁹⁷ *Id.* at 52.

¹⁹⁸ TWU Ex. 17 (Chaudhry Reb.) at 8–9 (Bates 09–10).

to update accounting entries.¹⁹⁹ For these reasons, OPUC's recommendation should be rejected as unnecessary.

iv. Construction [PO Issues 36, 37]

TWU requests a total of \$4,435,974 (\$3,784,798 for water and \$651,176 for sewer) to be included in rate base as its Construction Work in Progress Balance (CWIP) balance as of December 31, 2023.²⁰⁰ This balance includes major projects that were placed in service before March 31, 2024, and are used and useful in providing service to customers.²⁰¹ Commission Staff witness Mr. Roshan Pokhrel recommends that the entire requested amount for CWIP be disallowed, stating that it does not meet the requirements of 16 TAC § 24.41(c)(4).²⁰² Particularly, Mr. Pokhrel states that only projects that are under construction should be allowed as CWIP and that projects that are currently in service and completed do not satisfy these criteria.²⁰³ Mr. Pokhrel testifies that the projects TWU has classified as CWIP should be classified as Post-Test Year Adjustments (PTYA).²⁰⁴ However, Mr. Pokhrel also states that these TWU projects would not qualify as PTYA because they do not meet the 10% threshold requirement in 16 TAC § 24.41(c)(5).²⁰⁵ Mr. Pokhrel also states that these assets can be recovered through TWU's SIC application under 16 TAC § 24.76.²⁰⁶

TWU disagrees with Commission Staff's recommendation to disallow the assets recorded as CWIP. First, as noted by TWU, these assets were placed in service shortly after the end of the test year by March 31, 2024.²⁰⁷ Second, TWU's requested rate base in this proceeding is \$251 million.²⁰⁸ Therefore, for any asset to qualify for recovery as a PTYA based on TWU's total rate base and Commission Staff's interpretation of 16 TAC § 24.41(c)(5), TWU

¹⁹⁹ *Id.* at 8 (Bates 09).

²⁰⁰ TWU Ex. 1A (Application) at Schedule II-B (W), (WW) (Bates 098–099); TWU Ex. 3 (Bahr Dir.) at 8 (Bates 09).

²⁰¹ TWU Ex. 3 (Bahr Dir.) at 10 (Bates 11).

²⁰² Staff Ex. 2 (Pokhrel Dir.) at 5 (Bates 000005).

²⁰³ *Id.* at 5–6 (Bates 000005–06).

²⁰⁴ *Id.* at 6 (Bates 000006).

²⁰⁵ *Id.*

²⁰⁶ *Id.* at 7–8 (Bates 000007–08).

²⁰⁷ TWU Ex. 14 (Bahr Reb.) at 4 (Bates 05).

²⁰⁸ *Id.*

would need to meet a threshold requirement of \$25.1 million even though the average rate base per TWU system is less than \$1.5 million and the 10% threshold for PTYA recovery based on TWU system would only be \$150,000.²⁰⁹ Third, a SIC proceeding is not a reasonable mechanism for timely recovery of this CWIP amount as the earliest a TWU SIC application could be approved would be February 28, 2026, approximately two years after the assets were placed in service.²¹⁰ Per this timing, TWU would be burdened with exceptional and unnecessary regulatory lag before beginning to recover its investment in these assets if recovery of the requested CWIP is denied, and Commission Staff witness Pokhrel admitted at hearing that the purpose of the CWIP rule is to prevent a utility's financial integrity from being harmed due to regulatory lag provided the utility proves exceptional circumstances.²¹¹

Chapter 16 of the Texas Administrative Code § 24.41(c)(4) states that “[u]nder exceptional circumstances, the commission may include CWIP in rate base to the extent that the utility has proven that: (A) the inclusion is necessary to the financial integrity of the utility; and (B) major projects under construction have been efficiently and prudently planned and managed.” While these projects were placed in service by the first quarter of 2025, TWU has shown exceptional circumstances due to not being able to recover as a PTYA and the tremendous regulatory lag it would experience as a result of delaying recovery until a SIC filing and has therefore met the purpose of the rule for CWIP recovery. Overall, TWU is entitled to recovery of its investments, including the CWIP assets placed in service in the first quarter of 2025 is a reasonable balance for recovery that preserves the financial integrity.²¹²

v. Capital Allowance [PO Issue 38]

TWU requests the reasonable and necessary cash working capital allowance of \$2,196,034 under 16 TAC § 24.41(c)(4).²¹³ No party challenged this amount.

²⁰⁹ *Id.*

²¹⁰ *Id.*

²¹¹ Tr. at 100:4–19 (Pokhrel Cross) (Jan. 27, 2025).

²¹² TWU Ex. 14 (Bahr Reb.) at 5 (Bates 06).

