PROJECT NO. 43871

PUC RULEMAKING PROJECT TO AMEND CHAPTER 24 FOR THE IMPLEMENTATION OF PHASE II OF THE ECONOMIC REGULATION OF WATER AND SEWER UTILITIES	**§ § § § §**	**PUBLIC UTILITY COMMISSION OF TEXAS**

ORDER ADOPTING AMENDMENTS TO §§24.3, 24.8, 24.14, 24.21, 24.23, 24.31, 24.32, 24.34, 24.41, 24.44, 24.72, 24.73, 24.102, 24.109, 24.111, 24.114, 24.131, 24.150; REPEAL OF §§24.11, 24.22, 24.25, 24.26, 24.27, 24.28; AND NEW §§24.11, 24.22, 24.26, 24.28, 24.33, 24.36 AS APPROVED AT THE AUGUST 14, 2015 OPEN MEETING

The Public Utility Commission of Texas (commission) adopts amendments to §§24.3 (relating to Definitions of Terms), 24.8 (relating to Administrative Completeness), 24.14 (relating to Emergency Orders), 24.21 (relating to Form and Filing of Tariffs), 24.23 (relating to Time Between Filings), 24.31 (relating to Cost of Service), 24.32 (relating to Rate Design), 24.34 (relating to Alternative Rate Methods), 24.41 (relating to Appeal of Rate-making Pursuant to the Texas Water Code, §13.043), 24.44 (relating to Seeking Review of Rates for Sales of Water Under the Texas Water Code, §11.041 and §12.013), 24.72 (relating to Financial Records and Reports--Uniform System of Accounts), 24.73 (relating to Water and Sewer Utilities Annual Reports), 24.102 (relating to Criteria for Considering and Granting Certificates or Amendments), 24.109 (relating to Report of Sale, Merger, Etc.; Investigation; Disallowance of Transaction), 24.111 (relating to Purchase of Voting Stock in Another Utility), 24.114 (relating to Requirement to Provide Continuous and Adequate Service), 24.131 (relating to Commission's Review of Petition or Appeal), and 24.150 (relating to Jurisdiction of Municipality: Surrender of Jurisdiction) with changes to the proposed text as published in the March 20, 2015 issue of the *Texas Register* (40 TexReg 1607).

The commission repeals §§24.11 (relating to Informal Proceedings), 24.22 (relating to Notice of Intent to Change Rates), 24.25 (relating to Rate Change Applications, Testimony and Exhibits), 24.26 (relating to Suspension of Rates), 24.27 (relating to Request for a Review of a Rate Change by Ratepayers Pursuant to the Texas Water Code §13.187(b)), and 24.28 (relating to Action on Notice of Rate Change Pursuant to Texas Water Code, §13.187(b)) with no changes as published in the March 20, 2015 issue of the *Texas Register* (40 TexReg 1607).

The commission adopts new §§24.11 (relating to Financial Assurance), 24.22 (relating to Notice of Intent and Application to Change Rates Pursuant to Texas Water Code §13.187 or §13.1871), 24.26 (relating to Suspension of the Effective Date of Rates), 24.28 (relating to Processing and Hearing Requirements for an Application Filed Pursuant to Texas Water Code §13.187 and §13.1871), 24.33 (relating to Rate-Case Expenses Pursuant to Texas Water Code §13.187 and §13.1871), and 24.36 (relating to Application for a Rate Adjustment by a Class C Utility Pursuant to Texas Water Code §13.1872) with changes to the proposed text as published in the March 20, 2015 issue of the *Texas Register* (40 TexReg 1607).

The amendments, repeals, and new sections implement and conform the commission's substantive rules to House Bill 1600 (HB 1600) and Senate Bill 567 (SB 567) of the 83rd Legislature, Regular Session, enacted in 2013, which amended the ratemaking and reporting requirements for water and sewer utilities. In addition to conforming the commission's substantive rules to HB 1600 and SB 567, the amendments and new sections revise the procedures by which a utility can demonstrate financial assurance to the commission. Additional amendments, repeals, and new sections have resulted in the reorganization and/or restructuring of

several rule sections to promote clarity. Finally, additional amendments and new sections revise other limited aspects of ratemaking at the commission, including the removal of authorization for stand-by fees; instructions related to identifying a tariff change; clarification of the applicability of a rule section related to time between filings; modification to the allowable recovery on cost of service established via trending studies; clarification of the applicability of a negative acquisition adjustment; description of availability of intangible asset in rate base; removal of single issue rate change as an alternative rate method; clarification of commission authority in the appeal of ratemaking decisions; extension of the deadline by which a utility is required to file an annual report; and modification of the manner in which the commission provides notice of cities that have surrendered jurisdiction to the commission. In addition, the commission implements and conform the commission's substantive rules to SB 1148 of the 84th Legislature, Regular Session, enacted June 16, 2015 and effective September 1, 2015, relating to the economic regulation of water and sewer service. These new sections and amendments are adopted under Project Number 43871.

No public hearing on the amendments or proposed sections was requested or held at the commission offices.

The commission received initial comments on the proposed new sections, amendments, and repeals from the Water IOUs (Investor Owed Utilities) (comprised of Aqua Texas, Inc., Aqua Utilities, Inc., Aqua Development, Inc. d/b/a Aqua Texas (Aqua Texas), SJWTX, Inc. d/b/a Canyon Lake Water Service Company (CLWSC), SouthWest Water Company (SWWC), and Corix Utilities (Texas) Inc. (Corix)), the City of Houston, the Lower Colorado River Authority

(LCRA), the Office of Public Utility Counsel (OPUC), the Texans Against Monopolies' Excessive Rates (TAMER), and the Texas Alliance of Water Providers (TAWP). The commission received reply comments on the proposed new sections, amendments, and repeals from the Water IOUs, the City of Houston, the LCRA, OPUC, and TAMER.

General Comments

TAWP generally urged the commission to consider adopting procedures in rate-cases to allow for early dispute resolution through a structured settlement process, similar to those that have been adopted in other states, such as Minnesota, stating that these early procedures could save ratepayers millions of dollars. TAWP further recommended that the settlement procedures should include a way for parties to stipulate to uncontested issues of law or fact or provide a way for parties to come to a reasonable settlement agreement without the need for a contested hearing.

Commission response

The commission disagrees that a formal procedure should be adopted to allow for early dispute resolution through a structured settlement process. When appropriate, and possible and after the appropriate information has been provided by the utility, staff encourages settlement and strives to work together with parties to reach a reasonable resolution of all issues in a proceeding. Therefore, the commission does not find it necessary to add a structured process in the rules for a process that commonly occurs at the commission. The commission also recognizes that parties already have the ability to stipulate to uncontested issues of fact pursuant to §22.228 (regarding Stipulation of Facts), and therefore no process needs to be codified in chapter 24. The commission acknowledges

that there are instances where settlement may not be possible and, therefore, mandatory settlement conferences before a hearing could result in unnecessary expenses for ratepayers. For these reasons, the commission does not adopt TAWP's proposal, as it is unnecessary in light of the common practices regarding settlement in contested cases.

The Water IOUs generally appreciated the commission's efforts regarding the rules but commented that some of the proposed changes represent substantial new policy changes and do not represent sound policy choices. The Water IOUs pointed out that they are comprised of operations that are smaller than other utilities the commission regulates and that while certain issues should be handled consistently among the utilities the commission regulates, identical treatment may not be warranted in all circumstances. For example, the Water IOUs requested the commission review its filing requirements because those requirements might be too burdensome on smaller water utilities. In addition, the Water IOUs pointed out that no changes to the chapter 22 procedural rules are being considered.

Commission response

The commission's policy determinations made in this rulemaking represent sound policy choices. Through this rulemaking the commission has implemented HB 1600, SB 567 and SB 1148, while also making the chapter 24 rules consistent with the chapter 25 rules where appropriate. The commission has not provided for identical treatment between water and electric utilities in all instances because it recognizes that such consistency is not always possible or appropriate. The commission has implemented rules that will make the treatment of water and electric utilities similar where it is appropriate to do so and has

implemented differing treatment where distinctions should be made. For example, the commission has proposed the use of three different rate filing packages for water utilities to recognize the statutory mandate of classifying water utilities by size. The commission points out that any changes to the chapter 22 rules are outside of the scope of this particular rulemaking project, and the commission did not propose amendments to the chapter 22 rules in Project No. 43969.

Section 24.3 - Definitions

The Water IOUs stated that where a defined term is included in the rate filing package that goes beyond explaining what the acronym stands for, the definition should be included in §24.3. In addition, the Water IOUs argued that all definitions in chapter 24 should be consistent with those definitions in the rate filing package, the Texas Water Code Annotated Chapter 13 (West 2008 and Supp. 2014) (TWC), and industry definitions.

Commission response

The commission agrees that all chapter 24 definitions should be consistent with those definitions in the rate filing packages and has modified both the rule and rate filing packages accordingly. In addition, the definitions in this chapter are consistent with the definitions in the TWC. Finally, the commission disagrees with the Water IOUs that a defined term included in the rate filing package, must also be defined in §24.3. The commission finds that for terms used primarily in the water and sewer rate filing packages, it is appropriate to define those terms in the rate filing package rather than the rule.

Section 24.3(4) - Affiliated interest or affiliate

OPUC recommended expanding the definition of "affiliated interest or affiliate" stating that many water and wastewater utilities in Texas are affiliated with larger multijurisdictional entities or other rate regions, or company divisions within the state. Therefore, OPUC recommended the definition state "any person or corporation that allocates or assigns costs to the utility including multi-jurisdictional costs, Texas divisional costs, or costs allocated to the utility from other Texas rate regions."

The Water IOUs disagreed with OPUC's suggested modifications to the definition of "affiliated interest or affiliate," stating that an expansion to the definition cannot occur without a change to the TWC. In addition, the Water IOUs expressed their belief that "rate region" is an "affiliated interest or affiliate," per the TWC definition, and pointed out that a rate region or division will not necessarily be a stand-alone "person" or "corporation" as suggested by the definition OPUC provided. The Water IOUs argued that the term, as used in the TWC, has a very specific meaning that transcends particular allocation methods, which can vary by utility, and stated that allocation by itself does not create an "affiliate." In addition, the Water IOUs asked the commission to define the term "affiliate or affiliated" if these terms are supposed to hold a different meaning than they do in the TWC.

Commission response

At this time the commission does not adopt the proposed modifications to the "affiliated interest or affiliate" definition. The commission notes that the definition used in the proposal for publication tracks the TWC definition found in TWC §13.002(2). The

primary purpose of this rulemaking is to align the chapter 24 rules with the TWC and to make the necessary modifications to conform the rules to the commission's current practices. If, in the future, the commission determines that any modifications to this definition are needed such modifications will be made in a separate rulemaking where all issues can be fully considered.

The commission has addressed the comment from the Water IOUs that the term "affiliate or affiliated" should be defined if they are to hold a different meaning than they do in the TWC in the responses to comments on the rate filing packages, found in Project Nos. 43876 and 42967.

Section 24.3(12)-(14) - Class A, Class B, and Class C utilities

OPUC generally commented that the TWC created three new classes of utilities, Class A, Class B, and Class C utilities, based on the size of the utility, stating they are differentiated based on their provisions of service "through" a certain number of "taps or connections." OPUC argued that the commission's current definition of Class A, Class B, and Class C utilities departs from this statutory language by defining these classes of utilities by their provision of service "to" the applicable number of "taps or active connections." Though OPUC does not object to the use of the preposition "to" instead of "through," OPUC objected to the insertion of the word "active" before "connections," stating that this addition might have unintended consequences. In addition, OPUC stated that use of the term "active" should be defined because use of the term could create confusion for systems serving seasonal or intermittent communities. OPUC stated that for these systems the number of active connections could change depending on when the application is filed, and could result in a utilities' classification changing throughout the year.

OPUC questioned the statutory basis for this change, stating the commission has not provided an explanation for the modification. Therefore, OPUC recommends that the word "active" be deleted. In contrast, the Water IOUs stated that it is unclear if a "tap" is considered equivalent to an inactive connection or an active connection, and therefore, requested the commission modify the rule to include the term "active" before taps and modify the last section to state "the number of active water taps/connections determines how the utility is classified."

TAWP argued that the definitions for Class A, B, and C utilities should be amended to clarify that provision of both water and sewer service to the same customer consists of one "tap or connection" in order to prevent the misclassification of smaller utilities that provide both water and sewer service. TAWP argued that without this clarification the commission is imposing a greater burden than legislatively intended on smaller utilities. TAWP proposed including in the definition of Class B and Class C utility the following: "For the purpose of this definition, a customer receiving both water and sewer service from the same public utility is counted as one tap or connection." TAWP commented that this proposed language is also consistent with the proposed definition of ratepayer; §24.3(42) treats a customer receiving both water and sewer service from the same company as one "ratepayer" regardless of the number of bills it receives. In addition, §24.3(18) treats someone provided with retail public utility services as one customer, regardless of the number of services received from a particular utility. Therefore, TAWP urged the commission to modify the definitions for Class A, Class B, and Class C utilities. In addition, TAWP asked the commission to clarify that the rule is limited to taps or connections within the State of Texas because many utilities have operations in different states or jurisdictions. In their reply comments, the Water IOUs stated that they shared TAWP's concern that the definitions for

utility classification should be clear and stated that the commission should consider their proposed changes, as well as those changes proposed by the Water IOUs.

OPUC argued that instead of the rule containing the provision that if "a public utility provides both water and sewer utility service, the number of active water connections determines how the utility is classified" the rule should instead contain their recommended alternative language, which states, "if a public utility provides both water and sewer utility service, the number of unique addresses with either a water or sewer connection determines how the utility is classified." OPUC stated its proposed language would ensure that a customer is not counted twice because it receives both water and sewer service while at the same time not leaving any taps or connections uncounted. OPUC appreciated the commission's attempt at providing guidance for how connections should be counted. But, OPUC stated the commission's language fails to consider the situation where a system serves more sewer connections than water connections, which, under the commission's proposed definition, could result in the utility being improperly classified.

The Water IOUs expressed their disagreement with OPUC's suggested modifications, stating the TWC requires the definition to reference the use of taps/connections. The Water IOUs stated a better approach is to maintain consistency with the TWC and clarify that the terms mean "active." The Water IOUs continued to support the commission's proposal to use "active water connections" as the determinative figure for classification but continued to urge the commission to add the word "taps" for consistency purposes. In addition, the Water IOUs expressed their concern with using the term "unique addresses" in the definitions as problems might occur in separating billing addresses from physical addresses.

Commission response

The commission disagrees with OPUC and retains the use of the term "active" before "connections" in the definitions for Class A, Class B, and Class C utilities. In addition, the commission does not find the word "active" to be ambiguous or a material departure from the statutory language. Though the commission recognizes the concerns regarding the use of the term "active" expressed by OPUC, the commission finds that these concerns do not warrant modification of the proposed rule because seasonal fees are charged to seasonal residences. Therefore, those connections would still be "active" connections and thus the number of active connections would not change depending on the time of year. The commission retains the use of the term "active" in reference to "connections" in order to determine the appropriate water or sewer utility classification based on what is actually in use.

The commission does not adopt TAWP's modification because the proposed language does not add clarity to the definitions. TAWP's language would constitute an unnecessary change because TAWP's language does not change the definition proposed by the commission in any substantive way. In addition, the commission does not find it is necessary to clarify that the rule is limited to taps or connections within the State of Texas because the rules promulgated by the commission apply only to Texas utilities. Therefore, the clarification requested by TAWP is unnecessary.

The commission also declines to modify the rule to use the "number of unique addresses with either a water or sewer connection" to "determine how the utility is classified." The commission finds this modification could result in the undercounting of customers. There are customers who receive service via multiple taps, and for purposes of classifying a utility, these unique taps are important, even if they share the same unique address. The purpose of the class structure for water or sewer utilities is to determine the size of the utility, and the number of active connections is the appropriate way to determine the size of a water or sewer utility.

Section 24.3(19) - Customer class

OPUC noted that the definition of "customer class" was amended to include the statement that for "rate-setting purposes, a group of customers with similar cost of service characteristics that take basic utility service under a single set of rates." OPUC stated that for water and sewer utilities, the existence of "customer classes" for investor owned utilities (IOUs) is rare, and allocation is almost exclusively done by meter size. Though OPUC supported the commission's efforts to identify and standardize new customer classes, OPUC recommended the commission not add the proposed language to the definition of "customer class" because defining new functions and creating new customer classes is complex and would be better served through a separate project or rulemaking. OPUC expressed concern that proposing the issue of new customer classes without any further direction may result in functionalization, allocations, and customer classes that are not fully defined or understood and this could result in interpretations by utilities. Therefore, OPUC recommended this issue be addressed in a separate rulemaking project where the commission can give it the appropriate consideration.

Additionally, OPUC stated that changes to current rate classes could create rate shock to specific customers or groups of customers due to migration from one tariff to another.

However, if the commission chooses to pursue the creation of customer classes in this project, OPUC asked the commission to provide further guidance on the process of functionalizing costs and defining customer classes. The Water IOUs, in their reply comments, generally agreed with OPUC's comments regarding customer classes, expressed their shared concerns about the definition, and urged the commission to retain a broad definition. Although the Water IOUs stated OPUC's suggested edits are acceptable, the Water IOUs urged the commission to modify the definition as proposed in their initial comments. In their initial comments, the Water IOUs noted that the "customer class" definition in chapter 24 is slightly different than the definition in the rate filing packages. The Water IOUs urged the commission to only include the definition in the rule and not in the rate filing package. First, the Water IOUs argued the definition of customer class includes the unclear and undefined term "basic utility service." Second, the Water IOUs argued that it is not clear whether there are particular "customer class" designations that utilities should use going forward. The Water IOUs pointed out that the Texas Commission on Environmental Quality (TCEQ) rules did not define different types of customer classes, but noted that some individual utility tariffs have made such distinctions. The Water IOUs stated that while some tariffs have made distinctions, the primary classifications for water and sewer rates have been identification of rates set for various meter sizes based on meter equivalency factors (unless negotiated otherwise) and classification of system ratepayers as inside versus outside municipalities (who are subject to a different regulatory process). The Water IOUs

argued that rates have historically been designed to focus on residential and small commercial customers, with ratepayers who request larger meter size connections being typically commercial. But, the Water IOUs noted that the tariffs do not typically identify different customer classes in that way. The Water IOUs noted their interest in having the option to identify different customer classes, but did not want to be required to have certain authorized customer classes specified in their tariffs. OPUC in its reply comments stated that the request of the Water IOUs to not be required to specify certain customer classes in their tariff is concerning because successful rate regulation requires all utilities to follow the same set of rules and standards when developing methodologies for computing rates. OPUC argued that giving utilities unlimited options might encourage the use of methods that are most advantageous to the utilities without consideration of the ultimate impact to the ratepayers.

The Water IOUs also requested the commission clarify whether a particular meter size rate is a "type of rate" for purpose of this definition so that, for example, a utility may have a 5/8" x 3/4" meter size, customer class, and others. The Water IOUs stated and OPUC agreed that they do not understand how customer classes should be broken down, as required in the rate filing package, without very specific designations of customer classes. OPUC argued that the specific designations needed for a successful ratemaking process are not currently provided. The Water IOUs pointed out that not all cost of service data is maintained according to customer class. In addition, the Water IOUs questioned whether wholesale customers would be considered a "customer class" since the definition of "customer" in the proposed definition only speaks to "service by any retail public utility." The Water IOUs argued that historically water and wastewater tariffs have included retail water or utility service rates approved by the regulatory

authority, but not wholesale rates as they are directed by individual contracts. Therefore, the Water IOUs urged the commission to modify the definition of "customer class" to be defined as a "description of a customer group that receives utility service according to a specific designation based on nature of use, meter size, or other type of rate in the utility's tariff."

Commission response

Though the commission is sensitive to the concerns expressed by the parties regarding the term "customer class," the commission does not adopt the majority of the proposed modifications. The commission notes that at issue in this section is the definition of the term "customer class" and that many of the comments provided go to how this definition will be implemented, which is a different issue not being addressed in this rulemaking project. By defining the term "customer class," the commission is not imposing new requirements regarding how rates are to be designed or how customer classes should be broken down, and the commission is not creating specific customer classes. The commission notes that it modified the definition of "customer class" in the rate filing package in Project No. 43876 to be consistent with the definition in this subsection because the commission agrees that a term should be consistently defined in chapter 24 and the rate filing package. In addition, the commission agrees that the undefined term "basic utility service" may be confusing because the commission has not defined "basic service" and has therefore modified the definition to provide greater clarity to the definition.

Section 24.3(22) - Financial assurance

OPUC stated its general support for the commission's proposed definition of "financial assurance" but recommended deleting the phrase "owner's or operator's" because the rule itself identifies the owner or operator as the source of the financial assurance. OPUC argued that without this modification the definition as proposed is circular. OPUC recommended amending the "financial assurance" definition to "[demonstrate] that sufficient or adequate financial resources exist to operate and manage the utility and to provide continuous and adequate service to the current and proposed utility service area." In their reply comments, the Water IOUs did not oppose the changes suggested by OPUC and argued that the applicable financial assurance rule should govern who is required to make the demonstration, rather than the definition of what constitutes financial assurance. The Water IOUs also argued that the definition may not be necessary and may conflict with §24.11 if it does not specifically reference "financial test."

Commission response

The commission agrees with OPUC and modifies the definition of "financial assurance" consistent with their recommendation. The commission deletes the phrase "owner's or operator's" because new §24.11 (relating to Financial Assurance) identifies the owner or operator as the source of the financial assurance. The commission finds that the definition does not conflict with §24.11 (relating to Financial Assurance).

Section 24.3(47) - Stand-by fee (omitted)

The Water IOUs questioned why the term "stand-by fee," and all use of the term, was deleted from the proposed rules. The Water IOUs asked the commission to justify this deletion.

Commission response

The commission recognizes that the term "stand-by fee" still exists in chapter 24, and therefore, has reinstated the definition that was proposed for deletion in the Proposal for Publication. The definition for "stand-by fee" now appears in §24.3(65).

Section 24.3(55) - Test year

OPUC stated they supported the proposed definition of "test year" because it conforms to the statutory definition. However, OPUC argued there is uncertainty regarding whether this definition would apply to rate appeals from entities that are not required to file original rate applications. OPUC stated that though it is clear that the use of a historical test year is required for Class A, B, and C utilities under Subchapter B of chapter 24, a historical test year is neither required nor prohibited for rate appeals under Subchapter C. OPUC pointed out that the TCEQ did not require political subdivisions to use a historical test year but that the use of budgets and estimates by political subdivisions has resulted in considerable litigation and expense when appellants attempt to ascertain whether an appellee's rates are just and reasonable when not based on a historical test year.

OPUC argued that because the use of a historical test year is neither prohibited nor required, there exists an ambiguity of when and under what circumstances the use of a historical test year will be applied or when budgets and estimates will be allowed. OPUC, therefore, supported the use of a historical test year because it is the standard used at the commission and the use of actual data, rather than estimates, is more reliable and produces more reasonable rates. OPUC urged

that a good cause exception should be allowed when it is warranted. OPUC argued this modification will reduce litigation surrounding this issue and will remove any existing ambiguity.

In their reply comments, the Water IOUs pointed out that OPUC had not suggested a change to the proposed definition and disagreed that there is ambiguity about whether non-IOUs must use a historic test year in rate appeals. The Water IOUs pointed out that the TWC does not require "retail public utilities," a more broadly defined term, to follow the same cost of service requirements as the narrower term "utilities." In addition, the Water IOUs argued that the cost of service rules found in §24.31 should dictate whether certain data from outside the test year should be considered to adjust "actual data" from the historic test year for ratemaking purposes.

The LCRA in their reply comments stated that the precedent cited by OPUC from the TCEQ regarding the TCEQ not requiring political subdivisions to use a historical test year obviates the need for any change to the definition of test year because the precedent allows for either a budgeted or historical test year. LCRA agrees with OPUC that flexibility is needed for political subdivisions. However, LCRA expressed concern that OPUC's proposal may be too limiting and would considerably reduce the flexibility that political subdivisions have relied upon in setting wholesale water rates. In addition, the LCRA expressed concern that not all potentially affected parties have been fully engaged in this issue and that if the commission determines a change is appropriate, the commission should consider doing this in a separate rulemaking that specifically addresses the unique circumstances of water rate appeals governed by TWC Chapters 11 and 12.

Commission response

The commission acknowledges OPUC's concerns regarding the application of a "test year" for appeals of ratemaking decisions pursuant to TWC §13.043. However, the commission notes that at issue in §24.3(55) (now §24.3(71)) is the definition of the term and not the substantive cases in which a test year will be used. The commission agrees with the Water IOUs that the proposed definition is not ambiguous and that §24.31 addresses whether certain data from outside the test year should be considered to adjust "actual data" from the historic test year for ratemaking purposes. The commission also agrees with LCRA that flexibility needs to be maintained concerning the use of a test year for political subdivisions and that if the commission decides that modifications are necessary to change the use of a test year, this may be done in a separate rulemaking project.

Other Proposed Definitions

The Water IOUs noted that the rate filing package, being considered in Project No. 43876, contains defined terms that are not included in §24.3. The Water IOUs suggested the commission include definitions intended for use in the rate filing package within §24.3 and that the rate filing package is not the place to include original definitions for key terms. Specifically, the Water IOUs requested the commission define the following terms in §24.3: allocation, amortization, annualization, connections, customer, classes, function, functionalization, general rates revenues, block rates, known and measurable, multi-jurisdictional, normalization, rate region, affiliate or affiliated, and RFP.

Commission response

The commission finds that when a definition is included in the rate filing packages it should also be included in the substantive rule. However, the commission declines to include terms in the substantive rules that appear in the rate filing package as instructional information on how a term should be used. Where terms are not defined identically in both §24.3 and the rate filing packages the commission made modifications so that identical definitions are used in both the rule and rate filing packages, when appropriate. In some instances the definitions differ because additional instructions are included in the rate filing packages.

The Water IOUs urged that if the commission defines "amortization," it should be defined in §24.3 and should derive from generally referenced sources (Investopedia or the Oregon Public Utility Commission) instead of creating an original definition.

The Water IOUs also noted that the commission does not need to adopt a definition for "connections" but if it defines the term in the rate filing package, it should be included in §24.3 and should be modified in order to remove the use of the term "served" or "service" from the definition because the definition of "service" in both the TWC and Chapter 24 is extremely broad and covers utility activities other than just supplying water or collecting wastewater.

The Water IOUs also expressed their belief that the definition of the term "function" belongs in §24.3. The Water IOUs urged the commission to define the term as it is defined in the Glossary of the American Water Works Association; "functional cost category - Costs related to a particular operational function of a utility for which annual operation and maintenance expenses

and utility plant investment records are maintained…." The Water IOUs continued by arguing that the proposed electric rate filing package specifically defines which functions are considered "regulated functions," and not the term "function along." But, the Water IOUs noted this approach may not be necessary for the Class A IOUs unless a uniform set of regulated functions is desired but also noted that uniform regulated functions may not be flexible enough to capture all of a utility's functional cost categories.

The Water IOUs argued that if defined, the definition for "general rate revenue" should be included in §24.3 but also noted that as defined in the rate filing package, the definition is unclear.

The Water IOUs requested that the term "block rates" be defined in §24.3 and not in the rate filing package.

The Water IOUs also requested the term "known and measurable" be included in §24.3 but said it should be modified. The Water IOUs argued that known and measurable changes should be allowed if reasonably certain to occur during the time period when rates will be in effect as determined on the date the rate filing package is filed. The Class A IOUs also noted that there would be no record of the known and measurable change to verify on the date the rate filing package is filed, so defining the term as "verifiable on the record as to amount and certainty of effectuation" is improper.

The Water IOUs argued the term "multi-jurisdictional" be included in §24.3 and argued that the term as defined in the rate filing package is unclear. The Water IOUs rationalized that if a utility's parent/holding corporation has subsidiaries that provide service in more than one state, but the Texas utility/subsidiary corporation(s) does not, it is unclear whether that utility is "multi-jurisdictional" under the definition proposed.

The Water IOUs urged the commission to include the definition of "rate region" in §24.3 instead of the rate filing package.

Finally, the Water IOUs urged the commission to define the acronym "RFP" to mean rate filing package for the purpose of providing clarity.

Commission response

The commission finds it is appropriate to define the terms that appear in the rate filing packages in §24.3. The commission acknowledges the concerns expressed by the Water IOUs regarding consistency in definitions between §24.3 and the rate filing packages and has addressed these concerns by incorporating necessary terms into §24.3. The commission notes that additional instructive information is currently proposed to be included in the rate filing packages.

The commission continues to decline to define the term "RFP" in §24.3 because this is an acronym. The commission has not included definitions in §24.3 that only spell out acronyms.

The Water IOUs requested the commission use the definition of "annualization" as this term is used by the Oregon Public Utility Commission, which defines the term as the "process of adjusting a utility company's annual historical information to reflect a full 12-month period for known changes reasonably expected to continue into the future." The Water IOUs also asked the commission to provide any direction related to what should be annualized or how to perform amortization for purposes of the rate filing package.

In addition, the Water IOUs pointed out that as defined in the rate filing package, the term "functionalization" is defined to mean the same thing as "allocation," which might not have been intended.

The Water IOUs also suggested the commission add the definition of "normalization" as defined by the Oregon Public Utility Commission's Glossary of terms: "An accounting method that allows a utility to evenly recover over its year of operation, revenues from customers to pay income taxes."

Commission response

The commission has addressed comments for the definition of "annualization," "functionalization," and "normalization" in the responses to comments on the rate filing packages, found in Projects Nos. 43876 and 42967.

Section 24.8 - Administrative Completeness

OPUC expressed its support of the commission's efforts to conform this rule to HB 1600 and SB 567 and is particularly supportive of the repeal of subsection (b) that provided the ability for rates to go into effect 60 days after the date of filing. OPUC stated that the implementation of rates prior to a commission order approving final rates has been an issue of great concern to ratepayers and that suspension of rates will help alleviate unwarranted rate increases until the filing can be reviewed to determine if the request is reasonable.

The Water IOUs asserted that the proposed procedures for administrative completeness impose an unfair requirement on filings and are more stringent than the prior TCEQ version and should therefore not be adopted. The Water IOUs argued the revised TWC Chapter 13 provides discretion to the commission to suspend the proposed effective date for rate changes in TWC §13.187(e) and §13.1871(g) for a limited period of time. However, TWC §13.187(d) and §13.1871(e) only permit rejection of a statement of intent if it is "not substantially complete" or "does not comply with the regulatory authority's rules." The Water IOUs argued that suspensions are limited in duration and are not potentially infinite, as the commission's language suggests. In addition, the Water IOUs argued there must be a good reason for suspensions and a fair opportunity to contest and/or cure perceived deficiencies as afforded to electric utilities under §22.75 (Examination and Correction of Pleadings and Documents). The Water IOUs argued that the proposed rule does not include current rule language regarding "material deficiencies" and argued that without this modifier, any type of deficiency could prompt rejection of an application, which constitutes a drastic policy change that does not meet the Legislature's intent in HB 1600 and SB 567. In addition, the Water IOUs stated there are due process concerns

related to this proposed rule. Therefore, the Water IOUs requested the commission include a similar process in either chapter 22 or chapter 24 for addressing application deficiencies in the administrative review process that mimics §22.75, Examination and Correction of Pleadings and Documents. In addition, the Water IOUs requested a similar rule to §22.76, relating to Amended Pleadings.

In their reply comments, OPUC argued that the Water IOUs' presumption that a proposed effective date of a rate change cannot be changed or suspended was based on a flawed interpretation of the TWC, specifically §13.187 and §13.1871, which apply to Class A and Class B water utilities, respectively. OPUC argued that the TWC authorizes the commission to reject a utility's rate change application or statement of intent or suspend the effective date of the rate change if the application or statement of intent is not substantially complete or does not comply with commission rules. In contrast, OPUC argued that in the case of subsection (d-1) and (e), a local regulatory authority may suspend the effective date of a rate change for not more than 90 days from the proposed effective date after providing notice to the utility, and the commission may suspend the effective date of a rate change for not more than 150 days from the proposed effective date after providing notice to the utility. OPUC contended these subsections also state that if the regulatory authority does not make a final determination on the proposed rate before the expiration of the suspension period, the proposed rate shall be considered approved. However, OPUC also argued that neither of these subsections creates an exception to subsection (d), which relates to the sufficiency of the application or statement of intent. OPUC argued the process established in TWC §13.187 depends on the utility's filing of a substantially complete statement of intent and application and that each period is calculated based on a "proposed

effective date," which cannot be determined until after the utility files a valid statement of intent and application. Because the TWC expressly states that both the statement of intent and application for a rate change must include the information required by the regulatory authority's rules, OPUC argued the commission has discretion to determine in a rulemaking what must be included in the statement of intent and application before the time periods established in the statute begin to run. OPUC further contended that if the legislature intended that the date proposed in the utility's application be the actual effective date in all cases, there would be no need to use the phrase "proposed effective date." OPUC asserted that if the Water IOUs' interpretation was adopted, a Class A utility could impose its proposed rates after 185 days even if the "application" was filed consisting of a single page with the proposed rates and no other supporting documents. Finally, OPUC argued that the position taken by the Water IOUs ignores the legislative intent to allow the commission to adopt rules regarding the sufficiency of statements of intent and rate change applications and reject these items when not in compliance.

TAWP urged the commission to modify §24.8(b) to read

> If the commission determines that material deficiencies exist in any pleadings, statement of intent, applications, or other requests for commission action addressed by this chapter, effective date of the notice or application may be suspended, until the deficiencies are corrected. To the extent that the retail public utility fails to correct the deficiencies within a reasonable time, the commission may reject the application.

TAWP argued that as written, the commission has the ability to reject an application with only minor deficiencies, which could potentially require re-filing and re-noticing, both costly endeavors for small utilities. TAWP urged the commission to only reject a filing outright if the utility fails to correct deficiencies within a reasonable time to conserve resources and promote efficiency for smaller utilities. In their reply comments, the Water IOUs stated the commission

should consider the suggested revisions made by TAWP, along with their own suggested revisions.

Commission response

The commission's amendments to §24.8 are consistent with TWC §13.187(d) and §13.1871(e). The commission disagrees that §24.8 potentially allows for the indefinite suspension of the effective date of a proposed rate change and the assertion that this provision is inconsistent with TWC §13.187(e) and §13.1871(g).

TWC §13.187(d) and §13.1871(e) state that, if an application or statement of intent is not substantially complete or *does not comply with the commission's rules*, the effective date of the proposed change may be suspended until a "properly completed application is accepted by the regulatory authority and a proper statement of intent is provided." Accordingly, in the case of an application that does not comport with the commission's rules, the adopted §24.8 permits the suspension of the effective date until the deficiencies are corrected and an administratively complete application is filed. However, in response to the concerns expressed by the Water IOUs, the commission modifies subsection (b) to state that the commission may reject the application or filing if any deficiencies exist in "an application, statement of intent, or other requests for commission action addressed by this chapter" and deleted the word "pleadings."

In response to the Water IOUs' request to adopt a rule similar to §22.76 (relating to Amended Pleadings), the commission notes that pursuant to §22.1(b), the commission's

chapter 22 procedural rules govern proceedings under the TWC. Therefore, §22.76 applies to water and sewer retail public utilities and, therefore, does not need to be incorporated into chapter 24.

In response to the Water IOUs' concern that there must be an opportunity to contest and/or cure deficiencies, as afforded to electric utilities under §22.75 (Examination and Correction of Pleadings and Documents), the commission takes the position that §22.75, §22.78, and the current commission practice provide such an opportunity. Although §22.75(c) applies to rate changes for electric utilities, §22.75(a) and (b) apply to all pleadings and documents and §22.75(b)(2) states that upon notification by the presiding officer of a deficiency in a pleading or document, the responsible party shall correct or complete the pleading or document in accordance with the notification. Further, §22.78 (relating to Responsive Pleadings and Emergency Action) provides for responsive pleadings. Therefore, all regulated entities have the opportunity to contest and/or cure deficiencies.

Repealed Section 24.11 - Informal Proceedings

OPUC stated they did not oppose the repeal of §24.11 related to informal proceedings. However, OPUC pointed out that water and sewer utilities are not provided any guidance as to what is meant by an "informal proceeding" under the TWC §13.015, without this section. Therefore, OPUC recommended that the commission either provide guidance as to what is meant by informal proceeding under TWC §13.015 or specifically indicate that provision will no longer be used. Similarly, the Water IOUs requested clarification as to whether any type of "informal

proceedings" rule will apply to TWC Chapter 13 application matters, and argued that some type of informal proceeding should be allowed, especially because §22.35, relating to Informal Disposition, cannot apply to water utilities without a chapter 22 revision.

TAWP argued that TWC §13.1871 provides that a hearing for Class B utilities could be informal but that there are currently no parameters for what constitutes an informal hearing. Therefore, TAWP suggested the commission incorporate language from former §24.11 into the rules in order to facilitate efficiency and early resolution of cases. The Water IOUs agreed with TAWP's concerns and stated that the revisions suggested by TAWP should be considered along with other means of restoring the "informal proceeding" option.

Commission response

The commission has provided guidance regarding informal proceedings under TWC §13.015 in a separate project, Project No. 42079. In Project No. 42079 the commission delegated informal disposition authority to Commission Advising and Docket Management for certain water and sewer proceedings pursuant to §22.35 (relating to Informal Disposition). In the order issued on October 3, 2014, in Project No. 42079 the commission explicitly provided guidance to water and sewer utilities as to what proceedings qualify for informal disposition and can therefore be considered "informal proceedings." Due to this delegation of authority and the current §22.35, the commission finds §24.11 to be unnecessary, and therefore, maintains the repeal of this section.

New Section 24.11 - Financial Assurance

OPUC generally supported the addition of this substantive rule but recommended adding language to clarify the applicability of the financial assurance requirements. Because the financial assurance provisions in §24.11 only apply to proceedings for Certificates of Convenience and Necessity (CCN) and the Sale, Transfer, or Merger (STM) of retail public utilities, OPUC recommended that the scope of §24.11(a) be refined by adding "these criteria are to be used to determine financial assurance in proceedings before the commission involving Certificates of Convenience and Necessity and the Sale, Transfer, or Merger of utility systems" in order to provide clarity.

In their reply comments, the Water IOUs stated that they did not oppose the language OPUC proposed, but stated that it is unclear whether it is appropriate and expressed concern about the intent of the rule. The Water IOUs argued that in the past, financial assurance was required where TCEQ staff viewed a CCN or STM applicant as possessing thin financial resources and TCEQ staff wanted financial assurance, such as an irrevocable stand-by letter of credit that could be drawn upon in order to ensure that a CCN was not granted to a retail public utility without the means to construct their contemplated water or sewer facilities.

The Water IOUs questioned OPUC's comments and suggestions stating that OPUC indicated an understanding that this rule's intended applicability, including the "financial test" found in subsection (e) is for all CCN/STM applications. The Water IOUs stated that they are not sure when the proposed rule will apply. Therefore, the Water IOUs suggested that if the proposed rule is intended to apply to all CCN/STM application matters, it might be overly prescriptive in

terms of the different financial mechanisms specified. Thus, the Water IOUs urged the commission to carefully review and potentially restructure the rule based on its intended purpose.

TAWP argued that clarification is needed as to when an existing utility must be required to provide financial assurance, if at all. TAWP therefore suggested the commission add language to clarify that financial assurance is only required for existing utilities if there is a finding that the existing utility has failed to provide continuous and adequate service.

The Water IOUs stated they generally agreed with the concept proposed by TAWP as it is generally consistent with historic practice. However, the Water IOUs reasserted that creating a "financial assurance" requirement applicable to all CCN/STM applications, as suggested by OPUC, would be a new policy, if this is the intent of the rule.

Commission response

The commission declines to modify the rule as suggested by the parties because it is not necessary to list in §24.11 each type of proceeding to which the new rule can be applied. For each type of proceeding in which financial assurance may be required, the relevant substantive rules include a cross-reference to §24.11. However, the commission makes modifications to the rule as described below.

The commission notes that this provision applies to new and existing retail public utilities required to provide financial assurance pursuant to this chapter, and maintains that the policy to require that an owner or operator of a retail public utility has the financial

resources to provide continuous and adequate service is consistent with the prior practice at the TCEQ.

The commission agrees with the Water IOUs that it is appropriate to carefully review and potentially restructure or modify the rule based on its intended purpose. Although the financial assurance rule is not directly related to TWC amendments as a result of HB 1600 and SB 567, this rule is being established because the chapter references the form for financial assurance as specified in 30 TAC Chapter 37, Subchapter O (relating to Financial Assurance for Public Drinking Water Systems and Utilities).

This form for financial assurance references in chapter 24 are a carry-over from when TCEQ had jurisdiction over water and sewer CCNs and, therefore, must be updated to specify financial assurance requirements within the commission's substantive rules. Therefore, the commission takes this opportunity to carefully review and modify the rule based on its intended purpose, which is to ensure that water and sewer CCN owners and operators have the financial means, commitment, and ability to fund capital infrastructure necessary to provide retail water and/or sewer service, fund contracts for the provisions of such service, and for operations and maintenance expenses of such contracts and infrastructure over the long-term to provide continuous and adequate service for their customers.

For these reasons, the commission modifies the rule to maintain maximum flexibility in what it may require of CCN owners and operators who are required to provide financial

assurance with this section. The commission, therefore, modifies subsection (c) as follows: "Financial assurance must be demonstrated by compliance with subsection (d) or (e) of this section, unless the commission requires compliance with both subsections (d) and (e)." This modification provides discretion to require that an owner or operator provide an irrevocable stand-by letter of credit for a period of not less than five years in addition to the requirement to meet the financial test, including the leverage and operations tests.

Section 24.11(d) - Irrevocable stand-by letter of credit

OPUC stated they would provide comments regarding the stand-by letter of credit form in Project No. 43968, which is currently pending at the commission.

Commission response

The commission makes a non-substantive change to §24.11(d) of this subsection to clarify that the irrevocable stand-by letter of credit must permit the commission's executive director or the *executive director's* designee to draw upon the irrevocable letter of credit, subject to the conditions specified in the rule. Any comments regarding the form of the irrevocable stand-by letter of credit will be addressed in Project No. 43968, PUC Form Revisions for Phase II of the Implementation of the Economic Regulation of Water and Sewer Utilities (Additional Water Forms).

Section 24.11(e) - Financial test

OPUC urged the commission to clarify that meeting the financial test requires that both the leverage test and the operations test be met, which OPUC stated appears to be the intent of the

rule. The Water IOUs, in their reply comments, stated that they agree with OPUC that this issue requires clarification; but, stated they are unsure whether OPUC's suggestion is appropriate without a clear understanding of the intent of the rule.

Commission response

The commission agrees to modify subsections (e)(4) and (e)(6) consistent with the recommendation made by OPUC to clarify that both the leverage test and the operations test must be met. The commission modifies subsection (e)(2) to specify that to satisfy the leverage test the owner or operator must meet one *or more* of the listed criteria. The commission further modifies subsection (e) to specify that an owner or operator may demonstrate financial assurance by satisfying both the leverage and operations tests "unless the commission finds good cause exists to require only one of these tests." The commission makes this modification to maintain flexibility and make exceptions to this requirement, when appropriate.