²¹³ TWU Ex. 1A (Application, Schedules, WPs) at Schedule II-B-7.a-g Working Capital (Bates 127).

vi. Developer and Customer Contributions [PO Issues 39–41] [UNCONTESTED]

TWU includes (\$22,329,161) in its rate base for contributions in aid of construction.²¹⁴ TWU additionally includes in its rate base (\$3,959,943) for customer advances for construction and (\$3,407,226) for customer deposits.

vii. ADFIT [PO Issue 42] [UNCONTESTED]

TWU includes the reasonable and necessary amount of (\$2,530,402) in Accumulated Deferred Federal Income Tax (ADFIT), which includes excess ADFIT as part of its rate base.²¹⁵

III. RATE DESIGN & RATES [PO Issues 44–49]

A. Rate Design & Allocation [PO Issues 44–47]

Consistent with the two previous rate cases TWU has filed with the Commission, Docket Nos. 45570 and 50944, TWU is proposing bringing acquired customers onto TWU's water and wastewater rate schedules so that a single water rate schedule will be applicable to all water customers and a single sewer rate scheduled that will be applicable to all sewer customers.²¹⁶ Historically, TWU has classified its retail customers solely by meter size using the American Water Works Association (AWWA) meter equivalency factors, and TWU's proposed rate design continues this practice.²¹⁷ The National Association of Regulatory Commissioners has recognized the benefits of a uniform, systemwide rate schedule, including: incentivized investment in water supply infrastructure; decreased administrative costs to the Commission due to a decreased number of regulatory filings; decreased administrative costs to the utility; and incentivized regionalization and consolidation of utilities.²¹⁸ No party to this proceeding challenged TWU's request for uniform water and sewer rate schedules; therefore, the record supports TWU's request being approved.

The direct testimony of TWU witness Brian Bahr provides a step-by-step explanation of how TWU's proposed rates were developed,²¹⁹ and the methodology he describes was used

²¹⁴ *Id.* at Schedule II-B-10 Other Rate Base Items (Bates 134).

²¹⁵ TWU Ex. 9 (Shupak Dir.) at 7 (Bates 08).

²¹⁶ TWU Ex. 3 (Bahr Dir.) at 20 (Bates 21).

²¹⁷ *Id.* at 19 (Bates 20).

²¹⁸ *Id.* at 20 (Bates 21).

²¹⁹ *Id.* at 24–26 (Bates 25–27).

in TWU's last two rate cases.²²⁰ Rather than reiterate the entire methodology, TWU will focus on the contested elements, namely, the allocation of federal income tax expense between water and sewer, the appropriate treatment of revenues from wholesale contract customers, the fixed-variable split of TWU's proposed sewer rate design, and TWU's billing determinants.

1. Allocation of Federal Income Tax Expense

TWU's use of meter equivalents to allocate federal income tax expense between water and sewer is appropriate because it ensures that income tax expense is assigned to customers in proportion with their actual use of services.²²¹ Meter equivalents are a proxy for customer demand and usage; therefore, they are directly tied to the number of customers served, their consumption patterns, and the corresponding infrastructure demands.²²² An allocation using meter equivalents is a more holistic allocation than using rate base alone, which is the method recommended by OPUC's witness Ms. Heddin.²²³ This approach should be rejected in favor of TWU's allocation of federal income tax expense based on meter equivalents since TWU's approach directly ties to customer's use of TWU's services.²²⁴ Furthermore, no party, including OPUC, provided reasoning for why TWU's approach was not reasonable and without a showing of unreasonableness, OPUC's alternate suggestion for allocation should be ignored as a showing of unreasonableness should be required for a party to make an alternate proposal for calculation. Consequently, TWU's proposal to allocate federal income tax using meter equivalents provides a fair and equitable representation of actual cost responsibility between water and sewer customers and should be approved.²²⁵

2. Wholesale Contract Revenues

Treating wholesale contract revenues as "other revenues" that are deducted from the revenue requirement used to set TWU's rates is a longstanding and appropriate ratemaking treatment because the Commission does not have jurisdiction over wholesale rates.²²⁶ Treating

²²⁰ *Id.* at 26 (Bates 27).

²²¹ TWU Ex. 17 (Chaudhry Reb.) at 9 (Bates 10).

²²² *Id.* at 9 (Bates 10).

²²³ *Id.* at 9 (Bates 10); OPUC Ex. 1 (Heddin Dir.) at 65.

²²⁴ TWU Ex. 17 (Chaudhry Reb.) at 9 (Bates 10).

²²⁵ *Id.* at 9 (Bates 10).

²²⁶ *See* TWC §§ 13.041–.043.

wholesale revenues as an offset, ensures that the revenue requirement recovered from retail customers reflects the fact that TWU serves a class of customers that is not under the Commission's rate-setting jurisdiction. The arguments against this approach fail because they rely on the tenuous and unsupported assertion that treating wholesale revenues as an offset is not an acceptable ratemaking treatment because it *might* result in retail customers subsidizing wholesale customers *if* TWU's wholesale rates do not recover the full cost of serving those customers.²²⁷

As an initial point of clarification, the wholesale revenues that TWU deducted from the revenue requirement include revenues generated by all wholesale charges—base and gallonage—and are not gallonage revenues only as stated by Commission Staff witness Adrian Narvaez.²²⁸ Mr. Narvaez cites to Schedule II-G for this conclusion;²²⁹ therefore, it appears that he is reading the “Gallonage Charge Revenues” heading on line 12 of Schedule II-G to apply to lines 20 through 23, which is not correct. The “Gallonage Charge Revenues” heading applies to lines 18 and 19 only.²³⁰

As demonstrated by Mr. Narvaez's testimony, Commission Staff is seeking to determine if the rates charged to TWU's customers are “based on cost.”²³¹ Stated simply, Commission Staff is seeking to review the rate charged to wholesale customers using the same type of cost-of-service ratemaking approach applicable to retail rates. OPUC advocates for a similar approach.²³² This case is not a proceeding that involves multiple customer classes over which the Commission has jurisdiction such that a cost of service study is necessary to distribute recovery of the revenue requirement among the different customer classes.²³³ Nor is it a case where the Commission has jurisdiction over both wholesale and retail rates such that cost

²²⁷ OPUC Ex. 1 (Heddin Dir.) at 84; Staff Ex. 7 (Narvaez Dir.) at 9 (Bates 000009).