Section 24.21 - Forms and Filing of Tariffs

Section 24.21(a) - Approved tariff

The Water IOUs expressed their disagreement that the TWC authorizes suspension of a proposed effective date stating the TWC only permits limited suspension of the effective date of a rate change to periods that run from the "proposed effective date" stating that the "proposed effective date" cannot be changed or suspended. OPUC expressed its disagreement with this position stating that it was directly contrary to the plain language of TWC §13.187(e), which specifically states "the utility commission may suspend the effective date of a rate change for not more than

150 days from the proposed effective date." Therefore, OPUC concluded there is clear authority for the commission to suspend the effective date and the commission should reject the language proposed by the Water IOUs.

The Water IOUs also argued that if suspended or interim rates are not adopted, the TWC permits a utility to charge changed rates for service on or after the effective date, but not "before." The Water IOUs requested the rule language be modified to express this understanding of the TWC.

Commission response

The commission finds that TWC §13.187(e) specifically grants the commission the authority to "suspend the effective date of a rate change for not more than 150 days from the proposed effective date."

The commission agrees to modify the rule, as requested by the Water IOUs, to confirm the understanding that if suspended or interim rates are not adopted the TWC permits a utility to charge changed rates for service on or after the effective date, but not before. Therefore, the commission adopts the following language for §24.21(a): "may charge the rates proposed under TWC §13.187 or §13.1871 on or after the proposed effective date, unless the proposed effective date of the proposed rates is suspended or the commission sets interim rates."

Section 24.21(b) - Requirements as to size, form, identification, minor changes, and filing of tariffs

The Water IOUs argued that minor tariff changes are an example of the type of approval that the commission should permit by an "informal disposition" procedure. OPUC agreed that minor

tariff changes should be subject to a process that is more streamlined than a full rate-change proceeding. However, OPUC recommended that the commission develop such a process in a separate rulemaking to ensure that the new process includes sufficient checks and balances to protect customers.

The Water IOUs requested that subsection (b)(2)(A)-(B) be modified to allow for approval of extension policy additions/changes through a minor tariff change. The Water IOUs argued that extension policy additions/changes do not warrant a rate filing and noted that the TWC does not prohibit their treatment as a minor tariff change. OPUC, in their reply comments, pointed out that extension policies have traditionally been approved or amended as part of a rate change application because section 3.0 of the standard Water Utility Tariff covers these policies and that to the extent a utility proposes to amend the standard tariff terms and conditions, these amendments should only be done as part of a rate change application.

In addition, the Water IOUs requested that temporary water rates and purchased water/sewer pass-through provisions be allowed as minor tariff changes. The Water IOUs argued that these proceedings do not warrant an expansive rate filing, and noted that such additions/revisions may be appropriate between large rate filings.

OPUC argued that the current rule proposal does not seek changes to §24.21(b)(2)(A)(iii), which allows for the implementation of a purchased water or sewage treatment provision, a temporary water rate provision in response to mandatory reductions in water use imposed by a court, a government agency, or other authority, or water use fee provision previously approved by the

commission. OPUC, however, pointed out that the proposed rule provides for amendment to §24.21(l), which governs a temporary water rate provision for mandatory water reduction. OPUC expressed belief that there appears to be overlap with between §24.21(l) and §24.21(b)(2)(A)(iii) and therefore, OPUC recommended that these sections be combined where possible. However, OPUC cautioned that this would make the temporary water rate provision allowable through a minor tariff change as suggested by the Water IOUs. OPUC asked that temporary water rate provisions receive specific review by the commission prior to approval because temporary water rate provisions represent extraordinary rate relief.

Finally, the Water IOUs requested the commission incorporate the same provisions found in §24.21(l) that create an exception from the time between filings rules for rate change filings seeking to add or revise such a provision. The Water IOUs also requested that the rule be modified to allow for e-mail notice for implementation if the customer agrees, as is currently in §24.21(h).

Commission response

The commission agrees that a minor tariff change may be appropriate for informal disposition. In Project No. 42079, the commission issued an order on October 3, 2014 delegating authority to Commission Advising and Docket Management to informally approve specific categories of applications pursuant to §22.35, including informal tariff proceedings filed pursuant to §24.11(b). Therefore, at this time, the commission declines to adopt a separate process. The commission finds that through the delegation of authority,

pursuant to §22.35 (relating to Informal Disposition), minor tariff changes are already handled in a streamlined process.

The commission disagrees with the Water IOUs' proposal to include extension policy additions/changes in the list of items that can be approved through a minor tariff change. The commission finds that these provisions are properly part of §24.22 and should only be handled in a full rate package so that customers will receive notice of proposed service policy changes and have an opportunity to participate in the proceeding. The commission agrees with the rationale provided by OPUC that extension policies have traditionally been approved or amended as part of a rate change application. To the extent a utility proposes to amend the standard tariff terms and conditions, these amendments should be done as part of a full rate-change proceeding.

The commission disagrees with the Water IOUs that temporary water rates and the *establishment of new* purchased water/sewer pass-through provisions should be allowed as revisions through the minor tariff change procedure as these are significant changes. The commission clarifies that pursuant to §24.21(h)(2) the *establishment* of the purchased water or sewage treatment provision formula must be approved by the commission in a TWC §13.187 or §13.1871 proceeding. Once the formula is established in a full rate proceeding, purchased water or sewage treatment increases are allowed pursuant to §24.21(h)(4) and are eligible for informal disposition.

The commission declines to modify the rules as requested by OPUC. Although OPUC pointed out that §24.21(l) potentially overlaps with §24.21(b)(2)(A)(iii), the commission declines to combine these sections. The commission finds the rule is clear and although the provisions may overlap, the provisions are distinct.

The commission agrees that it is appropriate to modify the proposed §24.21(h) to allow for e-mail notice, if the customer has agreed to receive electronic communications. The commission recognizes that this same standard for e-mail notice is allowed under §24.21(l) and finds that it is reasonable to include it in §24.21(h).

Section 24.21(i) - Approved tariff

OPUC stated they generally supported §24.21(i) because the rule as published provides that the effective date is the proposed date on the notice to customers and the commission, unless suspended by the commission. OPUC argued that because the current practice at the commission is to routinely suspend matters, it is appropriate to allow for the effective date to be suspended as well. OPUC rationalized that by providing for the suspension of the effective date, this proposed rule adequately addresses concerns of ratepayers that significant rate increases were going into effect without any regulatory oversight. The Water IOUs stated, in their reply comments, that they do not share OPUC's enthusiastic support of subsections (a) and (i).

Commission response

The commission agrees with OPUC's comments and does not modify §24.21(i).

Section 24.21(l) - Temporary water rate provision for mandatory water use reduction

OPUC contended that temporary water rates may be needed to maintain the financial integrity of a utility during times of mandatory water use restrictions but stated that this remedy should be an extraordinary form of rate relief that merits additional scrutiny and overview by the commission. Therefore, OPUC recommended that a temporary water rate not be implemented unless the commission finds good cause for such a rate pursuant to a specific action requiring the reduction. In addition, OPUC urged the commission to modify subsection (l) in order to limit this form of rate relief to no more than six (6) months, unless the applicant proves to the commission that the mandatory water use restrictions are still in effect and that good cause continues to exist for the temporary water rates. The Water IOUs expressed their disagreement with OPUC's position on this section as well as OPUC's suggested changes and stated that the rule provides a useful opportunity for a utility to make up at least some portion of lost revenue caused by mandatory water use reductions that are out of the utility's control. Specifically, the Water IOUs argued that the suggested six month limit, without further proof, is arbitrary and the "good cause" justification is unwarranted if existing rule requirements are met.

The Water IOUs requested the commission include an option in this section to defer recovery of up to 100% of the lost revenues described in the rule and allow for the recovery of those revenues in a future rate proceeding, instead of through the methods prescribed in subsection (l) if the lost revenues are not recovered through implementation of a temporary water rate for mandatory water use reduction. The Water IOUs rationalized that this approach would result in additional lost revenues not being lost forever, providing for the opportunity to potentially recover them later. In their reply comments, OPUC recognized that 100% relief might be appropriate in some

cases to protect the financial integrity of the utility, but argued that this must be balanced with protecting ratepayers and allowing the deferral of these revenues for recovery at a later time grants too much latitude to the utility without fair representation of the customers. Therefore, OPUC urged the commission to reject this recommendation. In addition, the Water IOUs stated the defined terms "temporary water rate provision for mandatory water use reduction" and "temporary water rate for mandatory water use reduction" should be used throughout, if the definitions remain as proposed in §24.3(53) and §24.3(54).

Commission response

The commission acknowledges the comments regarding this section; however, these comments request changes beyond the scope of the project. At this time, the commission declines to modify this section as proposed. The commission finds that it may be appropriate to consider the requests in a separate, future rulemaking project where the issues can be fully considered. Specifically, the commission finds it premature to make any determination on what amount of lost revenue should be recovered because there is disagreement as to when lost revenue should be recovered and how ratepayers can be protected when temporary water rates are used for mandatory water use reduction. The commission recognizes there may be circumstances in which it is appropriate to consider recovery for lost revenues; but, the commission also recognizes that in times of mandatory water use reductions, a utility is able to charge more for the water and/or sewer service it sells. Due to the complexity of these issues, the commission finds that they are better addressed in a future project.

The commission agrees that the defined terms "temporary water rate provision for mandatory water use reduction" and "temporary water rate for mandatory water use reduction" should be used consistently throughout the chapter. Therefore, the commission accordingly modifies subsection (l).

Section 24.21(p) - Energy cost adjustment clause

The Water IOUs requested the commission examine this provision to see how it may be used more easily by water/wastewater utilities and provide options for incentivizing "green" energy investments and initiatives. In addition, the Water IOUs requested the commission examine all available options for pass-through tariff provisions and rules for recovery of costs outside the control of utilities in order to avoid the frequency of TWC §13.187 or §13.1871 rate change applications. However, the Water IOUs noted they have no specific changes to offer. In their reply comments, OPUC stated that it viewed the Water IOU's request as overly broad and argued the risk associated with utility service should remain with a utility's investors who are earning a return on that risk. OPUC further argued that to allow additional pass-through provisions without a fully vetted rulemaking could inappropriately shift that risk to the utility's ratepayers.

OPUC recommended that the energy cost adjustment clause described in §24.21(p) be amended to conform with the rules that apply to electric utilities for obtaining a purchased power capacity cost recovery factor. OPUC stated, as published, subsection (p) allows for the inclusion of an energy cost adjustment clause in a utility's tariff and that a water and/or wastewater utility can request an automatic pass-through of increases or decreases in electricity and natural gas costs. However, OPUC argued that the proposed rule does not provide enough guidance as to how long

these specific rates will remain in effect. Therefore, OPUC urged the commission to include the following language:

> Upon the establishment of a utility's energy adjustment clause, the utility shall annually file an application for an adjustment of the energy adjustment clause. The cost year used in an annual energy adjustment clause shall be the 12-month period that immediately follows the cost year used to set the existing energy adjustment clause. In addition, the utility shall file the application to adjust the energy adjustment clause promptly after the relevant cost-year data become available. The commission may establish a schedule for the filing of such applications. A utility may terminate its energy adjustment clause as part of any annual energy clause adjustment review. The final decision including the termination of an energy adjustment clause shall specify the date by which the utility shall be required to file an application for the final reconciliation of the costs and revenues associated with the terminated energy adjustment clause. Commission staff may petition at any time to terminate a utility's energy adjustment clause.

OPUC argued that because such pass-through charges are a form of extraordinary rate relief, the commission should include OPUC's offered language to ensure that ratepayers are not being unduly burdened.

In their reply comments, the Water IOUs expressed their disagreement with the additions suggested by OPUC. The Water IOUs argued that none of OPUC's suggested additions are required by the TWC and because this rule is based on TWC §13.188, OPUC's comments should be rejected in favor of maintaining the current rule provisions. In addition, the Water IOUs argued that the rule will lose its usefulness if more procedural burdens are put in place, which is contrary to the intent of the rule to establish a simplified process to pass-through a discrete set of costs. In addition, the Water IOUs disagree with OPUC's general statement that "pass-through charges are extraordinary rate relief." The Water IOUs instead stated that the intent is to provide interim rate relief for specific reasons to reduce the frequency and impact of full rate

proceedings, thus ultimately reducing rate-case expenses. The Water IOUs urged the commission to expand the pass-through provisions to allow for more frequent use.

Commission response

The commission appreciates the suggested modifications to this section; however, the commission declines to adopt the suggested modifications because it finds only the minor modifications made in the proposed rules should be made to §24.21(p) at this time. The primary focus of this project has been the implementation of HB 1600 and SB 567, and modifications made to this section were designed to track the changes made by HB 1600 and SB 567. The changes suggested by the parties for §24.21(p) exceed the scope of this project. The commission may consider the proposed modifications in a future rulemaking project in which the parties are provided the opportunity to comment on proposed rule changes.

Section 24.22 - Notice of Intent and Application to Change Rates Pursuant to Texas Water Code §13.187 or §13.1871

OPUC stated its general support for new §24.22 but urged the commission to adopt a few modifications specifically related to identified provisions.

Commission response

The commission appreciates the general comment made by OPUC and will address specific comments below.

Section 24.22(b) - Contents of application

OPUC pointed out that the proposed rule omits the billing comparisons required by TWC §13.187(a-1)(2) and §13.1871(b)(2), and are included in the current §24.22 proposed for repeal. OPUC argued that the billing comparisons required by TWC §13.187(a-1)(2) and §13.1871(b)(2) should continue to be included within this section. OPUC argued that while the billing comparisons requirement is reflected in the proposed application forms and notice forms, it should also be included in the rule. The Water IOUs did not oppose OPUC's proposed changes but, requested that these should be minimum requirements and argued that bill comparisons at other volumes should be permitted. In addition, the Water IOUs argued that if the rate filing package requires certain specified bill comparisons as additional minimum requirements, those requirements should also be incorporated into the rule as additional minimum requirements if OPUC's suggestion is adopted.

Commission response

The commission declines to modify the rule to include provisions requiring billing comparisons. Because TWC §13.187(a-1)(2) and §13.1871(b)(2) require billing comparisons, the commission finds that billing comparisons are not necessary in the rule at this time. Billing comparisons are included in the rate filing package being considered in Project No. 43876 and the form notice to customers being considered in Project No. 44706. The commission finds the TWC and the rate filing package provide sufficient guidance on this topic.

Section 24.22(c) - Notice required

TAWP requested the commission amend the rule to make clear that notice is considered completed upon mailing, not actual delivery. The Water IOUs agreed but stated the rule should be modified to include "mailing, e-mailing, or hand delivery."

The Water IOUs commented that subsection (c)(1)(B) and (d)(1)(B) require a utility to use the "commission-approved form included in the rate application" for rate application notices but argued that this needs to be more flexible for two reasons. First, the Water IOUs stated the proposed Class A rate filing package proposed in Project No. 43876 has no notice form, or sample notice form, included. Second, the Water IOUs argued the notice forms adopted from the TCEQ are not adequate to provide all the information a utility may wish to convey to its customers for a particular rate application filing. The Water IOUs pointed out that the forms do not provide adequate space for all meter sizes and billing comparisons, and, in some instances, create inconsistencies with the rate design section of the rate application form. The Water IOUs also stated that there might be instances where multiple tariff rate schedules are proposed for change, which would require multiple comparisons between existing and proposed rates and bills at various use volumes. In addition, utilities with multiple meter reading cycles may want to pick a single effective date on which to start charging new rates on a prorated basis since modern billing software provides for this ability. The Water IOUs urged the commission to provide approved sample notice forms in the rate filing package that include the minimum information required, but leaves room for modification according to the needs of each utility and each unique rate application.

Regarding subsections (c)(2) and (d)(2)(A), the Water IOUs stated they were unclear as to what an "affected…county" is because it is not a defined term. In addition, the Water IOUs commented that it is unclear what a utility's responsibilities for notice of the hearing is, when the commission requires "the utility to complete this notice requirement" as provided.

Commission response

The commission agrees to modify subsections (c) and (d) to specify that notice is considered completed upon mailing, e-mailing (if the customer has agreed to receive communications electronically), or hand delivery.

The commission recognizes that proposed notice forms were not included in the rate filing packages in Project Nos. 43876, 43967 and 44462; therefore, the commission modifies subsection (c)(1)(B) to require use of a "commission-approved form." The commission notes that proposed notice forms were published on May 21, 2015, in Project No. 44706, Annual Report Forms and Forms for Notice of Application to Change Rates for Water and Sewer Utilities. Once approved, utilities must use the commission-approved forms when notice is required; however, utilities may seek a good cause exception to include additional information in its notice to customers.

The commission declines to modify subsections (c)(2) and (d)(2)(A) because the rule language tracks TWC §13.187(g-1) and §13.1871(m), and both provisions require notice to affected municipalities or counties. In addition, the commission finds that any confusion regarding a utility's responsibility for notice of a hearing will be minimized because the

presiding officer will order the utility, in clear terms, to provide reasonable notice. In addition, the commission finds that it is unreasonable for a utility to not know what municipalities and counties must receive notice, as they are the municipalities and counties located within the utility's service area.

Section 24.22(d)(1)(A) - Notice requirements specific to applications filed pursuant to Texas Water Code §13.1871

OPUC requests modification of the rule to require that OPUC receive notifications of Class B rate applications in the same way it is required for Class A rate applications. OPUC argued that TWC §13.1325 allows OPUC to receive a copy of information provided during a rate proceeding and therefore requests modification of §24.22(d)(1)(A) to include "and to the Office of Public Utility Counsel." OPUC stated that they anticipate that they will participate in some Class B rate-cases and that notice would be helpful in order to ensure that they remain aware of all requested rate changes. In the alternative, OPUC recommended that it be served with applications filed under the Class A and Class B rate filing packages which can be accomplished informally through the delivery of a copy of the application in OPUC's box in central records or through email service to the agency.

In their reply comments, the Water IOUs opposed the additions suggested by OPUC and argued that TWC §13.1325 specifically states that the information provided to the commission shall be provided to OPUC, *upon request*, at no cost. In addition, the Water IOUs pointed out that TWC §13.1871(c) omitted a similar provision for Class B utility rate filing packages and therefore should likewise not be included in commission rules. Finally, the Water IOUs stated their

opposition to requiring service of Class A or Class B rate filing packages on OPUC since OPUC has the option to elect not to participate in rate proceedings. Therefore, the Water IOUs urged the commission not to adopt OPUC's requested modifications.

Commission response

The commission agrees to modify §24.22(d)(1)(A) to require a utility to provide OPUC with notifications of Class B rate applications in the same way it is required for Class A rate applications. The commission finds that it is reasonable to modify the subsection to provide OPUC with this notification so that OPUC can track and participate in these proceedings. In addition, the commission modifies §24.22(d)(1)(B) to clarify that an individual in these proceedings must file a "protest" rather than a "complaint."

Section 24.22(d)(1)(C) - Notice requirements specific to applications filed pursuant to Texas Water Code §13.1871

OPUC noted that §24.22(d)(1)(C) require that a utility filing an application pursuant to TWC §13.1871 must only include a docket number in the notice if the utility serves more than 1,000 active taps or connections. OPUC rationalized that because Class B utilities are defined as serving 500 or more active taps or connections, and this provision applies to Class B utilities, it does not make sense that a docket number would only be required for some Class B utilities. OPUC stated that it is unclear why the rule has been structured to only apply to utilities with 1,000 or more active taps or connections. OPUC therefore recommended that the commission align the rule with the definition of a Class B utility by reducing the number to 500.

The Water IOUs expressed their general agreement with OPUC's proposed revision.

Commission response

The commission agrees and modifies subsection (d)(1)(C) to require that a docket number be included in the notice for all Class B applications filed pursuant to TWC 13.1871. The commission finds it beneficial to require Class B utilities to include the docket number in notice sent to customers.

Section 24.22(d)(2)(B) - Notice requirements specific to applications filed pursuant to Texas Water Code §13.1871

TAWP proposed the elimination of the requirement that a Class B and Class C utility mail notice to each affected ratepayer 20 days before the hearing in a matter pursuant to TWC §13.1871. TAWP argued this requirement will result in the need to provide multiple notices to consumers, which will lead to customer confusion as to whether an additional rate increase is sought. In addition, TAWP argued that small utilities often do not have the time or staff to complete large mail-outs and therefore tend to use third party services that can cost thousands of dollars. TAWP also pointed out that there is no requirement that Class A utilities provide separate mailed notice of a hearing nor is there a similar requirement for electric or gas utilities within the state. TAWP argued this requirement is contrary to the legislative intent of HB 1600 and SB 567 because it requires a greater burden on Class B and Class C utilities than Class A utilities. TAWP stated that they believed the initial notice of the rate increase, with instructions on how to intervene in the proceeding or file a complaint, is sufficient to allow ratepayers an opportunity to comment or participate in any proposed filing and that this with the requirement to provide "reasonable notice" constitutes adequate protection to ratepayers.

TAWP also requested that the commission clarify why a municipality within two miles of a service territory is considered "affected" by a rate change.

In their reply comments, OPUC urged the commission not to adopt TAWP's recommendation because it may hinder ratepayer participation. OPUC argued that ratepayers should be granted every opportunity to participate in the ratemaking process and should be provided with the necessary information in order to do this. In addition, OPUC pointed out that the cost of notice, if reasonable, would be eligible for recovery as a rate-case expense.

The Water IOUs generally commented that the commission should review all notice requirements before adopting any revisions.

Commission response

The commission declines to eliminate the requirement that a utility mail notice to each affected ratepayer before the hearing in a matter filed pursuant to TWC §13.1871. The requirement in §24.22(d)(2) is consistent with the requirement in TWC §13.1871(n) that provides that a utility shall mail notice of the hearing to each ratepayer before the hearing, and that the notice must include a description of the process by which a ratepayer may intervene in the ratemaking proceeding. Although the statute uses the term "hearing," the context of the statute (requiring notice to include a description of the process by which a ratepayer may intervene in the proceeding) contemplates that such notice be provided prior to a prehearing conference. Further, the commission finds that this provision is consistent with the existing requirements in former §24.28(2), meaning that no new burden is imposed on Class B or Class C utilities. The commission finds that ratepayers should be

granted the opportunity to participate in the ratemaking process and therefore should be provided with the necessary information in order to participate.