²²⁸ Staff Ex. 7 (Narvaez Dir.) at 7–8 (Bates 000007–08).

²²⁹ *Id.* at fn. 8 (Bates 000007).

²³⁰ TWU Ex. 1A (Application, Schedules, WPs) at Schedule II-G (Bates 401).

²³¹ Staff Ex. 7 (Narvaez Dir.) at 8 (Bates 000008).

²³² OPUC Ex. 1 (Heddin Dir.) at 86.

²³³ *See, e.g.*, Docket No. 53601, Order on Rehearing at Finding of Fact Nos. 299 through 311 (Jun. 30, 2023) (addressing “Revenue Distribution”).

allocation is reviewed.²³⁴ However, the approach supported by Commission Staff and OPUC would require the Commission to determine the appropriate method for allocating wholesale costs as well as what TWU's wholesale revenue requirement and rates should be even though TWU was not required to seek Commission approval for those rates. This type of de facto jurisdiction is contrary to the well-established principle that a state agency such as the Commission, as a creature of the legislature, may only exercise those specific powers conferred by law and may not exercise what amounts to a new and additional power *or a power that contradicts statute* even if the power is viewed as being expedient for administrative purposes.²³⁵

Separate from the foregoing jurisdictional issue, neither OPUC nor Commission Staff has presented evidence sufficient to support deviating from TWU's proposed treatment of wholesale revenues. TWU has proposed a ratemaking treatment that lowers the revenue requirement used to set retail rates by taking into account all "other revenues," including wholesale revenues.²³⁶ No party has challenged the general approach whereby other revenues are deducted from the revenue requirement used to set rates, and wholesale revenues were included as other revenues in TWU's last two rate cases before the Commission.²³⁷ Because TWU has made a prima facie showing, it is incumbent on the parties challenging its methodology to present evidence to the contrary. However, the record contains no evidence of past Commission decisions where the Commission established a wholesale cost of service or approved allocation factors for wholesale service to set retail rates. It also does not contain evidence, such as an analysis of the rates charged per TWU's wholesale contracts, demonstrating why or how TWU's rates are under-recovering the cost of serving TWU's wholesale customers.

Further, Commission Staff's proposed alternative is currently not possible. Commission Staff recommends adjusting the test year billing determinants to include the gallons sold to wholesale customer and the meter equivalents for the retail customer served by

²³⁴ PURA §§ 32.001(a)(1), 33.002(b), and 35.004(d); *see also* Docket No. 53601, Order on Rehearing at Finding of Fact No. 5 ("On May 13, 2022, Oncor filed an application and statement of intent to change its retail transmission and distribution rates *and wholesale transmission rates.*") (emphasis added).

²³⁵ *Pub. Util. Comm'n of Tex. v. GTE-Sw.*, 901 S.W.2d 401, 406–07 (Tex. 1995) (emphasis added).

²³⁶ TWU Ex. 14 (Bahr Rec.) at 10 (Bates 11).

²³⁷ *Id.* at 9 (Bates 10).

each wholesale customer.²³⁸ TWU uses master meters to provide wholesale service, and therefore, may not have access to the number of retail connections behind the master meter.²³⁹ If a wholesale customer does not serve retail customers or some or all of the water purchased under the wholesale contract is used for a non-retail purpose (e.g. sold to another retail water provider), then there are no meter equivalents other than those based on the size of the master meter.²⁴⁰ Rather than using the meter equivalents corresponding to each master meter, Commission Staff elected to estimate the meter equivalents for each wholesale customer.²⁴¹ Once again, Commission Staff does not cite to any precedent supporting the use of estimated meter equivalents, and the preliminary order in this proceeding specifically refers to using the “current number of connection” as of either the date of the application or the end of the test year to design rates.²⁴²

OPUC’s proposal relies on the unsupported assumption that a wholesale allocation based solely on wholesale usage as a percentage of gallons sold during the test year is a reliable indicator of the cost of serving TWU’s wholesale customers.²⁴³ OPUC’s approach significantly increases the total amount deducted from the revenue requirement used to set retail rates from \$65,619 to \$2,403,252,²⁴⁴ yet OPUC did not present any analysis to demonstrate why this is an accurate approximation of wholesale costs nor did it provide any sort of explanation as to why it is reasonable to assume that TWU’s wholesale rates under-recover its wholesale cost of service by a factor of almost 37.²⁴⁵ In fact, OPUC’s sole argument for why this approach is reasonable rests on the conclusion that TWU has not met its burden of proof.²⁴⁶

As explained previously, TWU has made a *prima facie* case regarding treatment of wholesale rates. The fact that OPUC and Commission Staff do not agree with TWU’s proposal does not mean TWU has not met its burden of proof. Nor is it sufficient to rebut TWU’s *prima*

²³⁸ Staff Ex. 7 (Narvaez Dir.) at 9–10 (Bates 000008–10).

²³⁹ TWU Ex. 14 (Bahr Rcb.) at 9 (Bates 10).

²⁴⁰ *Id.* at 10 (Bates 11).

²⁴¹ Staff Ex. 7 (Narvaez Dir.) at 10 (Bates 000010).

²⁴² Preliminary Order at 8 (Sept. 12, 2024).

²⁴³ OPUC Ex. 1 (Heddin Dir.) at 86–87.

²⁴⁴ *Id.* at 87.

²⁴⁵ $2,403,252 / 65,619 = 36.6$.