Finally, the commission notes that TAWP commented on the strawman and that certain provisions relating to this section were not included in the Proposal for Publication, specifically the requirement to provide "reasonable notice" was removed from the Proposal for Publication. The commission maintains its position that affected ratepayers should be provided notice of a pre-hearing conference.

Section 24.22(e) - Line extension and construction charges

The Water IOUs commented that the current rule requires that a utility "request in a rate change application that its extension policy be approved or amended" but noted the proposed rule changes "extension policy" to "line extension and construction charges" stating this change is improper because most of these charges are negotiated and not specifically stated in a utility's tariff. In addition, the Water IOUs requested that these changes should be allowed through a minor tariff change. OPUC agrees that the rule should be amended to change the word "charges" to "policies." However, OPUC noted that amendments to extension policies should only be done as part of a rate change application, and not as a minor tariff revision.

Commission response

The commission modifies §24.22(e) to replace the word "charges" with the word "policies" as the commission recognizes that most of these charges are negotiated and not specifically stated in a utility's tariff and, therefore, the appropriate term is policies.

In addition, the commission declines to modify this subsection to allow for line extension and construction policies to be changed through a minor tariff change. The commission concludes that these changes are more appropriately sought through a full rate change application so that affected ratepayers receive notice of proposed changes. The commission finds that notice of these changes is essential and therefore finds that classifying them as a minor tariff change would not adequately protect ratepayers.

Repealed Section 24.22(f) - Stand-by fees

OPUC stated its support for the repeal of this section because there is no statutory authority to support it. The Water IOUs requested the commission explain why this section was removed and stated they do not support the repeal of the stand-by fee rule without a sound justification by the commission. In their reply comments, OPUC noted that stand-by fees were initially prohibited by rule at the Texas Water Commission (a TCEQ predecessor) because a stand-by fee was not considered a duly authorized rate as it is not collected in exchange for service, product, or commodity. In addition, OPUC pointed out that there is no clear guideline for who would be required to pay a stand-by fee and that if a utility is collecting a stand-by fee, it is offsetting its investment risk by shifting costs to landowners. OPUC reiterated that TWC Chapter 13 does not authorize the use of stand-by fees and that the stand-by fee goes against the requirement that a property be "used and useful" in providing service in order to be included in "invested capital." Therefore, OPUC urged the commission to repeal this section.

Commission response

The Water IOUs were the only party that provided comments opposed to the repeal of §24.22(f); but, the Water IOUs did not articulate statutory or policy reasons to retain the subsection. Therefore, the commission declines to reinstate this subsection.

Section 24.22(f) and (g) - Capital improvements surcharge and debt repayment surcharge

OPUC commented that surcharges for capital improvements and debt repayment are extraordinary forms of relief and therefore should only be permitted after thorough review and analysis. OPUC therefore recommended that all surcharges collected under §24.22(f) and (g) be subjected to the escrow requirements found in §24.30(b). However, OPUC also stated that if suspension of rates will not be routine pursuant to §24.26, then they recommend the commission adopt language to these provisions to prohibit the collection of these burdensome surcharges until the commission has determined that their collection is reasonable. In their reply comments, the Water IOUs expressed their disagreement with OPUC's recommended changes and argued that these provisions are already required to be requested through the requirement of a rate proceeding. The Water IOUs contended that adding more procedural impediments to using these types of charges further reduces the already limited opportunity for their use.

The City of Houston argued, and OPUC agreed, that subsection (g), like subsection (f), does not address the accounting treatment for the "additional revenues" and urged the commission to treat these "additional revenues" as an offset to rate base; the City of Houston suggested "additional revenues" be treated as a contribution in aid of construction, an offset to plant in service. The Water IOUs, in their reply comments, stated that they were not sure this suggested change was

proper and argued that whether there should be an offset to rate base probably depends on whether the debt being repaid through the surcharge relates to funds actually spent on rate base itself. Therefore, the Water IOUs stated that this issue is sufficiently covered by §24.31(c)(3), and thus no change is necessary.

Commission response

The commission finds that it may not always be necessary to escrow the surcharges collected under §24.22(f) and (g) and, therefore, maintains its discretion to escrow these surcharges when appropriate on a case-by-case basis.

The commission finds that the accounting treatment for "additional revenues" is adequately covered by §24.31(c)(3), and therefore, declines to modify the rule as proposed by the City of Houston. The commission finds that flexibility is important and, thus, the accounting treatment will be based on the specific facts of each case.

Section 24.23 - Time Between Filings

TAWP and the Water IOUs urged the commission to delete subsection (a), relating to the application, from the adopted rule. TAWP rationalized that many Class B utilities have varied service areas consisting of smaller water and/or sewer systems, which often operate as separate stand-alone companies with separate rate structures. TAWP further argued that when a particular system is overearning or under-earning, there is a need for a utility to file a statement of intent pertaining to that system. Conversely, if a particular system is not under-earning or overearning, there is no need to file a statement of intent for that system. Therefore, TAWP argued that

requiring a utility to file a rate-case pertaining to several different rate structures and systems or risk losing the right to file for those systems adds an unnecessary level of complexity to the filing and brings additional work to the utility, parties, and staff, thus creating a more burdensome requirement for smaller utilities. TAWP maintained their disagreement with the commission's inclusion of this provision in §24.23 and urged the commission to consider amending the rule to allow for separate rate filings for separate systems and rate structures, when appropriate.

OPUC disagreed that subsection (a) should be deleted but argued the term "system-wide" creates confusion and should be amended as it is not defined. OPUC argued that "system" is a shorthand term of art meaning "public drinking water system" and thus a utility may be composed of multiple "systems." Therefore, OPUC suggests the commission remove use of the term "system-wide" and instead use the phrase "consolidated or regional tariffs."

The Water IOUs also asked the commission to revise subsection (b) in order to be more flexible with respect to when a utility must wait to file a new rate application to further promote regionalization and the legislative intent of the applicable statute. In addition, the Water IOUs generally commented that this rule has been problematic for utilities with multiple systems, tariffs, CCNs or affiliated entities that provide retail water or sewer utility service in different parts of the state under different sets of rates. The Water IOUs stated that the problems that have arisen regarding this rule might have been a result of the interpretation given to it by the TCEQ and not because of the rule itself.

The Water IOUs noted that water utilities operate under multiple tariffs and different sets of rates that affect different ratepayers in distinct service areas and should therefore be able to file applications that seek changes to different tariffs or rate schedules that affect different ratepayers more than once in a twelve-month period. The Water IOUs stated that without being allowed to do this, ratepayers will be burdened and regionalization efforts will be thwarted, which the Water IOUs believe the commission should be facilitating and encouraging.

The Water IOUs requested the commission adopt a pro-regionalization approach to this issue, especially in light of the fact the TWC provides that "a utility or two or more utilities under common control or ownership may not file a statement of intent to change its rates more than once in a 12-month period," and argued that the use of "its rates" could be interpreted as a reference to a particular set of rates and not necessarily "any rate" that may apply to that utility or its affiliate utilities throughout the state. In their reply comments, the Water IOUs stated that if their suggested revisions are not adopted, the commission should consider modifying the rule as suggested by TAWP.

OPUC argued that with respect to the suggestions TAWP and the Water IOUs made to subsection (b), the commission should disregard these modifications as they clearly ignore the statutory language of §13.187(p) and §13.1871(w). In addition, OPUC asked the commission to reject TAWP and the Water IOUs' request to amend the rule to allow utilities to file more than one notice of intent to increase rates within a 12-month period, as long as rates for particular customers are not changed more than once in 12-months, because this was rejected not only by TCEQ but also the Legislature.

In contrast, OPUC stated its support of the clarifications the commission made to this rule. In their reply comments, the Water IOUs reiterated their opposition to the proposed changes to this rule.

Commission response

The commission recognizes that a rate case that includes different rate structures and systems may add complexity to the filing; however, absent a legislative change the commission declines to substantively modify the rule as proposed by TAWP and the Water IOUs. The commission finds that TWC §13.187(p) clearly states that, with certain exceptions, a utility or two or more utilities under common control and ownership may not file a statement of intent to increase its rates more than once in a 12-month period.

The commission agrees to modify §24.23(a) as proposed by OPUC because the undefined term "system-wide" has the potential to create confusion. The commission, therefore, replaces the term "system-wide" with the term "regional."

The commission further modifies §24.23(b) to reorganize it for clarity and to track the language in TWC §13.187(p).

Section 24.26 - Suspension of Effective Date of Rates

OPUC stated that it is of the belief that the commission intends to suspend the effective date of proposed increases, as it does in electric rate filings, until such time as the final just and

reasonable rates are determined. OPUC stated its support for this position and continued to encourage the commission to take this action whenever possible in order to minimize the over-collection of revenue from customers. OPUC pointed out that the implementation of water and wastewater rate increases prior to the determination of just and reasonable rates has historically led to confusion and has resulted in the difficulty of providing customer refunds. Therefore, OPUC concurred with the commission in the modifications made to this rule.

The Water IOUs expressed their concern over the proposed procedure for the suspension of an effective date. The Water IOUs argued that it is unclear at what point in the process between filing and the proposed effective date a utility may expect notice of what should be a commission order regarding a suspension, and whether a utility will be afforded an opportunity to contest/cure any perceived filing deficiencies.

In addition, the Water IOUs expressed concern over the apparently infinite nature of the possible suspension of an effective date, and stated that the TWC only provides for limited suspension durations where there is good reason for the suspension. The Water IOUs stated their primary concern is that the limited suspension periods set forth in the TWC are followed and not circumvented because if they are, the time during which new rates cannot be charged will be unreasonably extended. The Water IOUs argued that proposed subsection (b)(1) not only suggests that an infinite effective date suspension is possible, but they argued it broadens potential reasons for this type of suspension from those provided in TWC §13.187(d) and §13.1871(e), which only allow for suspension when the "application or the statement of intent is not substantially complete or does not comply with the regulatory authority's rules." Under their

interpretation of the proposed rule, the Water IOUs stated the proposed rule goes beyond the requirement that an application be substantially incomplete or violate a rule for a rejection and suspension to occur, but allows "rejection of an application or statement of intent via §24.8 for any reason at all (even if there was a good faith attempt to comply with commission rules for same), followed by an unlimited suspension period until an application is revised and filed according to an unspecified set of standards." The Water IOUs argued that as written the proposed rule would cause disputes to occur over whether a utility's cost of service was properly proposed, which would occur without the benefit of a contested case hearing. The Water IOUs reiterated their belief that the possibility of unlimited rate suspensions was not within the legislative intent of HB 1600 or SB 567. OPUC, in their reply comments, stated the process proposed in §24.26 is within the commission's authority to implement, and the commission should therefore reject the changes proposed by the Water IOUs.

As to subsection (c), the Water IOUs disagreed that the commission is authorized to require "a new proposed effective date," and stated that this seems to be an attempt to shift the utility's proposed effective date that commences the limited time period for suspensions under TWC §13.187(e) and §13.1871(g) and would unjustly prolong the time to complete a hearing. In addition, the Water IOUs argued that there should not be a second round of notice required if the commission suspends a utility's proposed effective date because not only would it be expensive, it would also be unnecessary and is not required by the TWC. The Water IOUs contended that, in the event of a suspension, the hearing should determine the final effective date for the proposed rate change without further notice being required. OPUC argued a utility's failure to file a substantially complete statement of intent or an application that complies with the

commission's rules could cause the original notice that was distributed to be insufficient, therefore, OPUC argued due process may require additional notice and that this additional notice should be required when necessary.

Generally the Water IOUs urged the commission to substantially amend §24.8, consistent with their recommendations, because as written, the rule gives rise to serious due process concerns and goes beyond what was contemplated in TWC.

The City of Houston generally commented that subsection (g) allows the commission to require the refund of money collected, including interest, under a proposed rate but does not identify the appropriate interest rate. The Water IOUs urged the commission to set the bar high for "good cause" before a utility is required to "refund money collected, including interest, under a proposed rate before the rate was suspended to the extent the proposed rate exceeds the existing rate." The Water IOUs rationalized that it would be an expensive administrative burden that will ordinarily apply to a very short period of time, if any, and should ordinarily be resolved at the end of a hearing along with other issues. The Water IOUs, in their reply comments, stated that interest should not be required for the type of refunds contemplated by subsection (g), which only addresses a rare "good cause" situation that would require refunds for what is expected to be a brief period, if any, between the proposed effective date and the suspension. The Water IOUs stated that even if interest was required for subsection (g), it would not be appropriate to identify a specific interest rate within the rules because the commission adjusts its annual interest rate for overbillings and under-billings annually.

Commission response

The commission understands the concerns expressed by the Water IOUs but declines to modify the rule as suggested. The commission finds that it has statutory authority to suspend an effective date until all deficiencies in an application are cured as discussed in its response regarding §24.8 above.

The commission modifies subsection (a)(2) to conform the provision to SB 1148 by changing "205 days" to "265 days." In response to the Water IOUs concerns that the proposed rule may cause disputes over whether a utility's cost of service was properly proposed, the commission modifies subsection (b)(1) to delete the phrase "has included in the cost of service for the noticed rates rate-case expenses other than those necessary to complete and file the application." The language regarding cost of service was a carry-over from the current rule that is not needed at this time. Additional non-substantive changes are made to subsection (b)(1) to further clarify the language.

Regarding the commission's authority to require a new effective date, if a utility sends a deficient statement of intent in violation of TWC §13.187(a-1) or §13.187(b) such that a revised statement of intent is necessary, a revised effective date may be required pursuant to the same statute. TWC §13.187(a-1) and §13.1871(b) also require that notice is provided at least 35 days before the effective date of the proposed change. However, the commission notes that not all deficiencies may result in requiring a revised statement of intent and therefore, the suspension of an effective date may not always require a revised statement of intent. The commission modifies subsections (b) and (c) to clarify that if the commission

suspends the effective date, the requirement under §24.28(b)(1) (relating to Processing and Hearing Requirements for an Application Filed Pursuant to Texas Water Code §13.187 or §13.1871) to begin a hearing within 30 days of the effective date does not apply. The commission also modifies subsection (f) to clarify rule language and to specify that it is the *effective date* that is suspended rather than *rates* that are suspended.

Regarding the appropriate interest rate for refunds ordered pursuant to subsection (g), the commission deletes ", including interest," from subsection (g). In the current subsection (g), interest is not authorized and as noted by the Water IOUs interest would apply infrequently and for brief periods of time.

Section 24.28 - Processing and Hearing Requirements for an Application Filed Pursuant to Texas Water Code §13.187 or §13.1871

OPUC expressed its general support of the proposed amendments to this substantive rule. The Water IOUs expressed their concern over the reference in §24.28(b)(1) and (c)(1) to an "effective date of the rate change," and argued that there is a potential for conflict between requirements related to a "proposed effective date" and the "effective date," if these dates are different. The Water IOUs argued that in the event of a suspension, a final "effective date" may not be known until the end of a hearing, but the "proposed effective date" would be known because it is the date from which all suspension periods are required to run and cannot be changed even if the actual "effective date" is changed. Therefore, the Water IOUs urged the commission to reference the "proposed effective date" as opposed to the "effective date" in order to prevent confusion and the potential for delay in conducting a hearing.

The City of Houston argued that §24.28(b), as proposed, makes the referral to the State Office of Administrative Hearing (SOAH) the beginning date of the "hearing". The City of Houston argued that under this provision, the resulting period would be insufficient and would deny interested parties necessary time to prepare for hearing. Therefore, the City of Houston recommended the commission strike "and the referral shall be deemed to be the beginning of the hearing required by paragraph (1) of this subsection." The Water IOUs stated they do not share this concern because there will ordinarily be a procedural schedule that will dictate the pace of the hearing once it begins. The Water IOUs, however, also emphasized that the limited suspension periods should be followed and that hearings should be conducted quickly.

TAWP urged the commission to include a provision that would allow for early settlement conferences for TWC §13.1871 proceedings within 90 days of filing the case in order to facilitate efficiency and early resolution. TAWP urged the commission to adopt the following language:

> Within 90 days of filing the parties shall convene a settlement conference. If during the settlement conference the parties reach an agreed settlement of all facts in controversy, the case shall not be considered a contested case and no proposal for decision or findings of fact are required.

TAWP argued that to the extent that rates are suspended for 205 days, regulatory lag is a significant concern for small utilities without significant resources and access to capital. Therefore, TAWP argued that to the extent that large capital expenditures have been made or operating expenses have significantly increased, rate relief is necessary on a more immediate basis for small utilities. TAWP also stated that they believe the suspension guidelines previously used by the TCEQ considered the unique needs of small water and sewer companies within the

state. The Water IOUs expressed their support for this suggested requirement of early settlement conferences.

In contrast, OPUC argued that the language proposed by TAWP would require parties to a rate case convene a settlement conference within 90 days of the filling of an application, should not be adopted. While OPUC recognized the potential cost-savings benefits of early settlement, OPUC argued that settlement discussions should not be imposed because they are sometimes not appropriate and can cause unnecessary delay and result in increased expenses. OPUC argued that the settlement procedures available at SOAH are adequate and that parties should be able to use their best judgment as to when settlement discussions will be productive.

Commission response

The commission declines to modify §24.28(b)(1) and (c)(1) to include the word "proposed" before effective date because the published language is consistent with TWC §13.187(f) and §13.1871(k). The commission also declines to modify §24.28(b) as suggested by the City of Houston. The commission disagrees that under the current language the period for conducting a hearing at SOAH would be insufficient and deny interested parties the time necessary to prepare for a hearing. Additionally, the Legislature recently passed SB 1148 that extended the suspension period for applications filed pursuant to TWC §13.1871 from 205 days to 265 days.

As discussed in further detail above, the commission declines to modify any of the rules to require a settlement conference. The commission maintains that settlement conferences

regularly take place on an informal basis, and it is not necessary to include them as a requirement in this chapter.

Consistent with the discussion regarding changing the term "complaint" to "protest" in §24.22(d)(1)(B), above, the commission modifies subsection (c) to replace the words "complaint" and "complaints" with "protest" and "protests" when referring to affected ratepayers. Consistent with the discussion regarding removing "with interest" above in §24.26, "including interest" is also deleted in subsection (e).

TWC §13.187(f) requires that not later than the 30th day after the effective date of the change, the commission shall begin a hearing to determine the propriety of the change. The commission modifies subsections (b) and (c) to clarify when a hearing is deemed to have begun for a matter that is not referred to the State Office of Administrative Hearings. The commission adds subsections (b)(3) and (c)(3) to state that if a matter is not referred to the State Office of Administrative Hearings, an order establishing a date for a prehearing conference shall be deemed to be the beginning of the hearing.

Section 24.29 - Interim and Bonded Rates

TAWP stated they disagreed with §24.29(c)(1)(A), which contemplates a finding of "unjust or unreasonable rates," which they argued is an ultimate issue to be determined after reviewing all of the evidence in the case. In addition, TAWP argued that the §24.29(b)(1)(B) requirement that a utility prove that its existing rates are just and reasonable is confusing. TAWP argued that the premise behind a rate filing by a utility is that existing rates are not just and reasonable and

therefore the provision would only apply when the rate application is an application to reduce rates brought by a party other than the utility.

The Water IOUs also argued §24.29 should be modified even though the commission has not proposed any changes to this section. Despite this, the Water IOUs argued the language that allows for interim rate hearings to become a hearing on the ultimate issues in the rate case should be removed. The Water IOUs noted that in the event of a suspension, this will likely be moot but argued that it should be removed anyway. In addition, the Water IOUs noted that there is no proposed language implementing the new bonded rate statutory provisions found in TWC §13.187 and §13.1871, and stated that this language could be added to §24.29, or to another commission rule. OPUC stated that they are not clear exactly what language the Water IOUs are requesting be removed as the quoted language is part of a series of bases upon which interim rates can be granted, but disagrees with any word removal as the statutory basis for interim rates is set out in the TWC, which the commission has implemented.

In their reply comments, the City of Houston took exception to the Water IOUs' request to remove language that allows interim rate hearings to become hearings on the ultimate issues in the case. The City of Houston argued that the commission or the Administrative Law Judge (ALJ) should be allowed adequate flexibility to determine the most appropriate form of action based on the facts available for a given situation. The City of Houston further argued that it is in the public interest to provide customers and the commission with as many potential avenues available to address unique situations that may arise.

OPUC, in its reply comments, clarified that in the past, water utilities have enjoyed a quasi-presumption of just and reasonable rates simply by filing a rate application because they were able to charge their proposed rates without a hearing on the merits. OPUC stated the interim rate language opposed by the Water IOUs simply removes this presumption. In addition, OPUC pointed out that an interim rate hearing is not an evidentiary hearing but can be based on oral arguments as well as on whether the rates "could" result in unjust or unreasonable rates. However, OPUC noted, if the rates are not suspended in a particular case, the relief provided by this interim rate provision is essential to prevent the imposition of potentially unjust and unreasonable rates.

Commission response

The commission declines to adopt the suggested changes to §24.29 as no changes to this section were included in the published notice of this rulemaking. During the strawman phase of this project, commission staff discussed with stakeholders potential changes to §24.29. However, the commission did not propose any changes to §24.29 to comply with the TWC amendments pursuant to HB 1600 and SB 567 and no changes are necessary to the rule at this time. The commission may consider amending §24.29 in a future rulemaking project.

Section 24.31 - Cost of Service

TAWP urged the commission to add a provision in this section that would incorporate the rate-case expense reimbursement provisions found in §25.245 (relating to Rate-Case Expenses). The Water IOUs, in their reply comments, agreed that TAWP's suggestion was an acceptable option

but noted that "size of the utility and number and type of consumers served" should be removed as a consideration since so many water and wastewater utilities are smaller than electric utilities. The Water IOUs argued that the proposed rule has included provisions that are not required by HB 1600 and SB 567 and constitute "substantial departures" from TCEQ rulemaking practice and are contrary to established legal precedent. In addition, the Water IOUs stated their belief that certain additions would constitute retroactive law and would result in retroactive ratemaking. Therefore, the Water IOUs urged the commission to revise these sections or delete them in order to prevent the commission from issuing "confiscatory rate orders."

Commission response

At this time, the commission declines to incorporate the rate-case expense reimbursement provisions found in §25.245 (relating to Rate-Case Expenses) into §24.31. The commission may consider modifying the rule in a future rulemaking project in which the issues may be more fully considered with input from all interested stakeholders.

To the extent commenters took specific issue with §24.31, and addressed instances where the commission included provisions in this section that are not required by HB 1600 and SB 567 and allegedly constitute substantial departures from TCEQ rulemaking practices, these comments will be addressed below. However, the commission notes that it disagrees that it is adopting changes to this section that are contrary to established legal precedent and finds that none of the changes made to the chapter 24 rules constitute retroactive ratemaking. The rule against retroactive ratemaking prohibits the commission from setting future rates to allow a utility to recoup past losses or to refund to consumers excess

utility profits. *State v. Public Utility Commission of Texas*, 883 S.W.2d 190, 199 (Tex. 1994) (*State*). While some of the adopted provisions in this rule relate to the accounting treatment for a utility's previous transactions, no part of the adopted rule authorizes the commission to make a retrospective inquiry to determine whether a prior rate was reasonable and imposing a surcharge when rates were too low or a refund when rates were too high. *State* at 119. Accordingly, no provision in the adopted rule implicates retroactive ratemaking.

Section 24.31(b)(1)(B) and (c)(2)(B)

The Water IOUs expressed concern over how the proposed rule addresses depreciation stating the TWC was amended to provide that the rule adopted under TWC §13.131(c) "must require the book cost less net salvage of depreciable plant retired to be charged in its entirety to the accumulated depreciation account in a manner consistent with accounting treatment of regulated gas and electric utilities in this state." The Water IOUs proposed the commission review the rules for consistency with electric utility requirements and simplify the rules so that the system of accounts used by each utility dictates the appropriate treatments, instead of trying to incorporate them into specific rule requirements, stating the electric utility rules do not have such provisions. The Water Utilities rationalized that group depreciation is something the National Association of Regulatory Utility Commissioners (NARUC) system of accounts has historically recognized as a common practice, but one that TCEQ was slow to recognize. The Water IOUs argued the provisions are confusing and are not all necessary and therefore subsections (b)(1)(B) and (c)(2)(B) should be revised.

In their reply comments, OPUC noted that while they generally support the rules regarding depreciation as proposed, they agree with the Water IOUs that additional refinement through a separate rulemaking project is desired.

The City of Houston disagreed with the assertion made by the Water IOUs that §24.31 was "very confusing" and argued that the Water IOUs failed to provide customers with appropriate price signals as it relates to capital recovery. The City of Houston rationalized that the reference to NARUC made by the Water IOUs was not proper because the referenced NARUC publications have not been recently updated and may no longer reflect mortality characteristics derived from current statistical methods such as actuarial analysis. The City of Houston urged the commission not to adopt the modification because in their opinion the publications referenced by the Water IOUs do not provide "better" guidance.

Commission response

The commission declines to make the changes proposed by the Water IOUs because the commission does not intend to address depreciation, at this time, as proposed by the Water IOUs. The commission may consider changing the standards for how depreciation is treated and accounted for in a future rulemaking project in which the issues may be more fully considered with input from all interested stakeholders.

Section 24.31(b)(1)(D) - Federal income tax expense

TAMER noted that the proposed rule would not alter subsection (b)(1)(D), which allows federal income tax as an expense, and further noted that the commission did not elaborate on the

commission's understanding of how that expense will be determined. TAMER pointed out that at the TCEQ, even limited partnerships that pay no federal income tax could assert a 35% federal income tax rate for purposes of calculating the ratepayers' duty to cover a utility's expenses. TAMER urged the commission to alter the text of this subsection in order to elaborate that the method of tax calculation used by the utility to derive this expense item must generally reflect the weighted average of the actual tax burdens borne by the ultimate federal tax payers on net income derived from, including tax savings attributable to, the utility. TAMER and OPUC argued that ratepayers should no longer be burdened with reimbursement of "phantom" federal income taxes that are not, in fact, paid by anyone. OPUC expanded that to the extent that a water or wastewater utility is a member of an affiliated group that files a consolidated return, the federal income tax computation for purposes of setting rates should take into account the savings that are achieved. OPUC urged the commission to modify the rule in order to reflect this requirement and provide for a computation that complies with TWC §13.185(f).

In their reply comments, the Water IOUs stated they do not agree with TAMER's suggested revisions to this subsection. In addition, the Water IOUs pointed out that TAMER did not provide any alternative rule language for them to comment on. The Water IOUs expressed their belief that TAMER incorrectly implies that allowing federal income tax provisions for limited partnerships was a practice unique to the TCEQ and pointed out the commission also has such a policy as seen in PURA §36.060(a) and (b). The Water IOUs argued that a consolidated tax adjustment (CTA) reduces a utility's tax expense (or rate base) when setting rates by the tax benefit of non-regulated affiliate corporations, and the federal income tax of a regulated utility is reduced by a portion of the tax benefits generated by non-regulated affiliates. The Water IOUs

argued that a CTA confiscates a portion of the tax benefits generated by affiliated non-regulated companies and allocates those benefits to the ratepayers of the regulated entity and therefore violates the basic regulatory principles of cost allocation. In addition, the Water IOUs pointed out that historically, public utility commissions have consistently eliminated non-regulated investments and the associated revenue/expenses from the determination of rate base and cost of service when determining authorized retail rates charged to the utility's customers. Commissions have tried to eliminate the possibility of the ratepayer being charged for non-regulated activities that would have the result of subsidizing the non-regulated operations. The Water IOUs urged the commission to follow this trend and continue to treat regulated companies on a stand-alone basis in order to prevent subsidizing non-regulated activities.

Commission response

The commission did not propose changes to subsection (b)(1)(D), and the commission declines to adopt the changes proposed by TAMER and OPUC. The commission has previously determined that federal income tax expense is appropriately calculated on a normalized basis, and the "actual taxes paid" methodology advocated by TAMER and OPUC is inconsistent with this method. The commission notes that the language of TWC §13.185(f) is consistent with language that was included in PURA §36.060 until it was amended in the 83rd Legislative session in 2013. The commission operated under and applied this statute for many years by incorporating a reference to the statute within its chapter 25 substantive rules, however, the commission points out that it did not include explicit methodologies or practices in the chapter 25 substantive rules. The commission's position is that, where possible, the rules should maintain flexibility especially in areas

where methodologies and practices may change. This flexibility allowed the commission to avoid having to amend its chapter 25 rules when the Legislature amended PURA in 2013 and the commission determines that the same flexibility should be maintained in the chapter 24 substantive rules.

Section 24.31(b)(1)(F) - Allowable expense

OPUC recommended changing the word "energy" to "water" in subsection (b)(1)(F)(i) as the proper reference would be to conserving water and not energy. The Water IOUs agreed but expressed their confusion as to the intent of the rule as it could include both energy and water.

LCRA expressed their concerns over the proposed limits included in §24.31(b)(1)(F) relating to advertising, contributions, and donations stating that the maximum limit included in the proposed rule, particularly as pertaining to advertising related to conserving energy, methods or water or wastewater savings, and water quality protection, places undue and counter-productive scrutiny on efforts that LCRA argued clearly provide benefit to water suppliers who are required by regulation to adopt and implement programs for water conservation and who play a role in water quality protection. LCRA pointed to Texan voters' approval in November 2013 that authorized the deduction of $2 billion in public funds for water infrastructure projects, which included a dedication of a portion of the money to water conservation efforts as proof that Texans favor increasing water supplies. LCRA further argued that water suppliers at all levels should not be unreasonably restricted from implementing policies and promoting methods that improve the efficient use of water throughout the state stating that the formula-determined limits on the advertising of an entity's efforts and programs in these areas may, in fact, discourage these efforts and programs and may not appropriately recognize the value they provide for Texans.

Therefore, LCRA recommended the removal of the words relating to "the calculation of the three tenths of 1% (0.3%) maximum" including subsections (b)(1)(F)(i)-(iii) and replacing this with a provision stating "However, advertising expenses related to water conservation, water quality protection and energy conservation shall not be limited by the foregoing and will be separately evaluated as a reasonable and necessary expense of providing service." The Water IOUs shared the concerns expressed by the LCRA and stated that if the intent of the rule is to promote the specific expense items it purports to limit, it should be restructured in order to achieve this goal. In their reply comments, OPUC argued LCRA's proposal is unreasonable and should not be adopted. OPUC argued the three-tenths of 1% limitation is meant to encourage cost-efficient and prudent advertising spending decisions and that advertising limitations ensure that utilities restrict their advertising spending to essential safety, conversation, and other messages that provide direct benefits to ratepayers rather than image-enhancing advertising that relays few, if any, customer benefits. In addition, OPUC argued that limitations help ensure that safety and conservation advertising does not become unduly repetitive where the marginal cost of the additional advertising exceeds the marginal benefit occurring from additional expenditures. Therefore, OPUC continued to support the rule as published.

The Water IOUs asked the commission to clarify the source and purpose of this new provision, specifically, the language regarding a 0.3% maximum of gross receipts maximum. The Water IOUs also stated it is unclear whether the intent of subsection (b)(1)(F)(i)-(iii) is to limit what may be included in the 0.3% maximum or to encourage such expenditures by not including those items. The items listed appear to be conservation-oriented.

Commission response

The commission agrees to modify subsection (b)(1)(F)(i) to change the word "energy" to "water" as the proper reference would be to conserve water and not energy. The commission finds that this change makes clear that this is a reference to water conservation.

The commission recognizes that a limit must be placed in subsection §24.31(b)(1)(F) relating to advertising, contributions, and donations to promote water conservation because at a certain point the expenditure is no longer reasonable or beneficial. The commission finds that a reasonable limit must be placed on these activities in order to promote responsible spending that will result in actual conservation. A limit encourages cost-efficient and prudent advertising spending decisions. In addition, the commission declines to modify the rule as proposed by LCRA to provide for separate, case-by-case, evaluation of the expenditures because this could lead to subjective and potential arbitrary analysis, and is not an efficient use of administrative resources. By limiting the expenditures to 0.3%, the commission has established an objective and reasonable amount for certain expenses to promote conservation. The commission developed the 0.3% gross receipts maximum based upon a similar provision for electric utilities in §25.231(b)(1)(E). In response to the comment from the Water IOUs stating that it is unclear what may be included in the 0.3% maximum, the commission modifies this rule to clearly indicate that §24.31(b)(1)(F)(i)-(iii) is an exhaustive list.

Section 24.31(b)(2)(J) - Allowable expense

The Water IOUs requested the commission either delete or revise the existing rule so that expenses for purchased groundwater may be recovered in situations where surface water purchased is mixed with supplemental groundwater from within a priority groundwater management area (PGMA) and in situations where an emergency requires the purchase of groundwater within a PGMA even though surface water is available. The Water IOUs argued that the provision, as written, is overly restrictive and should therefore be deleted or revised with these situations in mind, which would make the purchase of groundwater and recovery of its costs entirely reasonable despite the conservation-minded policy the rule promotes. OPUC urged the commission not to adopt this modification arguing that PGMAs are areas where within the next 50 years, the area is expected to experience a critical groundwater problem, including shortages of surface water or groundwater, land subsidence resulting from groundwater withdrawal and contamination of groundwater supplies. OPUC contended that given the expected constraints on groundwater supply in PGMAs, the use of groundwater from these areas should not be encouraged. OPUC argued that if a wholesale supply of surface water is available, then the costs incurred by a utility for purchasing groundwater from within a PGMA should not be allowed as a component of a utility's cost of service. Therefore, OPUC argues no change is appropriate.

TAMER argued that the Water IOUs do not make a case as to why groundwater purchases in situations where wholesale surface water purchases are possible should generate allowable expenses. TAMER urged the commission not to abandon its support of the state policy, absent a more rational argument than the Water IOUs' conclusions that mixing waters should "over-rule"

the policy or that there may be some "unexplained emergency" that make use of available surface water imprudent.

Commission response

The commission did not propose any changes to §24.31(b)(2), and therefore declines to make the proposed modifications to the rule at this time. The purpose of this project is to amend the Chapter 24 to comply with the TWC amendments as a result of HB 1600 and SB 567, along with related ratemaking changes consistent with moving the economic regulation of water and sewer utilities to the PUC. The commission may consider the proposed modifications in a future rulemaking project where the issues related to this section can be fully considered and analyzed, and where parties are provided the opportunity to comment on proposed rule changes.

Section 24.31(c) - Return on invested capital

TAWP and the Water IOUs expressed concern over the definition of "debt capital" and argued there should be flexibility in determining the appropriate cost of debt and capital structure, particularly for small water or sewer utilities. TAWP argued that the risk characteristics of Class B and Class C utilities vary greatly depending upon factors such as location, size, need for growth, and age of the system, and that allowing flexibility and the ability to determine reasonableness on a case-by-case basis would allow for the commission to consider all relevant factors. In their reply comments, the Water IOUs maintained their position that there should be flexibility in proposing reasonable cost of debt and capital structures. In their reply comments, OPUC argued that the commission has well-established precedent that requires the use of the

embedded cost of debt in setting the cost of capital and that the need for flexibility in setting a cost of debt that varies from the embedded cost should be limited to extraordinary circumstances, and therefore concluded the existing rule is appropriate.

Commission response

The commission addresses specific comments regarding cash working capital in the relevant subsection, below.

Subsection 24.31(c)(2)(B)(i)

The Water IOUs applauded the commission's recognition and acceptance in the proposed rule for the long-established practice in the TCEQ rate-cases of allowing water/wastewater utilities to use trending studies for acquired assets where reliable and verifiable historical records are not available. The Water IOUs argued this practice promotes regionalization by allowing a purchasing utility to establish rate base for acquired assets even though the selling utility may not have kept good asset records or the asset records kept are insufficient.

However, the Water IOUs also requested the commission make substantial modifications to this section, arguing that the subsections' apparent shortcomings make it unacceptable. First, the Water IOUs expressed concern that there may be systems in Texas which may not qualify as a "nonfunctioning system or utility" under the proposed definition in §24.3(33). The Water IOUs asserted that the nonfunctioning system or utility may have problems, and may want to sell, but may not have good asset records (or any asset records) for a variety of reasons. The Water IOUs argued that allowing asset trending for those systems without a reduction in rate of return would

promote regionalization and prevent more capable utilities from walking away from those potential transactions for fear of not being able to earn a return on the purchased assets. Second, the Water IOUs argued that the entire concept of lowering the reasonable rate of return on equity by 3% for trended assets is arbitrary and unreasonable and rationalized that the point of trending is to come up with a reliable estimate of the original cost of the assets so that proper return and depreciation expense amounts can be established in the rate-case. The Water IOUs maintained that calculating a reliable estimate of the original cost of an asset, just to lower a portion of return, defeats the purpose of trending, which is to ensure a reasonable return based on original cost, less depreciation. The Water IOUs rationalized that, if anything, a utility taking such a risk should receive a higher rate of return on equity for undertaking the risk. By reducing a return on equity by 3%, the Water IOUs argued, the commission would be discouraging the acquisition of these types of assets. Finally, the Water IOUs argued the proposed rule would apply without limitation to all "cost of plant and equipment allowed in the cost of service that has been estimated by trending studies or other means which has no historical records for verification purposes," without specifying that the rule would apply to acquired assets prospectively only. The Water IOUs expressed fear that the rule will result in retroactive ratemaking by applying to previously acquired trended assets, and recommending setting the standards for trending studies in a separate rulemaking.

The City of Houston disagreed with the Water IOUs that subsection (c)(2)(B)(i) has "many problems" and disagreed with their recommended changes. The City of Houston argued that the Water IOUs are seeking reward for reliance on trending studies where reliable and verifiable historical records are not available for the acquired assets. The City of Houston asserted that the

commission should not be rewarding older "mom and pop" systems who chose not to maintain adequate records by allowing a higher purchase price. The City of Houston argued that reliance on indices like the Handy-Whitman Index would overstate costs because they recognize increases in overhead costs like pensions and healthcare which might not exist for "mom and pop" systems. In addition, the City of Houston disagrees with the assertion made by the Water IOUs that it would be unjust and unfair for the commission to decide to reduce return on equity for all Water IOU's assets when a utility could not have foreseen the possibility now presented at the time of an acquisition. The City of Houston argued that utilities are granted an opportunity to earn a rate of return, which includes a return on equity above the cost of debt, to compensate for financial risk, which includes items that could or could not be reasonably foreseen, but that may transpire in the future. In addition, the City of Houston pointed out that the return level is never expected to be constant. The City of Houston expressed that they are of the opinion that the commission's proposed rules properly address a change in rate of return to all assets on a going forward basis and does not constitute retroactive ratemaking.

In their reply comments, TAMER stated their belief that it is not clear if this section, as proposed, sanctions trended valuation of capital plant. TAMER pointed out that the legislature transferred jurisdiction to the commission because of a perception that some TCEQ practices and policies were not in accord with good regulation and therefore urged the commission to not feel compelled to defer to the TCEQ's prior judgments regarding when or if ever trending studies may be used in lieu of actual purchase prices. In addition, TAMER added that trended valuations allow a purchaser of a system to establish an "original cost" of plant that bears no relationship to the price of the plant that the purchaser purchased. TAMER argued that absent an explicit tie

between the allowable trended valuation for an asset and what the purchasing utility actually paid for the asset, trended valuations should not be allowed.

In their reply comments, OPUC disagreed that trending studies are an adequate replacement for original cost calculation and should therefore not be recognized. However, OPUC noted that if the commission determines that trending studies may be used to estimate original cost in extraordinary circumstances, then there must be some appropriate means to counter their inherent unreliability. OPUC argued that trending studies are an estimate of original cost and not the actual cost amounts and that because experts are determining these estimates, two experts performing separate studies can arrive at vastly different figures using different, yet equally plausible, assumptions. OPUC concluded that the commission is not bound to adopt the TCEQ practice allowing trending studies and that the commission should reject trending study estimates as a substitute for actual original costs except in extraordinary circumstances because they are unreliable and susceptible to manipulation.

Commission response

The commission recognizes that at TCEQ trending studies were sometimes used because some utilities' books and records were not properly kept or were destroyed. The commission establishes a rule for trending studies and seeks to incentivize water and sewer utilities to obtain and keep proper books and records. As a general rule, the commission discourages the use of trending studies except when historical records are unavailable from any source. Trending studies are a subjective estimate of depreciable utility plant, which is the single most significant cost driver in most rate cases. Adjustments to a utility's rate

base and/or rate of return on equity may be warranted when a trending study is used to estimate a utility's level of invested capital on which the utility may earn a rate of return. The commission acknowledges that there are benefits to healthy utilities acquiring non-functioning utilities. The commission modifies published subsection (c)(2)(B)(i) to provide flexibility on a case-by-case basis, rather than requiring a mandatory 3 percent reduction to the rate of return on equity. The commission further modifies the rule to allow an adjustment to rate base in addition to a reduction to the rate of return on equity, if warranted. If trending studies were not permitted and no records existed for a utility, the alternative would be assigning assets $0 or market value, which could be inflated or deflated, and neither option provides for an accurate assessment of a utility's reasonable return on invested capital. Therefore, for instances in which adequate books or records are not available and the use of a trending study may be necessary, the commission maintains the discretion to make adjustments to the utility's rate base and/or rate of return as appropriate.

Because the commission modifies subsection (c)(2)(B)(i) as described above, the commission deletes the following sentence, "[i]f, however, the cost of plant and equipment is estimated using a trending study for a nonfunctioning utility where there are no historical records, the commission may consider other factors when establishing a reasonable rate of return." The commission modifies subsections (c)(1) and (c)(2) for additional clarity, and this change results in renumbering the remainder of subsection (c).

Section 24.31(c)(2)(B)(iii)

OPUC argued that §24.31(c)(2)(b)(iii) does not conform to TWC §13.131 and §13.184 and that as written, the subsection provides for the accounting for a return on a retired asset in the accumulated depreciation balances. OPUC stated that under TWC §13.184 "the utility commission may not prescribe any rate that will yield more than a fair return on the invested capital used and useful in rendering service to the public." Therefore, OPUC concluded that a utility is only authorized to obtain a return on investment for utility plant that is "used by and useful to the utility in providing service." In addition, OPUC stated that the language of TWC §13.131 provides for the accounting for retired assets to be reflected in the accumulated reserve for depreciation based on the original book cost of the retired asset less net salvage. OPUC asserted that based on TWC §13.131 and §13.184, it would appear that allowing a return on a retired asset is not appropriate when the plant is not used and useful. Therefore, OPUC urged the commission to strike the sentence in this subsection which reads: "Return is allowed for assets removed from service after June 19, 2009, that results in an increased rate base through recognition in the reserve for depreciation if the utility proves that the decision to retire the asset was financially prudent, unavoidable, necessary because of technological obsolescence, or otherwise reasonable."

In their reply comments, the Water IOUs expressed their disagreement with OPUC's recommendations and stated that the entire depreciation section needs to be reviewed for consistency with electric regulation in a separate rulemaking.