²⁴⁶ OPUC Ex. 1 (Heddin Dir.) at 87.

facie case. To accept OPUC's or Commission Staff's alternative treatment of wholesale contract revenues would establish a precedent whereby the applicant fails to meet its burden simply because another party disagrees with the ratemaking treatment chosen and proposes an unsupported alternative. Such an outcome must be avoided. Thus, TWU's deduction of wholesale contract revenues from the revenue requirement used to set rates should be approved.

3. Sewer Rates, Fixed-Variable Split

TWU's proposal to recover 89.92% of its sewer revenue requirement through the monthly minimum charge is reasonable.²⁴⁷ There is no statute or Commission rule that expressly addresses the fixed-to-variable component of a rate design, and no party has used any data specific to TWU's fixed and variable costs to challenge TWU's sewer rates. In fact, OPUC witness Nelisa Heddin confirmed that her recommended 60/40 split was not based on any information or analysis demonstrating that this accurately reflects TWU's fixed and variable sewer costs.²⁴⁸ She also did not review any recent Commission precedent setting sewer rates.²⁴⁹ Instead, Ms. Heddin based her recommendation solely on her personal experience.²⁵⁰ However, in response to a request for information asking Ms. Heddin to identify the percentage of fixed costs relative to total costs in each sewer cost of service study she has performed for a client, Ms. Heddin responded that she had not performed any such analysis.²⁵¹

Ms. Heddin also failed to provide any information or analysis supporting her assertion that TWU's combined water and sewer minimum monthly charge of \$140 is "extraordinarily high."²⁵² It is not relevant this is what a customer will pay even if they do not use a single drop of water²⁵³ because that is the function of the minimum monthly charge—to recover costs that do not fluctuate with the amount of water consumed by customers.²⁵⁴ The Environmental Protection Agency (EPA) has established 4.5% of household income as the threshold for

²⁴⁷ TWU Ex. 1A (Application, Schedules, WPs) at Workpaper III.6 (Bates 728).

²⁴⁸ Tr. at 32:2–14 (Heddin Cross) (Jan. 27, 2025).

²⁴⁹ Tr. at 30:18–25 (Heddin Cross) (Jan. 27, 2025).

²⁵⁰ TWU Ex. 28 (OPUC Response to TWU-OPUC 1-11) at 2 (Bates 02).

²⁵¹ TWU Ex. 29 (OPUC Response to TWU-OPUC RFI No. 1-12a) at 2 (Bates 02).

²⁵² OPUC Ex. 1 (Heddin Dir.) at 95.

²⁵³ *Id.* at 95.

²⁵⁴ *See* Tr. at 35: 6–13 (Heddin Cross) (Jan. 27, 2025).

determining whether a combined water and sewer rate is affordable.²⁵⁵ During the 2023 test year, the median household income in Texas was \$76,292.²⁵⁶ Using the EPA's threshold, an affordable combined monthly water and sewer bill would be \$286.10.²⁵⁷ In contrast, TWU's combined monthly water and sewer bill for a customer using 5,000 gallons would be \$197.65.²⁵⁸

TWU has been collecting \$81.45 per month from the majority of its sewer customers under its existing sewer minimum monthly charge and sewer SIC of \$68.52 and \$12.93 per month, respectively.²⁵⁹ The sewer minimum monthly charge of \$82.92 proposed in this proceeding is in line with this amount, and adopting OPUC's recommendation would result in a decrease that substantially disrupts TWU's proposed rate design.²⁶⁰ Given that TWU is proposing the same fixed-variable split for sewer that has been used to calculate the rates approved in two previous cases before the Commission, the unsupported assertions presented in this case do not rise to a level sufficient to justify any changes. Therefore, TWU's proposed sewer rate design should be approved.

i. Billing Determinants

In designing its rates, TWU made adjustments to normalize billing determinants.²⁶¹ Billing determinants "refers to a utility's connection count by meter size and the gallonage used by customers, by usage tier[]" and are used to make sure the utility recovers its revenue requirement.²⁶² TWU's billing determinants are based on the number of active billed connections by meter size at the end of the test year as well as the normalized total gallons billed to all customers by usage tier during the test year.²⁶³ The adjustments made by TWU to normalize its billing determinants are the following: adjustments for the addition of customers,

²⁵⁵ TWU Ex. 14 (Bahr Rec.) at 20 (Bates 21).

²⁵⁶ *Id.*

²⁵⁷ *Id.* $((76,292 * .045) / 12 = 286.10)$.

²⁵⁸ *Id.* at 20 (Bates 21). This calculation excludes passthroughs, surcharges, surcredits, etc.

²⁵⁹ *Id.* at 19 (Bates 20).

²⁶⁰ *Id.*

²⁶¹ TWU Ex. 4 (Freitag Dir.) at 15 (Bates 16).