Commission response

The commission's proposed changes to published subsection (c)(2)(B)(iii) in the proposal for publication were limited to the re-numbering of the subsection; therefore, the commission declines to make the substantive changes proposed by the Water IOUs. However, the commission acknowledges the OPUC's comments and modifies published subsection (c)(2)(B)(iii) to state that return "may be allowed" rather than return "is allowed" to harmonize this subsection with TWC §13.131 and §13.184. To the extent that the entire subsection may need to be reviewed for consistency with electric regulation, the commission agrees with the Water IOUs that it would be appropriate in a separate, future rulemaking project where the issues related to this section can be fully considered and analyzed and where parties are provided the opportunity to comment on proposed rule changes.

Subsection 24.31(c)(2)(C)(i)

The Water IOUs asked the commission to clarify how the commission plans to determine whether materials and supplies inventories are "unreasonable, excessive, or not in the public interest." The Water IOUs argued the language seems to set the stage for arbitrary reductions to the working capital allowance, but that it would be helpful to know if the commission had some criteria it would be using to make this determination.

Commission response

The commission finds that the language in §24.31(c)(2)(C)(i) does not set the stage for arbitrary reductions to the working capital allowance because the commission will base its

decision on the evidence and the facts of each specific case. The Water IOUs expressed general concern about the rule language but did not propose specific changes. Accordingly, the commission does not modify the rule.

Section 24.31(c)(2)(C)(iii)

OPUC requested the commission make a minor modification to subsection (c)(2)(C)(iii)(IV) in order to create uniformity. OPUC rationalized that the rules refer to Class C utilities and then to Class B utilities before discussing in sub-clause IV that "Operations and maintenance expense does not include depreciation, other taxed, or federal income taxes, for purposes of sub-clauses (I), (II), (III), and (V) of this clause." OPUC suggested the commission restructure the subsection so that sub-clause IV would be moved to the beginning or end of §24.31(c)(2)(C)(iii). The Water IOUs agreed that there needs to be a correction made to the numbering of this section, however, they are unsure if OPUCs suggested correction in fact corrects the problem.

The Water IOUs, TAWP, and the City of Houston requested the commission clarify why there are different default amounts for cash working capital for Class A versus Class B versus Class C utilities in the proposed rule. In addition, TAWP asked the commission for the rationale behind the utilization of 1/12th of operations in maintenance expense for Class B utilities. Similarly, the Water IOUs stated it is unclear how the 1/12th operations and maintenance (O&M) amount was derived for Class B utilities and why the default of 1/8th O&M cannot be maintained for all, like has historically been the case. The City of Houston pointed out that the 1/8th rule has been in place for approximately 100 years and is no longer valid based on computerized billing systems and modern technology. The City of Houston therefore urged the commission to adopt a

negative 1/8th rule for Class A utilities that do not perform a valid and realistic lead-lag study to better reflect the abilities of "more capable utilities." In addition, the City of Houston argued that a zero cash working capital allowance should be adopted as the default position for Class B and Class C utilities.

The Water IOUs expressed their appreciation for the default provision of zero cash working capital, however, they expressed their belief that the reference in proposed subsection (c)(2)(C)(iii)(VI) should be (c)(2)(C)(iii)(IV), in order to allow for the default.

In their reply comments, OPUC supported the implementation of lead-lag studies in determining allowed cash working capital allowances for Class A utilities as they are appropriate given the size of a Class A utility. OPUC noted that while it may be appropriate to use a default amount for smaller utilities, it is not appropriate for the Class A utilities and therefore the commission should allow the utility to use a lead-lag study completed within five years of the application date unless the study is no longer valid, which should reduce the overall expense of conducting such studies. OPUC also noted they do not support the proposal in §24.31(c)(2)(C)(iii)(VI) of including a default allowance of zero when a utility has failed to file a lead-lag study or where the study is unreliable and argued that if a utility has not provided a lead-lag study and has not provided an explanation, the commission should deem the application materially deficient. Therefore, OPUC concluded that a utility should not be allowed to use a default of zero when a negative number may be more appropriate.

Commission response

The commission agrees to reorder the subsection as suggested by OPUC because it finds it does not change the substance of the rule, but merely reorders the provisions in a manner that enhances clarity in the organization of the rule.

The commission established different default amounts for cash working capital for Class A, Class B, and Class C utilities because these utilities, by definition, vary in size. As the Water IOUs have noted in this project, while certain issues should be handled consistently among the utilities the commission regulates, identical treatment may not be warranted in all circumstances, particularly with respect to the smaller Class C utilities. The commission finds the 1/12th ratio is more appropriate for Class B utilities because of their general size and is within a reasonable range.

In addition, the commission finds the 1/12th ratio appropriate for Class B utilities because utilities of this size may have the capital to pay for a lead-lag study, which would replace this default provision if it is demonstrated that a different cash working capital is necessary. In addition, the commission points out that the 1/8th ratio was the default before utilities were classified based on size.

The commission also finds that, for the most part, it is unreasonable to require a Class B or Class C utility to perform a lead-lag study in all cases because of the size of the utility and the cost of the study. The commission finds it unreasonable to adopt a zero cash working capital allowance for these utility classes because the small size of the utility increases the

effects of variations in cash collections and disbursements which may subsequently affect financial integrity, particularly with a system maintaining an older infrastructure.

For Class A utilities, the commission recognizes that in the past these larger utilities used a 1/8th ratio as a default allowance. However, the commission finds that 1/8th is not an appropriate estimate for companies of this size. Therefore, the commission adopts the zero default for Class A utilities but notes that a utility may prepare a lead-lag study to support a request for additional cash working capital.

Section 24.31(c)(3)

OPUC referenced their discussion in Project No. 43876 regarding the rate filing package for Class A utilities stating that there has historically been some disagreement with water and wastewater utilities regarding the need to deduct cost free capital items from rate base. OPUC expressed its general support for the proposed changes in §24.31(c)(3) because it clarifies a topic that has been debated; however, OPUC requested that the commission delete the provision in §24.31(c)(3)(F) which reverses these requirements for Class C utilities. OPUC stated that regardless of a utility's size and affiliation to other entities or companies, cost free capital represents a resource to the utility that has not resulted in the incurrence of cost and therefore even Class C utilities should be required to deduct these costs from rate base. OPUC argued that to allow a utility to include these items in rate base, and then obtain a return on them, violates the core tenets of rate regulation and would be an inappropriate windfall to the utilities. The Water IOUs stated they have no position on this issue because there may be a sound reason for the different treatment.

Commission response

The commission agrees with OPUC's comments that allowing a utility, regardless of size, to include cost-free capital in its rate base and earn a return thereon is inconsistent with basic principles of rate regulation. Cost-free capital provides to a utility a source of funds for which the utility does not actually incur a cost, and allowing such amounts to be included in the utility's return-earning rate base results in an inappropriate windfall to the utility. Accordingly, the commission has deleted §24.31(c)(3)(F) from the rule.

Section 24.31(c)(4)

OPUC expressed its support for the clarification found in this section that construction work in progress (CWIP) is an extraordinary form of relief. The Water IOUs disagree that this statement is necessary and argued it adds nothing to the ratemaking process, arguing that the requirements for proving CWIP is already required.

Commission response

The commission agrees that it clarified §24.31(c)(4) regarding CWIP in the proposal for publication, and the commission now adopts the change. The commission's intent was to state that inclusion of CWIP is an exceptional form of relief, consistent with its policy and precedent for electric utilities. Therefore, the commission declines to modify this section because it finds it provides clarity regarding the commission's policy on CWIP.

Section 24.31(e) - Negative acquisition adjustments

OPUC expressed its support for the inclusion of this section on negative acquisition adjustment stating that because the previous rule did not specifically address negative adjustments, some utilities have argued that the rules prohibit negative adjustments. However, OPUC argued that if a utility pays less than the net original cost of a system, then a negative acquisition adjustment may be reasonable and should therefore be authorized, which is why OPUC supports the inclusion of a negative acquisition adjustment in the proposed rule. The Water IOUs disagreed with the position taken by OPUC and argued that the proposed rule does not allow any discretion to include or not include a negative acquisition adjustment but in fact requires a negative acquisition adjustment for all utility property acquired in an STM since September 1, 1997.

The Water IOUs noted that practice at the TCEQ was to exclude all acquisition adjustment amounts for ratemaking purposes while allowing acquisition adjustment amounts to be carried on a utility's books for accounting purposes. In addition, they pointed to a 1994 case, *Technology Hydraulics*, at the Texas Natural Resource Conservation Commission (a TCEQ predecessor), which found that pursuant to "Section 13.185(j) of the TWC, a negative acquisition adjustment cannot be applied to reduce a utility's depreciation expense on the currently used, depreciable property owned by the utility." They also pointed out that the TWC does allow for specific alternate ratemaking methodologies, such as incorporation of acquisition adjustments for utilities in limited circumstances, but that these must be adopted by commission rule. In addition, the Water IOUs argue TWC §13.183(c) requires a rule about incorporation of a negative acquisition adjustment in ratemaking, and noted that such rule must be adopted before it can be applied to an administratively complete application. The Water IOUs argued that the commission proposed a

rule that: (1) reverses course on negative acquisition adjustments; (2) would apply negative acquisition adjustments retroactively to acquisitions since September 1, 1997, which directly contradicts the TWC and the Texas Constitution; (3) could result in unlawful retroactive ratemaking due to the proposed inquiry into past transactions; (4) would act as a disincentive to regionalization; and (5) does not propose to apply negative acquisition adjustments in the correct manner as an amortized amount credited against depreciation over time until it is extinguished.

The Water IOUs urged the commission to modify all of the rules to promote regionalization and sound business decisions. The Water IOUs expressed fear that if the commission adopted the proposed language of the rule, it could discourage broader investment in Texas water and wastewater utilities. The Water IOUs stated that if the commission must adopt a negative acquisition adjustment rule, it should do so in a separate rulemaking project so that the commission can fully consider the issue and that a fair and balanced approach should be taken when addressing negative acquisition adjustment alongside positive acquisition adjustment. In the alternative, the Water IOUs suggested the commission adopt a more limited rule that simply instructs how a utility may prospectively request an accounting order for its negative and positive acquisition adjustment amounts so that they may be maintained for accounting purposes on a utility's books, but instructing that the amount will not be used for ratemaking unless a positive acquisition adjustment amount is requested, and if they are, will be amortized against depreciation expense over time. As a third alternative, the Water IOUs asked the commission to consider adopting a balanced prospectively applicable rule that would allow both positive and negative acquisition amortized amounts in either depreciation or rate base over time until extinguished, combined with relaxed requirements for allowing positive acquisition adjustments

compared to those currently found in subsection (d). Optimally, however, the Water IOUs expressed their desire to have subsection (e) removed from the rule all together.

In their reply comments, OPUC argued that the negative acquisition adjustment provision is necessary to clarify that it is available for use, given that its absence has been alleged by utilities to mean that it is disallowed. Because there has been so much confusion on whether a negative acquisition adjustment is allowed absent a rule specifically allowing for it, OPUC urged the commission to adopt a negative acquisition adjustment rule to finally settle this controversy. OPUC argued that negative acquisition adjustment is an important tool and that the proposed rule would fill the silence and would allow an ALJ to speak to the authority for disallowing un-purchased value as a basis for return. OPUC argued that a negative acquisition adjustment flows naturally from the exclusion of cost free capital from the utility's rate base, and a rule is needed to ensure that utilities do not receive a "windfall" and that customers are not charged twice for the same plant. In addition, though OPUC agrees with the Water IOUs that regionalization is desired, OPUC disagreed that a negative acquisition adjustment would deter regionalization and argued that a key benefit of regionalization and larger systems acquiring smaller, possibly failing, systems is that the larger system will invest capital in improving those systems. Therefore, OPUC continued to support the inclusion of a negative acquisition adjustment in the proposed rule and urged the commission to adopt the published language.

OPUC also commented that the 1997 date appears to be unnecessary and could therefore be deleted.

OPUC also noted that §24.31(d) was tailored specifically to the water utility industry, with input from stakeholders, to make it equally available to large and small utility companies, without favoring the large utilities that might have stronger purchasing power. OPUC concluded that as a result the proposed rule language is more appropriate for water utilities than the language proposed by the Water IOUs.

In contrast, the City of Houston strongly disagreed with the recommendation of the Water IOUs to delete proposed §24.31(e) and stated that the commission should permit the equitable recognition of cost benefits obtained for customers when systems are acquired at a cost lower than net book cost. Likewise, in their reply comments, TAMER urged the commission to retain the current form of the proposed rule stating that if the Water IOUs actually have a reason for an exception, they should petition for a rule change and explain the situations that justify expansion of the exception.

The City of Houston argued that they did not believe this rule constituted retroactive ratemaking because utilities already received the benefits of a higher return and received substantial benefits of the purchase of a system at a price less than net book value. The City of Houston stated its belief that the recognition of a negative acquisition adjustment does not result in a claw back of prior returns, would impact returns only on a going forward basis, and is therefore not retroactive ratemaking. In addition, the City of Houston disagrees that the rule would act as a disincentive to regionalization, although the city acknowledged that the level of return a Water IOU may obtain could be diminished if a negative acquisition adjustment is implemented. The City of Houston pointed out that there has been no demonstration that such single action would eliminate an

acquisition by a Water IOU or other potential purchaser. The City of Houston urged the commission not to adopt the recommendations made by the Water IOUs stating that they failed to consider the customer when balancing public interest.

Commission response

After considering the comments of the stakeholders, the commission is convinced that it is appropriate to modify the final rule language to give the commission the flexibility to recognize a negative acquisition adjustment in the ratemaking process to the extent the commission believes the facts lead to such a conclusion. Conversely, the provision as revised does not require the commission to take such action. Indeed, the commission recognizes the importance of adopting a policy that will encourage financially healthy retail water companies to purchase distressed retail water companies in order to ensure that all Texans have access to healthy, affordable drinking water. The rule has been modified accordingly.

Although the commission retains the ability to recognize a negative acquisition adjustment in the ratemaking process, it finds that the reference to September 1, 1997 is no longer necessary and modifies the rule accordingly.

The commission also finds the inclusion of a negative acquisition adjustment does not constitute retroactive ratemaking. As discussed above, the rule against retroactive ratemaking prohibits the commission from setting future rates to allow a utility to recoup past losses or to refund to consumers excess utility profits. *State* at 199. To recognize a

negative acquisition adjustment in the ratemaking process does not involve an inquiry into the reasonableness of a utility's previously tariffed rates and, therefore, does not implicate the rule against retroactive ratemaking. Further, the commission disagrees that accounting for a negative acquisition adjustment in the ratemaking process discourages regionalization.

Section 24.31(f) - Intangible assets

The Water IOUs argued that subsection (f) is contrary to established legal precedent and should therefore not be adopted. The Water IOUs stated that the authority to include utility "property" in rate base, both tangible and intangible assets under original cost ratemaking, was decided in *State*, a case in which the Texas Supreme Court interpreted the section of the Public Utility Regulatory Act equivalent to TWC §13.185(c). The Texas Supreme Court determined that original cost is the actual money cost, or the actual money value of any consideration paid other than money, of the property at the time it shall have been dedicated to public use. The Water IOUs argued the court in *State* determined that the plain meaning of the term "property" includes intangible assets that could be included in rate base. Additionally, the TWC defines "facilities" to include "all tangible and intangible real and personal property without limitation." The Water IOUs urged the commission to modify the rule in order to lower the bar for what intangible assets can be included in rate base. The Water IOUs specifically pointed out that subsection (f)(3) is confusing as written in that intangible assets are "actual assets" but stated that it is unclear whether organization costs toward acquisition of intangible CCN rights could be included in rate base under this standard, and argued that if they cannot, regionalization efforts could be chilled. Therefore, the Water IOUs urged the commission to modify the rule in such a way that intangible

assets "shall be allowed in rate base, shall not be disallowed from rate base because the assets are intangible, and shall not be amortized as annual expense items unless requested by the utility." In addition, the Water IOUs requested the commission remove subsections (f)(1)-(4).

In contrast, OPUC argued that there is nothing in *State* that prohibits establishing standards that must be met for including intangible assets in rate base and argued that the decision merely states that intangible assets are "property" within the ordinary meaning and, as such may be included in rate base. OPUC contended that intangible assets, by their nature, require greater substantiation than physical plant, which is all the rule requires. OPUC reasoned that intangible assets therefore should only be included in rate base when the reasonableness of such assets can be proven and the benefit to the consumer can be justified. Therefore, OPUC supports the proposed rule and requested the commission not adopt the Water IOUs' proposed changes.

Commission response

The commission declines to modify §24.31(f) because it finds that intangible assets shall only be allowed in rate base if it meets one of the stated requirements, which each provide some justification for the amount the intangible asset is worth. The requirements of this subsection address the reasonableness of the assets and justify their inclusion in rate base. By their very nature, intangible assets cannot be physically touched or seen. The value of an intangible asset must be supported by evidence to support its recovery. In addition, the commission finds that there is nothing in *State* that prohibits the commission from establishing standards that must be met for including intangible assets in rate base.

Section 24.32 - Rate Design

The Water IOUs and the City of Houston urged the commission to consider clarifying how costs related to providing fire flow or otherwise providing water for fire protection services should be recovered for areas where a utility is required to provide such water or has elected to do so. They stated that this clarification could be appropriate at this time or in a separate rulemaking project, and the Water IOUs argued that this issue must be addressed as it was left unresolved at the TCEQ due to the impending transfer of economic regulation to the commission.

In their reply comments, OPUC stated its general support of the comments made by the Water IOUs regarding clarification of the allocation and recovery of costs associated with fire protection. OPUC noted that the proper handling of fire protection cost is related to functionalization as well as customer class cost allocation. In addition, OPUC agreed that the issue should be handled in a separate rulemaking project.

Commission response

The commission's proposed changes to this section were non-substantive in nature, and therefore, the commission declines to modify the rule as proposed. The commission may consider addressing fire flow and fire protection issues in a separate, future rulemaking project in which the issues can be fully considered and parties are provided the opportunity to comment on proposed rule changes.

Section 24.33 - Rate-case Expenses Pursuant to Texas Water Code §13.187 or §13.1871

OPUC and TAMER expressed their general support for the inclusion of this section and OPUC stated that rate-case expenses are not expressly authorized in TWC Chapter 13 and that if rate-case expenses will continue to be allowed under commission rules, their collection should be limited. OPUC stated that the proposed rule for water and sewer utilities regarding rate-case expenses is consistent with the practices at TCEQ, and therefore, do not result in a change in practice and should be adopted. TAMER also expressed their belief that the proposed rule will have the result of encouraging settlement by providing a strong incentive to the utilities to propose reasonable rates in the first instance.

In contrast, the Water IOUs urged the commission to substantially modify the proposed rule because it is not consistent with the practices and policies of the commission. The Water IOUs stated that one of their prime concerns since the jurisdictional transfer has been the recovery of rate-case expenses and the means of minimizing these expenses before they are incurred. The Water IOUs rationalized that water and sewer utilities are not as large as the electric utilities the commission regulates, have smaller staffs, and have fewer customers among whom they may spread rate-case expense costs. They argued that the rule, as carried over from the TCEQ, arbitrarily prohibits recovery of reasonable rate-case expenses based on either 51% recovery or settlement offer circumstances, both of which are unfair and unjust, especially in light of more stringent filing requirements. The Water IOUs argued that there will always be some amount of rate-cases expenses that will be reasonable, even if the application is not fully approved, and therefore recovery of rate-case expenses should not be limited as proposed in the rule. In addition, the Water IOUs noted that the commission, in Project No. 41622 relating to rate-case

expenses, has expressed that mechanical/formulistic approaches to rate-case expenses should only be used as a last resort. The Water IOUs also disagreed with the commission's inclusion of the settlement offer rate-case expense provision because it is inconsistent with the commission's adopted stance on whether such a rate-case expense rule is appropriate for electric utilities. The Water IOUs pointed out that the commission has stated that such provisions are "not practical to implement because there exist many components to a settlement proposal other than revenue requirement." In addition, the Water IOUs argued that the provision will have a chilling effect on settlement negotiations and would create a need for the commission to analyze confidential settlement offers and related communications in order to determine the reasonableness of rate-case expenses.

The Water IOUs asked the commission to clarify why subsection (d) was included and argued that if it is not universally applicable, it should be deleted. Overall the Water IOUs urged the commission to either: (1) adopt the remainder of the proposed rule without subsections (b) or (c); (2) adopt a version of §25.245 applicable to water and wastewater utilities; or (3) delete proposed (b) and (c) and open a separate rulemaking project to consider whether to apply a version of §25.245 to water and wastewater utilities.

The City of Houston, in their reply comments, argued against the proposal made by the Water IOUs to eliminate proposed §24.33 and argued that the commission's concern regarding the allowable recovery of rate-case expenses is valid considering the limited customer base of water and sewer utilities, and the unfair bargaining position of the utility. The City of Houston contended that the Water IOUs were not considering the balancing of the public interest as it

relates to customers and that absent a concern for recovery of rate-case expenses there is little incentive for a utility to enter into meaningful and fair settlement discussions. The City of Houston supported the commission's efforts stating that the proposed rule provides somewhat of a level playing field and encourages meaningful settlement activities.

In their reply comments, OPUC reiterated that there is no statutory basis for water or sewer utilities to collect rate-case expenses within TWC Chapter 13, and therefore, for a water or sewer utility to recover any rate-case expenses, it must be included in a rule. OPUC reiterated its concern for removing the 51% threshold noting that a utility may have an incentive to overreach in their rate applications if it believes that the customer will ultimately bear all rate-case expenses. OPUC stated its support that there should be clearly set instances when rate-case expenses will be considered unreasonable, unnecessary, and against the public interest. OPUC continued to express their support for checks on the collection of rate-case expenses especially in light of the fact that in water cases, rate-case expenses can have a crushing effect on a water customer's bill because water utilities usually have a smaller pool of customers to spread the expense over. OPUC argued that without incentive on both sides of the meter, a utility could set unreasonable rates, and then when protested, incur rate-case expenses that dwarf the rate base itself and concluded that though imperfect, the 51% rule and the settlement offer rule serve an important check on rate-case expenses.