²⁶² *Id.*

²⁶³ *Id.*

normalization to convert the water gallons sold at “single tier” district to four gallonage tiers, normalization to reflect those systems added during the test year.²⁶⁴

OPUC, in the direct testimony of Ms. Heddin, argues that TWU should have adjusted its billing determinants to account for watering restrictions during the test year.²⁶⁵ As a result, Ms. Heddin proposes a recommendation for adjusting billing determinants due to drought conditions during the test year as shown in Attachment NH-43 to her direct testimony.²⁶⁶ Ms. Heddin’s recommendation assumes that there was a 10% reduction in consumption due to watering restrictions and then calculates an assumed consumption for the systems based on what she believes are normal circumstances.²⁶⁷ Ms. Heddin also assumed in making her recommendation that all usage was within the 0-2,000 gallon rate tier, which has the lowest rates and shows the total assumed water rates in her Attachment NH-50.²⁶⁸ Ms. Heddin states that TWU “should normalize consumption adjusting for reduced consumption which occurred during the test year due to watering restrictions[]”²⁶⁹ and that “[c]onsumption during extreme weather events such as drought conditions that resulted in watering restrictions should not be relied upon for the purpose of determining rates.”²⁷⁰

TWU does not agree with Ms. Heddin that the billing determinants should be adjusted based on the water use restrictions in place during the test year. First, as TWU witness Mr. George Freitag explains, the sole purpose of drought restrictions and TWU’s User Drought Contingency Plan is not to reduce demand such that the total volume of water used decreases, but rather to spread out demand for non-essential usage over non-peak periods.²⁷¹ As explained by Mr. Freitag, “[i]n many cases, TWU implements its water use restrictions over the summer months simply because of heavy customer demand due primarily to outdoor watering.”²⁷² Furthermore, most of the 53 water systems that were under watering restrictions during the test

²⁶⁴ *Id.* at 16 (Bates 17).

²⁶⁵ OPUC Ex. 1 (Heddin Dir.) at 92.

²⁶⁶ *Id.* at 94.

²⁶⁷ *Id.* at 95.

²⁶⁸ *Id.* at 95.

²⁶⁹ *Id.* at 93.

²⁷⁰ *Id.*

²⁷¹ TWU Ex. 15 (Freitag Recb.) at 4 (Bates 05).

²⁷² *Id.*

year are still under water restrictions today.²⁷³ The primary goal of drought restrictions is to preserve the ability of water systems to have adequate water to provide normal household usage.²⁷⁴ Additionally, over half of the systems' water usage restrictions were put on restrictions at the request of groundwater conservation districts as a proactive measure, not because the specific systems could not provide adequate service.²⁷⁵

There have been water use restrictions in place for over 14 years and it is unlikely that there will ever be a year there will be not some systems on drought restrictions.²⁷⁶ While Ms. Heddin's recommendation normalized sales volumes it did not recommend normalizing adjustments for operations expenses.²⁷⁷ Overall, Ms. Heddin's proposed normalization adjustment based solely on water use restrictions is not practical and should not be adopted.

B. Rates [PO Issues 48–49]

TWU is requesting the water rates shown below. These rates, together with TWU's miscellaneous and contract water revenues, recover TWU's requested water revenue requirement of \$55,730,016.²⁷⁸

Meter Size	Monthly Minimum Charge
5/8"	\$62.99
5/8"x3/4"	\$62.99
3/4"	\$94.49
1"	\$157.48
1.5"	\$314.95
2"	\$503.92
3"	\$944.85
4"	\$1,574.75
6"	\$3,149.50
8"	\$5,039.20
10"	\$7,243.85
12"	\$13,542.85

²⁷³ *Id.*

²⁷⁴ Tr. at 185:13–16 (Jan. 27, 2025).

²⁷⁵ TWU Ex. 15 (Freitag Reb.) at 4 (Bates 05).

²⁷⁶ *Id.* at 6 (Bates 07); Tr. at 184:12–13 (Freitag Redir.) (Jan. 27, 2025).

²⁷⁷ TWU Ex. 15 (Freitag Reb.) at 6 (Bates 07).

²⁷⁸ TWU Ex. 3 (Bahr Dir.) at 22–23 (Bates 23–24).

Gallons Used	Charge
0 – 2,000	\$7.27
2,001 – 10,000	\$8.95
10,001 – 20,000	\$10.15
20,001+	\$10.82

TWU is also requesting the sewer rates shown below. These rates, together with TWU's miscellaneous and contract sewer revenues, recover TWU's requested sewer revenue requirement of \$13,475,874.²⁷⁹

Meter Size	Charge
5/8"	\$82.92
5/8"x3/4"	\$82.92
3/4"	\$124.38
1"	\$207.30
1.5"	\$414.60
2"	\$663.36
3"	\$1,243.80
4"	\$2,073.00
6"	\$4,146.00
8"	\$6,633.60
10"	\$9,535.80
12"	\$17,827.80
Gallons Used	Charge
All Usage	\$2.07

TWU's requested rates are just and reasonable.²⁸⁰ They are not unreasonably preferential, prejudicial, or discriminatory and are sufficient, equitable, and consistent in application to each class of customers.²⁸¹

C. Tariffs [PO Issues 50-51] [UNCONTESTED]

TWU's proposed water and wastewater tariffs are included in its application.²⁸² TWU's

²⁷⁹ *Id.* at 23–24 (Bates 24–25).

²⁸⁰ TWC § 13.182(a).

²⁸¹ TWC § 13.182(b).

²⁸² TWU Ex. 1F (First Errata to Application) at Bates 76–110; TWU Ex. 1F (First Errata to Application) at Bates 151–175.

proposed tariffs include a few revisions including that TWU is proposing to align the miscellaneous fees approved in Docket No. 50944 to apply to all customers.²⁸³ Examples of these miscellaneous fees include seasonal reconnect fees, meter relocation fees, monthly supplemental service rate, damage or diversion fees, etc.²⁸⁴ These are in Section 1.02 of TWU's proposed tariffs.²⁸⁵ TWU also proposes to add the following miscellaneous fees: customer service inspection fee (\$100 water), connection inspection fee (\$100 wastewater), and an after-hours call-out fee (\$75 water and wastewater).²⁸⁶