Commission response

The commission recognizes all of the comments provided regarding §24.33; however, the commission declines to modify this rule at this time. The commission determines that enhanced clarity and organization of chapter 24 was achieved by moving the rate-case expense provisions from the current §24.28 into a separate and distinct rule. The commission finds that the adopted rule is not substantively different than the previous rule provisions regarding rate-case expenses, with the exception of the addition of subsection (d). The commission adds subsection (d) to confirm the commission's practice to not include unamortized rate-case expenses as a component of invested capital for rate of return calculation purposes. In the future, the commission may decide to review the rate case expense rule provisions for water and sewer utilities; but, declines to make substantive modifications to the rule at this time.

Section 24.34 - Alternative Rate Methods

OPUC supported the deletion of the "single issue rate change" subsection as proposed and the Water IOUs opposed this modification.

The Water IOUs asked why subsection (b), related to single issue rate changes, is proposed for repeal. The Water IOUs stated that it seems like this subsection could be a useful tool for situations where a pass-through provision revision is requested if it is not included within the list of available minor tariff changes or where a miscellaneous fee change is requested, so that the expense of a full rate proceeding is not needed. In their reply comments, OPUC expressed its support of the commission's proposed repeal of subsection (b) and rationalized that single-issue

rate changes are not specifically required by statute. In addition, OPUC noted that while they agree that rate-case expenses to customers should be limited where possible, they argued that this should be coupled with sufficient checks and balances to ensure that rate increases to customers are thoroughly reviewed and that ratepayers are protected. Therefore, OPUC concluded that methods of extraordinary rate relief should be properly reviewed and vetted by the commission and the application of such methods should be limited so as to provide the necessary protections to ratepayers.

Commission response

The commission adopts the repeal of the subsection relating to "single issue rate change." The commission finds that single-issue rate changes to reflect a change in "any one specific cost component" do not appear to be authorized by the TWC. However, the commission notes that TWC §13.188 provides statutory authority for specific pass-through adjustments for changes in energy costs, and such adjustments are addressed in §24.21(p). The commission finds it reasonable to ensure that any other rate increases to customers are thoroughly reviewed in a full rate proceeding. Accordingly, the commission repeals the provisions providing for a single issue rate change.

Section 24.36 - Application for a Rate Adjustment by a Class C Utility Pursuant to §13.1872

OPUC supported the commission's use of the U.S. Department of Commerce - Bureau of Economic Analysis Department's (BEA) Gross Domestic Product Implicit Price Deflator (GDP Deflator) as the price index for Class C water and sewer utilities found in subsection (g). OPUC argued that the use of the GDP Deflator results in protecting both the utility and ratepayers from

inflationary and deflationary pressures because it accounts for inflation by converting output measured at current prices into constant-dollar GDP; the GDP Deflator shows how much a change in the base year's GDP relies upon changes in the price level. OPUC further argued that the GDP Deflator reflects changes in consumption patterns or the introduction of new goods and services automatically and is the measure of choice when economists need precision in the analysis of inflation and related macroeconomic occurrences. OPUC expressed its support of the commission's use of the GDP Deflator as the price index, urging the commission to continue to adopt its use because it provides a more comprehensive measure of the price level and thus inflation making it a more accurate measure of the price level. The Water IOUs stated in their reply comments that they took no position on these issues.

Commission response

The commission modifies subsection (c) to remove a duplicative provision. The commission modifies §24.36(f) to clarify that the requirement to stagger applications filed pursuant to TWC 13.1872 is effective beginning January 1, 2016. The commission also modifies subsection (g) for greater clarity, and to confirm that the price index percentage difference established in the rule is for calendar year 2015 until the commission adopts its first order establishing a price index. The commission acknowledges OPUC's support for the use of the GDP Deflator as the price index for Class C water and sewer utilities. The commission agrees that the use of the GDP Deflator results in the protection of both the utility and ratepayers from inflationary and deflationary pressures.

Section 24.72 - Financial Records and Reports

TAWP argued that there is an inconsistency in the definitions of Class A, Class B, and Class C utilities between §24.3(12)-(14) and §24.72 because §24.72 uses annual revenue and not the number of "taps or connections." TAWP urged the commission to amend the rule to conform to the definitions found in §24.3(12)-(14) because the inconsistency could result in utilities being categorized into different classes for reporting purposes versus rate proceedings. The Water IOUs, in their reply comments noted that, in their opinion, this issue was resolved in the published version of the rule.

Commission response

The commission notes that it appears that TAWP filed their comments based upon the strawman publication in this project. The commission agrees with the Water IOUs that the issues raised by TAWP regarding §24.72 were addressed in the published version of this rule. Therefore, the commission declines to modify §24.72.

Section 24.73- Water and Sewer Annual Reports

TAWP urged the commission to change the filing date for annual reports to May 1st, at the earliest, if filed tax return information is included. In the alternative, TAWP argued the requirement of including filing filed tax return information should be removed if the commission does not change the filing date for the annual reports. In their reply comments, the Water IOUs noted that the date was changed to May 15 in the published version of the rule.

Commission response

The commission agrees that the filing date for the annual report should be changed, and modifies subsection (a) to establish June 1 as the deadline to file annual reports. The commission further modifies subsection (a) to delete "unless otherwise specified in a form prescribed by the commission" because this language from the current rule is no longer necessary.

Seciton 24.93 - Adequacy of Water Utility Service

The Water IOUs proposed the following addition to the first paragraph: "Sufficiency of service shall not be determined based upon whether a retail public utility provides access to its public drinking water system by emergency service providers for fire protection." The Water IOUs argued that continuous and adequate service should be judged based on the supply of drinking water to consumers and not upon whether the system offers fire protection.

In their reply comments, OPUC stated that they did not support the proposed additions to §24.93 proposed by the Water IOUs regarding adequacy of utility service. OPUC argued that if a utility is required to provide fire flow service, then the adequacy of this service must also be included when considering the system. OPUC concluded that they could support this proposal if it was amended to include "Except where fire flow service is required of the retail public utility by rule or is provided by agreement with ratepayers," before the language proposed by the Water IOUs.

Commission response

The commission declines to adopt any suggested changes to §24.93 because no proposed changes to this rule were published. Though the commission appreciates the concerns and comments expressed by the parties, the commission declines to modify §24.93 as it not a rule that is open for consideration at this time. The commission may consider amending §24.93 in a separate rulemaking project in which the commission can fully consider all issues and parties have the opportunity to comment on proposed rule changes.

Section 24.106 - Notice and Mapping Requirements for Certificate of Convenience and Necessity Applications

TAMER expressed their concern that the notice provisions for sale, transfers, and mergers need to be clarified because both the to-be-subsumed/transferred and the subsuming/transferred utilities ratepayers should be given notice of an impending CCN transfer or merger because the ratepayers of both entities have an interest in the rate impacts. TAMER argued that §24.106 and §24.109 do not ensure the necessary level of notice.

In their reply comments, the Water IOUs noted that TAMER did not offer a specific modification to either §24.106 or §24.109 and therefore argued that no change should be made. The Water IOUs further stated that the type of notice TAMER is requesting is unreasonable and would call for a great deal of speculation. The Water IOUs pointed out that under the current practice rates will not change in the near-term as a result of an acquisition or CCN amendment because a rate application has historically been required for this; rate filings still provide the primary context for a rate discussion and a rate notice will outline very specifically what the rate differences will be.

The Water IOUs further argued that the specific rate impact years after a CCN or STM filing will be the result of a variety of factors, many of which cannot be known at the time of filing. The Water IOUs concluded by stating that absent a procedural change, utilities will not have the ability to include the requested information, but instead can only include the fact that rates will change if authorized.

Commission response

The commission declines to modify §24.106 because no proposed changes to this rule were published for public comment. The commission may consider amending §24.106 in a separate rulemaking project in which the commission can fully consider all issues and parties are provided the opportunity to comment on proposed rule changes.

Section 24.109 - Report of Sale, Merger, Etc.; Investigation; Disallowance of Transaction

TAMER argued that §24.109 does not consider the possibility that though there may be situations in which all ratepayers are positively served by a sale, transfer, or merger event, this is not always the case and there are some instances where there are clear "winners" and "losers." TAMER urged the commission that in these situations, the public interest must be balanced which is not currently provided for in §24.109. TAMER urged the commission to modify this substantive rule in order to provide for the appropriate balance.

Commission response

The commission declines to make any modifications to §24.109 because the amendments to this section are solely to update the reference on financial assurance to ensure all

stakeholders and the regulated community are aware that the financial assurance rule applies to this section. The commission finds that any other modifications to this section may be appropriate in a separate rulemaking project in which the commission can fully consider all issues contemplated in this rule.

All comments, including any not specifically referenced herein, were fully considered by the commission. In adopting this section, the commission makes other minor modifications for the purpose of clarifying its intent.

These amendments, new sections, and repeals are adopted under the TWC §13.041(b), which provides the commission with the authority to make and enforce rules reasonably required in the exercise of its powers and jurisdiction; and specifically, TWC §§13.246(c), 13.253, and 13.302(c), which permit the commission to require the provision of financial assurance; TWC §13.136(b), which requires the commission to require by rule the filing of an annual service, financial, and normalized earnings report; TWC §13.183, which directs the commission on how to fix the overall revenues for water and sewer utilities; TWC §13.185, which governs components of invested capital and net income; and HB 1600, SB 567, and SB 1148.

Cross Reference to Statutes: Statutes: TWC §§13.041; 13.136; 13.183; 13.185; 13.246; 13.253; 13.302; HB 1600 and SB 567; and SB 1148.

§24.3. Definitions of Terms.

The following words and terms, when used in this chapter, have the following meanings, unless the context clearly indicates otherwise.

(1) **Acquisition adjustment** --

(A) The difference between:

(i) the lesser of the purchase price paid by an acquiring utility or the current depreciated replacement cost of the plant, property, and equipment comparable in size, quantity, and quality to that being acquired, excluding customer contributed property; and

(ii) the original cost of the plant, property, and equipment being acquired, excluding customer contributed property, less accumulated depreciation.

(B) A positive acquisition adjustment results when subparagraph (A)(i) of this paragraph is greater than subparagraph (A)(ii) of this paragraph.

(C) A negative acquisition adjustment results when subparagraph (A)(ii) of this paragraph is greater than subparagraph (A)(i) of this paragraph.

(2) **Active connections** -- Water or sewer connections currently being used to provide retail water or sewer service, or wholesale service.

(3) **ADFIT** -- Accumulated deferred federal income tax -- The amount of income tax deferral, typically reflected on the balance sheet, produced by deferring the payment of federal income taxes by using tax advantageous methods such as accelerated depreciation.

(4) **Affected county** -- A county to which Local Government Code, Chapter 232, Subchapter B, applies.

(5) **Affected person** -- Any landowner within an area for which an application for a new or amended certificate of public convenience and necessity is filed; any retail public utility affected by any action of the regulatory authority; any person or corporation, whose utility service or rates are affected by any proceeding before the regulatory authority; or any person or corporation that is a competitor of a retail public utility with respect to any service performed by the retail public utility or that desires to enter into competition.

(6) **Affiliated interest or affiliate** --

(A) any person or corporation owning or holding directly or indirectly 5.0% or more of the voting securities of a utility;

(B) any person or corporation in any chain of successive ownership of 5.0% or more of the voting securities of a utility;

(C) any corporation 5.0% or more of the voting securities of which is owned or controlled directly or indirectly by a utility;

(D) any corporation 5.0% or more of the voting securities of which is owned or controlled directly or indirectly by any person or corporation that owns or controls directly or indirectly 5.0% or more of the voting securities of any utility or by any person or corporation in any chain of successive ownership of 5.0% of those utility securities;

(E) any person who is an officer or director of a utility or of any corporation in any chain of successive ownership of 5.0% or more of voting securities of a public utility;

(F) any person or corporation that the commission, after notice and hearing, determines actually exercises any substantial influence or control over the policies and actions of a utility or over which a utility exercises such control or that is under common control with a utility, such control being the possession directly or indirectly of the power to direct or cause the direction of the management and policies of another, whether that power is established through ownership or voting of securities or by any other direct or indirect means; or

(G) any person or corporation that the commission, after notice and hearing, determines is exercising substantial influence over the policies and action of the utility in conjunction with one or more persons or corporations with which they are related by ownership or blood relationship, or by action in concert, that together they are affiliated within the meaning of this section, even though no one of them alone is so affiliated.

(7) **Agency** -- Any state board, commission, department, or officer having statewide jurisdiction (other than an agency wholly financed by federal funds, the legislature, the courts, the Texas Department of Insurance Division of Workers' Compensation, and institutions for higher education) which makes rules or determines contested cases.

(8) **Allocations** -- For all retail public utilities, the division of plant, revenues, expenses, taxes, and reserves between municipalities, or between municipalities and unincorporated areas, where such items are used for providing water or sewer utility service in a municipality or for a municipality and unincorporated areas. A non-municipal allocation is the division of plant, revenues, expenses, taxes and reserves between affiliates,

jurisdictions, rate regions, business units, functions, or customer classes defined within a retail public utility's operations for all retail public utilities and affiliates.

(9) **Amortization** -- The gradual extinguishment of an amount in an account by distributing the amount over a fixed period (such as over the life of the asset or liability to which it applies).

(10) **Annualization** -- An adjustment to bring a utility's accounts to a 12 month level of activity

(11) **Base rate** -- The portion of a consumer's utility bill which is paid for the opportunity of receiving utility service, which does not vary due to changes in utility service consumption patterns.

(12) **Billing period** -- The usage period between meter reading dates for which a bill is issued or in nonmetered situations, the period between bill issuance dates.

(13) **Block rates** -- A rate structure set by using blocks, typically inclining cost for increased usage, which changes the cost per 1,000 gallons as usage increases to the next block.

(14) **Certificate** -- The definition of certificate is that definition given to certificate of convenience and necessity in this subchapter.

(15) **Certificate of Convenience and Necessity (CCN)** -- A permit issued by the commission which authorizes and obligates a retail public utility to furnish, make available, render, or extend continuous and adequate retail water or sewer utility service to a specified geographic area.

(16) **Certificate of Public Convenience and Necessity** -- The definition of certificate of public convenience and necessity is that definition given to certificate of convenience and necessity in this subchapter.

(17) **Class A Utility --** A public utility that provides retail water or sewer utility service to 10,000 or more taps or active connections. If a public utility provides both water and sewer utility service, the number of active water connections determines how the utility is classified.

(18) **Class B Utility --** A public utility that provides retail water or sewer utility service to 500 or more taps or active connections but fewer than 10,000 taps or active connections. If a public utility provides both water and sewer utility service, the number of active water connections determines how the utility is classified.

(19) **Class C Utility --** A public utility that provides retail water or sewer utility service to fewer than 500 taps or active connections. A Class C utility filing an application pursuant to TWC §13.1871 shall be subject to all requirements applicable to Class B utilities filing an application pursuant to TWC §13.1871. If a public utility provides both water and sewer utility service, the number of active water connections determines how the utility is classified.

(20) **Code** -- The Texas Water Code (TWC).

(21) **Commission** -- The Public Utility Commission of Texas or a presiding officer, as applicable.

(22) **Corporation** -- Any corporation, joint-stock company, or association, domestic or foreign, and its lessees, assignees, trustees, receivers, or other successors in interest, having any of the powers and privileges of corporations not possessed by individuals or partnerships, but shall not include municipal corporations unless expressly provided otherwise in the TWC.

(23) **Customer** -- Any person, firm, partnership, corporation, municipality, cooperative, organization, or governmental agency provided with services by any retail public utility.

(24) **Customer class --** A description of utility service provided to a customer that denotes such characteristics as nature of use or type of rate. For rate-setting purposes, a group of customers with similar cost-of-service characteristics that take utility service under a single set of rates.

(25) **Customer service line or pipe** -- The pipe connecting the water meter to the customer's point of consumption or the pipe which conveys sewage from the customer's premises to the service provider's service line.

(26) **Facilities** -- All the plant and equipment of a retail public utility, including all tangible and intangible real and personal property without limitation, and any and all means and instrumentalities in any manner owned, operated, leased, licensed, used, controlled, furnished, or supplied for, by, or in connection with the business of any retail public utility.

(27) **Financial assurance --** The demonstration that sufficient or adequate financial resources exist to operate and manage the utility and to provide continuous and adequate service to the current and proposed utility service area.

(28) **Functional cost category** -- Costs related to a particular operational function of a utility for which annual operations & maintenance expenses and utility plant investment records are maintained.

(29) **Functionalization** -- The assignment or allocation of costs to utility functional cost categories.

(30) **General rate revenue** -- A rate or the associated revenues designed to recover the cost of service other than certain costs separately identified and recovered through a pass-through or any specific rate such as a surcharge. For water and wastewater utilities, generally rates typically include the base rate and gallonage rate.

(31) **Inactive connections** -- Water or wastewater connections tapped to the applicant's utility and that are not currently receiving service from the utility.

(32) **Incident of tenancy** -- Water or sewer service, provided to tenants of rental property, for which no separate or additional service fee is charged other than the rental payment.

(33) **Known and measurable** (K&M) -- Verifiable on the record as to amount and certainty of effectuation. Reasonably certain to occur within 12 months of the end of the test year.

(34) **Landowner** -- An owner or owners of a tract of land including multiple owners of a single deeded tract of land as shown on the appraisal roll of the appraisal district established for each county in which the property is located.

(35) **License** -- The whole or part of any commission permit, certificate, registration, or similar form of permission required by law.

(36) **Licensing** -- The commission process respecting the granting, denial, renewal, revocation, suspension, annulment, withdrawal, or amendment of a license, certificates of convenience and necessity, or any other authorization granted by the commission in accordance with its authority under the TWC.

(37) **Main** -- A pipe operated by a utility service provider that is used for transmission or distribution of water or to collect or transport sewage.

(38) **Mandatory water use reduction** -- The temporary reduction in the use of water imposed by court order, government agency, or other authority with appropriate jurisdiction. This

does not include water conservation measures that seek to reduce the loss or waste of water, improve the efficiency in the use of water, or increase the recycling or reuse of water so that a water supply is made available for future or alternative uses.

(39) **Member** -- A person who holds a membership in a water supply or sewer service corporation and who is a record owner of a fee simple title to property in an area served by a water supply or sewer service corporation, or a person who is granted a membership and who either currently receives or will be eligible to receive water or sewer utility service from the corporation. In determining member control of a water supply or sewer service corporation, a person is entitled to only one vote regardless of the number of memberships the person owns.

(40) **Membership fee** -- A fee assessed each water supply or sewer service corporation service applicant that entitles the applicant to one connection to the water or sewer main of the corporation. The amount of the fee is generally defined in the corporation's bylaws and payment of the fee provides for issuance of one membership certificate in the name of the applicant, for which certain rights, privileges, and obligations are allowed under said bylaws. For purposes of TWC §13.043(g), a membership fee is a fee not exceeding approximately 12 times the monthly base rate for water or sewer service or an amount that does not include any materials, labor, or services required for or provided by the installation of a metering device for the delivery of service, capital recovery, extension fees, buy-in fees, impact fees, or contributions in aid of construction.

(41) **Multi-jurisdictional** -- A utility that provides water and/or wastewater service in more than one state, country, or separate rate jurisdiction by its own operations, or through an affiliate.

(42) **Municipality** -- A city, existing, created, or organized under the general, home rule, or special laws of this state.

(43) **Municipally owned utility** -- Any retail public utility owned, operated, and controlled by a municipality or by a nonprofit corporation whose directors are appointed by one or more municipalities.

(44) **Net Book Value** -- The amount of the asset that has not yet been recovered through depreciation. It is the original cost of the asset minus accumulated depreciation.

(45) **Nonfunctioning system or utility** -- A system that is operating as a retail public utility that is required to have a CCN and is operating without a CCN or a retail public utility under the supervision of a receiver, temporary manager, or that has been referred for the appointment of a temporary manager or receiver, pursuant to §24.142 of this title (relating to Operation of Utility That Discontinues Operation or Is Referred for Appointment of a Receiver) and §24.143 of this title (relating to Operation of a Utility by a Temporary Manager).

(46) **Person** -- Any natural person, partnership, cooperative, corporation, association, or public or private organization of any character other than an agency or municipality.

(47) **Point of use or point of ultimate use** -- The primary location where water is used or sewage is generated; for example, a residence or commercial or industrial facility.

(48) **Potable water** -- Water that is used for or intended to be used for human consumption or household use.

(49) **Potential connections** -- Total number of active plus inactive connections.

(50) **Premises** -- A tract of land or real estate including buildings and other appurtenances thereon.

(51) **Public utility** -- The definition of public utility is that definition given to water and sewer utility in this subchapter.

(52) **Purchased sewage treatment** -- Sewage treatment purchased from a source outside the retail public utility's system to meet system requirements.

(53) **Purchased water** -- Raw or treated water purchased from a source outside the retail public utility's system to meet system demand requirements.

(54) **Rate** -- Includes every compensation, tariff, charge, fare, toll, rental, and classification or any of them demanded, observed, charged, or collected, whether directly or indirectly, by any retail public utility, or water or sewer service supplier, for any service, product, or commodity described in TWC §13.002(23), and any rules, regulations, practices, or contracts affecting any such compensation, tariff, charge, fare, toll, rental, or classification.

(55) **Ratepayer** -- Each person receiving a separate bill shall be considered as a ratepayer, but no person shall be considered as being more than one ratepayer notwithstanding the number of bills received. A complaint or a petition for review of a rate change shall be considered properly signed if signed by any person, or spouse of any such person, in whose name utility service is carried.

(56) **Rate region** -- An area within Texas for which the applicant has set or proposed uniform tariffed rates by customer class.