TWU also proposes adding additional language to Section 1.01 of the wastewater tariff stating that all wastewater customers will be billed based on water meter size and monthly usage.²⁸⁷ If water usage is not available, TWU proposes billing these customers in the following manner:

- a) Residential: 5/8" meter minimum monthly charge and usage of 4,000 gallons per month.
- b) Small Commercial: 1" meter minimum monthly charge and usage of 4,000 gallons per month.
- c) Large Commercial: 2" meter minimum monthly charge and usage of 8,000 gallons per month.
- d) Industrial: 8" meter minimum monthly charge and usage of 20,000 gallons per month.²⁸⁸

TWU also proposes language that allows wastewater only customers with a private water source to install a water supply meter at the customer's own expense and request that TWU bill based on that meter size and usage.²⁸⁹ Additional language allows TWU the discretion to install temporary or permanent flow meter on wastewater connections for which meter size and water usage is unavailable to determine the wastewater usage to be used for the purpose of determining a customer's monthly usage and equivalent meter size for billing.²⁹⁰

²⁸³ TWU Ex. 4 (Freitag Dir.) at 12 (Bates 13).

²⁸⁴ *Id.* at 12, fn. 8 (Bates 13).

²⁸⁵ *Id.* at 12 (Bates 13).

²⁸⁶ *Id.* at 13 (Bates 14).

²⁸⁷ *Id.*

²⁸⁸ *Id.*

²⁸⁹ *Id.*

²⁹⁰ *Id.*

TWU also proposes new language to Section 2.0 of the water tariff that “[n]o direct connection between a public water supply system and any potential source of contamination or between a public water supply system and a private water source will be allowed[.]”²⁹¹ Section 2.0 of the wastewater tariff grants TWU the discretion to require the applicant for wastewater service to provide a permanent recorded public utility easement on and across the applicant’s real property sufficient to provide service.²⁹² In Section 2.0 of both the water and wastewater tariffs add language to clarify that payments after 5:00pm on the due date are considered late.²⁹³

TWU’s tariffs also propose the following uniform tap fees for water and wastewater:

Water

- Tap Fee (Residential Meter Installation Only)\$490
- Tap Fee (Residential)\$1690²⁹⁴
- Tap Fee (Non-residential, Large, or Nonstandard Service) .. Actual cost + \$190

Wastewater

- Tap Fee (Residential Pre-Installed Service Line)\$100
- Tap Fee (Residential Gravity Sewer)\$2,800
- Tap Fee (Residential On-site Pressure Sewer).....\$3,700
- Tap Fee (Large Volume and Non-Standard Service) Actual cost + \$100²⁹⁵

TWU’s proposed tap fees and other tariff provisions and including additional language were not contested by any party to this proceeding.

D. Pass-Through Rates [PO Issues 57-60]

TWU proposed a single water passthrough rate of \$2.47 per 1,000 gallons to be charged to all water customers and a single sewer passthrough rate of \$0.38 per 1,000 gallons to be charged to all sewer customers.²⁹⁶ TWU agrees with Commission Staff witness Kathryn

²⁹¹ *Id.* at 14 (Bates 15).

²⁹² *Id.*

²⁹³ *Id.*

²⁹⁴ Tr. at 166:21–25 (Freitag Cross) (Jan. 27, 2025) (correcting error in direct testimony).

²⁹⁵ TWU Ex. 4 (Freitag Dir.) at 10 (Bates 11).

²⁹⁶ TWU Ex. 3 (Bahr Dir.) at 29 (Bates 30).

Eiland's testimony stating that, based on corrected test year gallonage sold, the water passthrough rate should be \$2.41 per 1,000 gallons.²⁹⁷ TWU's proposed passthrough rates recover costs such as fees imposed by groundwater conservation districts or purchased water, which are costs that are not recovered through base rates.²⁹⁸

As a result of the settlement in its most recent rate case, Docket No. 50944, and the acquisition of other utilities, TWU currently administers 23 different water passthrough rates and one sewer passthrough rate.²⁹⁹ TWU's request for a uniform water passthrough rate and a uniform sewer passthrough rate applicable to all customers will result in a less confusing, more user-friendly tariff; more efficient and less resource-intensive billing; and a reduced administrative burden due to the decreased number of passthrough applications (true-ups, etc.) that TWU must file.³⁰⁰ A single, uniform passthrough rate is also equitable for customers because passthrough costs are operational costs that are akin to other costs included in the revenue requirement and recovered from all customers through base rates.³⁰¹ For example, if TWU needed to obtain additional water for a specific system, it could do so by drilling a well or agreeing to purchase water from a third party supplier.³⁰² If TWU drilled a well, this cost would be included in rate base and recovered via base rates charged to all customers.³⁰³ Operationally, there is no material difference between drilling a well and purchasing water from a third party sufficient to justify recovering the former from all customers and the latter from only those customers who receive service using the water purchased.³⁰⁴ Therefore, TWU should be able to recover both the cost to drill a well and the cost to purchase water from a third party from all customers as part of single, uniform rate.³⁰⁵

TWU calculated its proposed passthrough rates using the existing passthrough formulas in TWU's water and sewer tariff that correspond to the passthrough rates that are currently

²⁹⁷ Staff Ex. 3 (Eiland Dir.) at 10–11 (Bates 000011–12); TWU Ex. 14 (Bahr Rebuttal) at 7 (Bates 08).

²⁹⁸ TWU Ex. 3 (Bahr Dir.) at 27, 30, and fn. 24 (Bates 28 and 31).

²⁹⁹ *Id.* at 27 (Bates 28).

³⁰⁰ *Id.* at 27–28 (Bates 28–29).

³⁰¹ *Id.* at 28 (Bates 29).

³⁰² *Id.*

³⁰³ *Id.*

³⁰⁴ *Id.*

³⁰⁵ *Id.*

applicable to the majority of TWU's water and sewer customers.³⁰⁶ These passthrough formulas were included in the tariffs approved in TWU's last comprehensive rate case, Docket No. 50944, and were used in TWU's most recent passthrough true-up proceeding, Tariff Control No. 56066.³⁰⁷ If TWU's proposed uniform passthrough rates are approved, TWU further proposes to file a reconciliation for each of its existing, individual passthroughs that identifies any over- or under-recovery of its passthrough costs. TWU will collect or refund the amounts identified over a 12-month period via system-specific surcharges or surcredits, as applicable.³⁰⁸ This will ensure that customers who are charged system-specific passthroughs are made whole for any difference between revenues collected from their respective passthrough and the passthrough costs incurred up through the date the new, uniform passthroughs take effect.³⁰⁹

TWU's requested water and sewer passthrough rates are just and reasonable.³¹⁰ They are not unreasonably preferential, prejudicial, or discriminatory and are sufficient, equitable, and consistent in application to each class of customers.³¹¹ No party challenged TWU's proposed uniform water and sewer passthrough rates; therefore, they should be approved.

IV. INTERIM RATES [PO Issues 52-53] [UNCONTESTED]

TWU did not request interim rates in this proceeding, nor were interim rates set by the Commission, and therefore, no refunds or surcharges should result from this proceeding regarding interim rates.

V. RATE CASE EXPENSES [PO Issues 54-56]

In the Application and as supplemented by TWU witness, William A. Faulk, III, TWU has incurred \$567,733.14 in reasonable and necessary rate case expenses for both the Application and TWU's prior SIC proceedings.³¹² These expenses are appropriate to be

³⁰⁶ *Id.* at 29 (Bates 30).

³⁰⁷ *Id.*

³⁰⁸ *Id.* at 30–31 (Bates 31–32).

³⁰⁹ *Id.* at 31–32 (Bates 32–33).

³¹⁰ TWC § 13.182(a).

³¹¹ TWC § 13.182(b).

³¹² TWU Ex. 13A (Faulk Rebuttal and Supp. Dir.) at 5 and Attachment WAF-S-1 (Rate Case Expense Summary Sheet) (Bates 006 and 049).

recovered from ratepayers via a surcharge pursuant to Commission rules and authorized by TWC § 13.185(g), and for the SIC proceedings under 16 TAC § 24.76(j). It was reasonable and necessary for TWU to seek legal advice and assistance in the prosecution of the Rate Application and SIC proceedings, the time spent was reasonable and necessary, and the hourly rates charges are reasonable.³¹³ TWU supports the recommendation of Commission Staff witness, Ms. Eiland, I am supportive of Ms. to allow TWU to update the allowed amount of the rate case expenses to include costs incurred through the end of the filing of post-hearing briefs, and to authorize TWU to record a regulatory asset for rate case expenses incurred after it files post-hearing briefing.³¹⁴

TWU proposes to recover reasonable and necessary rate case expenses through a surcharge assessed over a 24-month period, as more fully described in the rebuttal testimony of Mr. Bahr.³¹⁵ No party challenged TWU's proposed method of recovery, and no record evidence supports a contrary recovery methodology.

While Commission Staff witness Kathryn Eiland recommends the disallowance of \$86,351.60 in requested rate case expenses incurred by consultants utilized by TWU for which TWU did not provide invoices or a sufficiently detailed description of the work performed.³¹⁶ Specifically, Ms. Eiland recommends the disallowance of: (1) \$50,402 associated with Willis Towers Watson's (WTW) consultant expenses; (2) \$28,800 associated with Horn Solutions' accounting expenses; and (3) \$7,149.60 associated with BGSF'S accounting expenses.³¹⁷ In response to Ms. Eiland's proposed disallowance, TWU provided evidence to substantiate the contested amounts. Specifically, TWU provided confidential Attachment WAF-R-1 being the revised invoice of WTW, which provides a more detailed breakdown of the work performed to complete the compensation report and accompanying direct testimony of Robert Mustich submitted with the application.³¹⁸ TWU also provided Attachment WAF-R-2 are the revised invoices of Horn Solutions, which provide more detailed descriptions of the work performed

³¹³ *Id.* at 16 (Bates 017).

³¹⁴ Staff Ex. 3 (Eiland Dir.) at 8 (Bates 000009).

³¹⁵ TWU Ex. 14 (Bahr Rebuttal) at 11–12 (Bates 12–13).

³¹⁶ Staff Ex. 3 (Eiland Dir.) at 7 (Bates 000008).

³¹⁷ *Id.* at 8 (Bates 000009).

³¹⁸ TWU Ex. 13A (Faulk Rebuttal and Supp. Dir.) at 8 (Bates 009).

by those consultants, substantiating the contested \$28,800 associated with Horn Solutions' accounting expenses in TWU's SIC Applications.³¹⁹ Lastly, TWU provided Attachment WAF-R-3 are the revised invoices of BGSF, which provide more detailed descriptions of the accounting-related services performed by that consultant, including assistance with TWU's lead/lag study, preparation of TWU's 2023 Annual Report, and responding to discovery. The revised invoices are sufficient to substantiate the contested \$7,149.60 associated with BGSF's consulting expenses in this proceeding.³²⁰

TWU should be allowed to recover the contested rate case expenses because TWU has provided information that sufficiently details and itemizes all rate case expenses and sufficiently details the descriptions of the work performed.

VI. TAX CUTS AND JOBS ACT [PO Issues 61-62] [UNCONTESTED]

The Tax Cuts and Jobs Act (TCJA) was resolved for TWU as part of its last general rate case.³²¹ However, this application includes customers who were transferred from SWWC Utilities, Inc. dba Hornsby Bend Utility Company, Inc. (Hornsby Bend).³²² Hornsby Bend customers are currently receiving monthly water and wastewater credits associated with the TCJA.³²³ No other TWU customers are receiving TCJA credits.³²⁴ As part of this application, TWU is requesting to cease the monthly water and wastewater TCJA credits to customers transferred to TWU from Hornsby Bend.³²⁵

VII. OTHER ISSUES [PO Issues 63-66]

A. Transaction Closing Costs [PO Issue 63] [UNCONTESTED]

Under 16 TAC § 24.238(k), TWU may request the recovery of the fee paid to a utility valuation expert to perform an appraisal in the Commission's fair market value process. Here, TWU requests \$262,772, which it has recorded as a regulatory asset, and TWU proposes an

³¹⁹ *Id.* at 8 (Bates 009).

³²⁰ *Id.* at 9 (Bates 010).

³²¹ TWU Ex. 9 (Shupak Dir.) at 8 (Bates 09).

³²² *Id.*

³²³ *Id.*

³²⁴ *Id.*

³²⁵ *Id.*

amortization period of two years for recovery of those costs.³²⁶ The amount requested and time frame for recovery is reasonable.

B. System Improvement Charge Costs [PO Issue 64-65]

Under 16 TAC § 24.76(i), any SIC revenues collected by the utility related to assets that were included in the SIC and later found in a general rate case to be unreasonable, unnecessary, or imprudent, shall be refunded to customers. In this proceeding, no party made any specific challenges to the eligible plant that TWU has been recovering through its SIC and no eligible plant challenged was due to a reconciliation. Additionally, under 16 TAC § 24.76(j), TWU may request recovery of its costs to incurred to prepare and process the SIC application. TWU included in this proceeding rate case expenses for its last two approved SIC applications in Docket Nos. 54201 and 55585 in the amounts of \$119,789 and \$65,518, respectively.³²⁷ These costs are reasonable and necessary and should be approved for recovery.

C. Docket No. 50944 Final Order Issues [PO Issue 66] [UNCONTESTED]

TWU has complied with all the requirements in the final order of TWU's last rate case.³²⁸ First, ordering paragraph 11 requires TWU to file a general rate case at least one year and within three years after the date of the final order in Docket No. 50944.³²⁹ The final order in Docket No. 50944 was issued on February 23, 2022, and TWU met the requirement in ordering paragraph 11 by filing a general rate case in this proceeding on June 24, 2024. Ordering paragraph 13 also required TWU to use authorized depreciation rates in this filing, which it has done.³³⁰ Additionally, TWU has complied with the first five ordering paragraphs of the final order in Docket No. 50944 as well as ordering paragraph number 9 by filing tariffs in Docket No. 50944 on March 11, 2022.³³¹ TWU has also met the requirements related to reconciliation of interim rates, which were addressed in Docket Nos. 53061 and 56066.³³²

³²⁶ TWU Ex. 3 (Bahr Dir.) at 14 (Bates 15).

³²⁷ *Id.* at 18 (Bates 19).

³²⁸ Docket No. 50944, Order (Feb. 23, 2022).

³²⁹ *Id.* at 27; TWU Ex. 3 (Bahr Dir.) at 33 (Bates 34).

³³⁰ Docket No. 50944, Order at 28; TWU Ex. 3 (Bahr Dir.) at 33 (Bates 34).

³³¹ *See* Docket No. 50944, Order at 26–27; *see also* Docket No. 50944, Clean Tariffs (Mar. 11, 2022), TWU Ex. 3 (Bahr Dir.) at 33 (Bates 34).

³³² *Compliance Filing for Docket No. 50944 (Application of Monarch Utilities I L.P. for Authority to Change Rates)*, Docket No. 53061, Order No. 10 Finding Filing in Compliance and Requiring Filing

Regarding ordering paragraph numbers 8 and 10, which relate to rate case expenses, TWU recovered \$526,132.78 of its approved \$525,000 amount.³³³ TWU requests that it not be ordered to refund the \$1,132.78 collected above the authorized amount as the administrative costs of implementing the refund would be greater than the refund amount itself. Overall, TWU has met all of its obligations from the final order in Docket No. 50944.

VIII. CONCLUSION

For the reasons stated in this Initial Brief, TWU's requested revenue requirement, capital structure, and rate design should be approved. Accordingly, TWU respectfully requests that the Commission approve the rates and tariff requested in the application and grant such other relief to which TWU has shown itself entitled.

Respectfully submitted,

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**ATTORNEYS FOR TEXAS WATER
UTILITIES, L.P.**

(Dec. 18, 2023); *Application of Texas Water Utilities, L.P. for Pass-Through True-Up Reports*, Docket No. 56066, Corrected Notice of Approval (Apr. 3, 2034); TWU Ex. 3 (Bahr Dir.) at 33 (Bates 34).

³³³ Docket No. 50944, Order at 27; TWU Ex. 3 (Bahr Dir.) at 33 (Bates 34).

CERTIFICATE OF SERVICE

I hereby 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 March 7, 2025, in accordance with the Second Order Suspending Rules, issued in Project No. 50664.

/s/ William A. Faulk, III

William A. Faulk, III