(57) **Reconnect fee** -- A fee charged for restoration of service where service has previously been provided. It may be charged to restore service after disconnection for reasons listed in §24.88 of this title (relating to Discontinuance of Service) or to restore service after disconnection at the customer's request

(58) **Retail public utility** -- Any person, corporation, public utility, water supply or sewer service corporation, municipality, political subdivision or agency operating, maintaining, or controlling in this state facilities for providing potable water service or sewer service, or both, for compensation.

(59) **Retail water or sewer utility service** -- Potable water service or sewer service, or both, provided by a retail public utility to the ultimate consumer for compensation.

(60) **Return on invested capital** -- The rate of return times invested capital.

(61) **Safe drinking water revolving fund** -- The fund established by the Texas Water Development Board to provide financial assistance in accordance with the federal program established under the provisions of the Safe Drinking Water Act and as defined in TWC §15.602.

(62) **Service** -- Any act performed, anything furnished or supplied, and any facilities or lines committed or used by a retail public utility in the performance of its duties under the TWC to its patrons, employees, other retail public utilities, and the public, as well as the interchange of facilities between two or more retail public utilities.

(63) **Service line or pipe** -- A pipe connecting the utility service provider's main and the water meter or for sewage, connecting the main and the point at which the customer's service line is connected, generally at the customer's property line.

(64) **Sewage** -- Ground garbage, human and animal, and all other waterborne type waste normally disposed of through the sanitary drainage system.

(65) **Stand-by fee** -- A charge imposed on unimproved property for the availability of water or sewer service when service is not being provided.

(66) **Tap fee** -- A tap fee is the charge to new customers for initiation of service where no service previously existed. A tap fee for water service may include the cost of physically tapping the water main and installing meters, meter boxes, fittings, and other materials and labor. A tap fee for sewer service may include the cost of physically tapping the main and installing the utility's service line to the customer's property line, fittings, and other material and labor. Water or sewer taps may include setting up the new customer's account, and allowances for equipment and tools used. Extraordinary expenses such as road bores and street crossings and grinder pumps may be added if noted on the utility's approved tariff. Other charges, such as extension fees, buy-in fees, impact fees, or contributions in aid of construction (CIAC) are not to be included in a tap fee.

(67) **Tariff** -- The schedule of a retail public utility containing all rates, tolls, and charges stated separately by type or kind of service and the customer class, and the rules and regulations of the retail public utility stated separately by type or kind of service and the customer class.

(68) **TCEQ** -- Texas Commission on Environmental Quality.

(69) **Temporary water rate provision for mandatory water use reduction** -- A provision in a utility's tariff that allows a utility to adjust its rates in response to mandatory water use reduction.

(70) **Temporary rate for services provided for a nonfunctioning system** -- A temporary rate for a retail public utility that takes over the provision of services for a nonfunctioning retail public water or sewer utility service provider.

(71) **Test year** -- The most recent 12-month period, beginning on the first day of a calendar or fiscal year quarter, for which operating data for a retail public utility are available.

(72) **Utility** -- The definition of utility is that definition given to water and sewer utility in this subchapter.

(73) **Water and sewer utility** -- Any person, corporation, cooperative corporation, affected county, or any combination of those persons or entities, other than a municipal corporation, water supply or sewer service corporation, or a political subdivision of the state, except an affected county, or their lessees, trustees, and receivers, owning or operating for compensation in this state equipment or facilities for the production, transmission, storage, distribution, sale, or provision of potable water to the public or for the resale of potable water to the public for any use or for the collection, transportation, treatment, or disposal of sewage or other operation of a sewage disposal service for the public, other than equipment or facilities owned and operated for either purpose by a municipality or other political subdivision of this state or a water supply or sewer service corporation, but does not include any person or corporation not otherwise a public utility that furnishes the services or commodity only to itself or its employees or tenants as an incident of that employee service or tenancy when that service or commodity is not resold to or used by others.

(74) **Water use restrictions** -- Restrictions implemented to reduce the amount of water that may be consumed by customers of the system due to emergency conditions or drought.

(75) **Water supply or sewer service corporation** -- Any nonprofit corporation organized and operating under TWC Chapter 67, that provides potable water or sewer service for compensation and that has adopted and is operating in accordance with bylaws or articles of incorporation which ensure that it is member-owned and member-controlled. The term does not include a corporation that provides retail water or sewer service to a person who

is not a member, except that the corporation may provide retail water or sewer service to a person who is not a member if the person only builds on or develops property to sell to another and the service is provided on an interim basis before the property is sold. For purposes of this chapter, to qualify as member-owned, member-controlled a water supply or sewer service corporation must also meet the following conditions.

(A) All members of the corporation meet the definition of "member" under this section, and all members are eligible to vote in those matters specified in the articles and bylaws of the corporation. Payment of a membership fee in addition to other conditions of service may be required provided that all members have paid or are required to pay the membership fee effective at the time service is requested.

(B) Each member is entitled to only one vote regardless of the number of memberships owned by that member.

(C) A majority of the directors and officers of the corporation must be members of the corporation.

(D) The corporation's bylaws include language indicating that the factors specified in subparagraphs (A) - (C) of this paragraph are in effect.

(76) **Wholesale water or sewer service** -- Potable water or sewer service, or both, provided to a person, political subdivision, or municipality who is not the ultimate consumer of the service.

§24.8. Administrative Completeness.

(a) An application to change rates, including a minor rate change, applications for sale, acquisition, lease, rental, merger, or consolidation, assignment of facilities or certificates; requests for purchase of voting stock or change in controlling interest of a utility; applications for cessation of operations by a retail public utility and applications for certificates of convenience and necessity shall be reviewed for administrative completeness within thirty calendar days of receipt of the application. If notice is required, upon determination that the notice or application is administratively complete, the applicant shall be notified of that determination.

(b) If the commission determines that any deficiencies exist in an application, statement of intent, or other requests for commission action addressed by this chapter, the application or filing may be rejected and the effective date suspended, as applicable, until the deficiencies are corrected.

(c) In cases involving a proposed sale, acquisition, lease, rental, merger, or consolidation of any water or sewer system required by law to possess a certificate of convenience and necessity, the proposed effective date of the transaction must be at least 120 days after the date that an application is received by the commission and public notice is provided, unless notice is waived for good cause shown.

(d) A report of sale, acquisition, lease, rental, merger, or consolidation; requests for purchase of voting stock or change in controlling interest of a utility; applications for cessation of operations by a retail public utility; and applications for certificates of convenience and necessity are not considered filed until the commission makes a determination of administrative completeness.

§24.11. Informal Proceedings. (REPEAL)

§24.11. Financial Assurance.

(a) **Purpose.** This section establishes criteria to demonstrate that an owner or operator of a retail public utility has the financial resources to operate and manage the utility and to provide continuous and adequate service to the current and proposed utility service area.

(b) **Application.** This section applies to new and existing owners or operators of retail public utilities that are required to provide financial assurance pursuant to this chapter.

(c) Financial assurance must be demonstrated by compliance with subsection (d) or (e) of this section, unless the commission requires compliance with both subsections (d) and (e) of this section.

(d) **Irrevocable stand-by letter of credit.** Irrevocable stand-by letters of credit must be issued by a financial institution that is supervised or examined by the Board of Governors of the Federal Reserve System, the Office of the Controller of the Currency, or a state banking department, and where accounts are insured by the Federal Deposit Insurance Corporation. The retail public utility must use the standard form irrevocable stand-by letter of credit approved by the commission. The irrevocable stand-by letter of credit must be irrevocable for a period not less than five years, payable to the commission, and permit a draw to be made in part or in full. The irrevocable stand-by letter of credit must

permit the commission's executive director or the executive director's designee to draw on the irrevocable stand-by letter of credit if the retail public utility has failed to provide continuous and adequate service or the retail public utility cannot demonstrate its ability to provide continuous and adequate service.

(e) **Financial test.**

(1) An owner or operator may demonstrate financial assurance by satisfying a financial test including the leverage and operations tests that conform to the requirements of this section, unless the commission finds good cause exists to require only one of these tests.

(2) **Leverage test.**

To satisfy this test, the owner or operator must meet one or more of the following criteria:

(A) The owner or operator must have a debt to equity ratio of less than one, using long term debt and equity or net assets;

(B) The owner or operator must have a debt service coverage ratio of more than 1.25 using annual net operating income before depreciation and non-cash expenses divided by annual combined long term debt payments;

(C) The owner or operator must have sufficient unrestricted cash available as a cushion for two years of debt service. Restricted cash includes monetary resources that are committed as a debt service reserve which will not be used for operations, maintenance or other payables;

(D) The owner or operator must have an investment-grade credit rating from Standard & Poor's Financial Services LLC, Moody's Investors Service, or Fitch Ratings Inc.; or

(E) The owner or operator must demonstrate that an affiliated interest is capable, available, and willing to cover temporary cash shortages. The affiliated interest must be found to satisfy the requirements of subparagraphs (A), (B), (C), or (D) of this paragraph.

(3) **Operations test**. The owner or operator must demonstrate sufficient cash is available to cover any projected operations and maintenance shortages in the first five years of operations. An affiliated interest may provide a written guarantee of coverage of temporary cash shortages. The affiliated interest of the owner or operator must satisfy the leverage test.

(4) To demonstrate that the requirements of the leverage and operations tests are being met, the owner or operator shall submit the following items to the commission:

(A) An affidavit signed by the owner or operator attesting to the accuracy of the information provided. The owner or operator may use the affidavit included with an application filed pursuant to §24.105 of this title (relating to Contents of Certificate of Convenience and Necessity Applications) pursuant to the commission's form for the purpose of meeting the requirements of this subparagraph; and

(B) A copy of one of the following:

(i) the owner or operator's independently audited year-end financial statements for the most recent fiscal year including the "unqualified opinion" of the auditor; or

(ii) compilation of year-end financial statements for the most recent fiscal year as prepared by a certified public accountant (CPA); or

(iii) internally produced financial statements meeting the following requirements:

(I) for an existing utility, three years of projections and two years of historical data including a balance sheet, income statement and an expense statement or evidence that the utility is moving toward proper accountability and transparency; or

(II) for a proposed or new utility, start up information and five years of pro forma projections including a balance sheet, income statement and expense statement or evidence that the utility will be moving toward proper accountability and transparency during the first five years of operations. All assumptions must be clearly defined and the utility shall provide all documents supporting projected lot sales or customer growth.

(C) In lieu of meeting the leverage and operations tests, if the applicant utility is a city or district, the city or district may substantiate financial capability with a letter from the city's or district's financial advisor

indicating that the city or district is able to issue debt (bonds) in an amount sufficient to cover capital requirements to provide continuous and adequate service and providing the document in subparagraph (B)(i) of this paragraph.

(5) If the applicant is proposing service to a new CCN area or a substantial addition to its current CCN area requiring capital improvements in excess of $100,000, the applicant must provide the following:

(A) The owner must submit loan approval documents indicating funds are available for the purchase of an existing system plus any improvements necessary to provide continuous and adequate service to the existing customers if the application is a sale, transfer, or merger; or

(B) The owner must submit loan approval documents or firm capital commitments affirming funds are available to install plant and equipment necessary to serve projected customers in the first two years of projections or a new water system or substantial addition to a currently operating water system if the application includes added CCN area with the intention of serving a new area or subdivision.

(6) If the applicant is a nonfunctioning utility, as defined in §24.3(45) of this title (relating to Definitions of Terms), the commission may consider other information to determine if the proposed certificate holder has the capability of meeting the leverage and operations tests.

§24.14. Emergency Orders.

(a) The commission may issue emergency orders under Chapter 22, Subchapter P of this title (relating to Emergency Orders for Water and Sewer Utilities), with or without a hearing:

(1) to compel a water or sewer service provider that has obtained or is required to obtain a certificate of public convenience and necessity to provide continuous and adequate water service, sewer service, or both, if the discontinuance of the service is imminent or has occurred because of the service provider's actions or failure to act. These orders may contain provisions requiring specific utility actions to ensure continuous and adequate utility service and compliance with regulatory guidelines;

(2) to compel a retail public utility to provide an emergency interconnection with a neighboring retail public utility for the provision of temporary water or sewer service, or both, for not more than 90 days if service discontinuance or serious impairment in service is imminent or has occurred; and/or

(3) to establish reasonable compensation for the temporary service required under paragraph (2) of this subsection and may allow the retail public utility receiving the service to make a temporary adjustment to its rate structure to ensure proper payment.

(b) The commission may also issue orders under Chapter 22, Subchapter P of this title (relating to Emergency Orders for Water and Sewer Utilities):

(1) to appoint a temporary manager under TWC §5.507 and §13.4132; and/or

(2) to approve an emergency rate increase under TWC §5.508 and §13.4133 in certain circumstances:

(A) for which a temporary manager has been appointed under TWC §13.4132; or

(B) for which a receiver has been appointed under TWC §13.412; and

(C) if the increase is necessary to ensure the provision of continuous and adequate services to the utility's customers.

(c) If an order is issued under this section without a hearing, the order shall fix a time, as soon after the emergency order is issued as is practicable, and place for a hearing to be held before the commission.

§24.21. Form and Filing of Tariffs.

(a) **Approved tariff.** A utility may not directly or indirectly demand, charge, or collect any rate or charge, or impose any classifications, practices, rules, or regulations different from those prescribed in its approved tariff filed with the commission or with the municipality exercising original jurisdiction over the utility, except as noted in this subsection. A utility may charge the rates proposed under TWC §13.187 or §13.1871 on or after the proposed effective date, unless the proposed effective date of the proposed rates is suspended or the commission sets interim rates. The regulatory assessment required in TWC §5.235(n) does not have to be listed on the utility's approved tariff to be charged and collected but must be included in the tariff at the earliest opportunity. A person who possesses facilities used to provide water utility service or a utility that holds a certificate of public convenience and necessity to provide water service that enters into an agreement in accordance with TWC §13.250(b)(2), may collect charges for wastewater services on behalf of another retail public utility on the same bill with its water charges and shall at the earliest opportunity include a notation on its tariff that it has entered into such an agreement. A utility may enter into a contract with a county to collect solid waste disposal fees and include those fees on the same bill with its water charges and shall at the earliest opportunity include a notation on its tariff that it has entered into such an agreement.

(b) **Requirements as to size, form, identification, minor changes, and filing of tariffs.**

(1) **Tariffs filed with applications for certificates of convenience and necessity.**

(A) Every public utility shall file its tariff with the commission containing schedules of all its rates, tolls, charges, rules, and regulations pertaining to all of its utility service when it applies for a certificate of convenience and necessity to operate as a public utility. The tariff must be on the form the commission prescribes or another form acceptable to the commission.

(B) Every water supply or sewer service corporation shall file with the commission a complete tariff containing schedules of all its rates, tolls, charges, rules, and regulations pertaining to all of its utility service when it applies for a certificate of convenience and necessity to operate as a retail public utility.

(2) **Minor tariff changes.** Except for an affected county, a public utility's approved tariff may not be changed or amended without commission approval. An affected county may change rates for water or wastewater service without commission approval but shall file a copy of the revised tariff with the commission within 30 days after the effective date of the rate change.

(A) The commission may approve the following minor changes to tariffs:

(i) service rules and policies;

(ii) changes in fees for customer deposits, meter tests, return check charges, and late charges, provided they do not exceed the maximum allowed by the applicable sections;

(iii) implementation of a purchased water or sewage treatment provision, a temporary water rate provision in response to mandatory reductions in water use imposed by a court, government

agency, or other authority, or water use fee provision previously approved by the commission;

(iv) surcharges over a time period determined to reflect the change in the actual cost to the utility for sampling costs, commission inspection fees, or as appropriate, other governmental requirements beyond the utility's control;

(v) addition of the regulatory assessment as a separate item or to be included in the currently authorized rate;

(vi) addition of a provision allowing a utility to collect wastewater charges in accordance with TWC §13.250(b)(2) or §13.147(d);

(vii) rate adjustments to implement authorized phased or multi-step rates or downward rate adjustments to reconcile rates with actual costs;

(viii) addition of a production fee charged by a groundwater conservation district as a separate item calculated by multiplying the customer's total consumption, including the number of gallons in the base bill, by the actual production fee per thousand gallons; or

(ix) implementation of an energy cost adjustment clause.

(B) The addition of an extension policy to a tariff or a change to an existing extension policy does not qualify as a minor tariff change because it must be approved or amended in a rate change application.

(3) **Tariff revisions and tariffs filed with rate changes.**

(A) The utility shall file its revision with the commission. Each revision must be accompanied by a cover page that contains a list of pages being revised, a statement describing each change, its effect if it is a change in an existing rate, and a statement as to impact on rates of the change by customer class, if any. If a proposed tariff revision constitutes an increase in existing rates of a particular customer class or classes, then the commission may require that notice be given.

(B) Symbols for changes. Each proposed tariff sheet accompanying an application filed pursuant to TWC §13.187 or §13.1871 shall contain notations in the right-hand margin indicating each change made on the sheets. Notations to be used are: (C) to denote a change in regulations; (D) to denote discontinued rates or regulations; (E) to denote the correction of an error made during a revision (the revision which resulted in the error must be one connected to some material contained in the tariff prior to the revision); (I) to denote a rate increase; (N) to denote a new rate or regulation; (R) to denote a rate reduction; and (T) to denote a change in text, but no change in rate or regulation. In addition to symbols for changes, each changed provision in the tariff shall contain a vertical line in the right-hand margin of the page, which clearly shows the exact number of lines being changed.

(4) **Rate schedule.** Each rate schedule must clearly state the territory, subdivision, city, or county in which the schedule is applicable.

(5) **Tariff sheets.** Tariff sheets must be numbered consecutively. Each sheet must show an effective date, a revision number, section number, sheet number, name of the utility, the name of the tariff, and title of the section in a consistent manner. Sheets issued under new numbers must be designated as original sheets. Sheets being revised must show the number of the revision, and the sheet numbers must be the same.

(c) **Composition of tariffs.** A utility's tariff, including those utilities operating within the corporate limits of a municipality, must contain sections setting forth:

(1) a table of contents;

(2) a list of the cities and counties, and subdivisions or systems, in which service is provided;

(3) the certificate of convenience and necessity number under which service is provided;

(4) the rate schedules;

(5) the service rules and regulations, including forms of the service agreements, if any, and customer service inspection forms required to be completed under 30 TAC §290.46(j) (relating to Minimum Acceptable Operating Practices for Public Drinking Water Systems) if the form used deviates from that specified in 30 TAC §290.47(d) (relating to Appendices);

(6) the extension policy;

(7) an approved drought contingency plan as required by 30 TAC §288.20 (relating to Drought Contingency Plans for Municipal Uses by Public Water Suppliers); and

(8) the form of payment to be accepted for utility services.

(d) **Tariff filings in response to commission orders.** Tariff filings made in response to an order issued by the commission must include a transmittal letter stating that the tariffs attached are in compliance with the order, giving the docket number, date of the order, a list of tariff sheets filed, and any other necessary information. Any service rules proposed in addition to those listed on the commission's model tariff or any modifications of a rule in the model tariff must be clearly noted. All tariff sheets must comply with all other sections in this chapter and must include only changes ordered. The effective date and/or wording of the tariffs must comply with the provisions of the order.

(e) **Availability of tariffs.** Each utility shall make available to the public at each of its business offices and designated sales offices within Texas all of its tariffs currently on file with the commission or regulatory authority, and its employees shall lend assistance to persons requesting information and afford these persons an opportunity to examine any of such tariffs upon request. The utility also shall provide copies of any portion of the tariffs at a reasonable cost to reproduce such tariff for a requesting party.

(f) **Rejection.** Any tariff filed with the commission and found not to be in compliance with this section must be so marked and returned to the utility with a brief explanation of the reasons for rejection.

(g) **Change by other regulatory authorities.** Tariffs must be filed to reflect changes in rates or regulations set by other regulatory authorities and must include a copy of the order or ordinance authorizing the change. Each utility operating within the corporate limits of a municipality exercising original jurisdiction shall file with the commission a copy of its current tariff that has been authorized by the municipality.

(h) **Purchased water or sewage treatment provision.**

(1) A utility that purchases water or sewage treatment may include a provision in its tariff to pass through to its customers changes in such costs. The provision must specify how it is calculated and affects customer billings.

(2) This provision must be approved by the commission in a rate proceeding. A proposed change in the method of calculation of the provision must be approved in a rate proceeding.

(3) Once the provision is approved, any revision of a utility's billings to its customers to allow for the recovery of additional costs under the provision may be made only upon issuing notice as required by paragraph (4) of this subsection. The review of a proposed revision is an informal proceeding. Only the commission staff, or the utility may request a hearing on the proposed revision. The recovery of additional costs is defined as an increase in water use fees or in costs of purchased water or sewage treatment.

(4) A utility that wishes to revise utility billings to its customers pursuant to an approved purchased water or sewer treatment or water use fee provision to allow

for the recovery of additional costs shall take the following actions prior to the beginning of the billing period in which the revision takes effect:

(A) submit a written notice to the commission; and

(B) e-mail (if the customer has agreed to receive communications electronically) or mail notice to the utility's customers. Notice may be in the form of a billing insert and must contain the effective date of the change, the present calculation of customer billings, the new calculation of customer billings, and the change in charges to the utility for purchased water or sewage treatment or water use fees. The notice must include the following language: "This tariff change is being implemented in accordance with the utility's approved (purchased water) (purchased sewer) (water use fee) adjustment clause to recognize (increases) (decreases) in the (water use fee) (cost of purchased) (water) (sewage treatment). The cost of these charges to customers will not exceed the (increased) (decreased) cost of (the water use fee) (purchased) (water) (sewage treatment)."

(5) Notice to the commission must include a copy of the notice sent to the customers, proof that the cost of purchased water or sewage treatment has changed by the stated amount, and the calculations and assumptions used to determine the new rates.

(6) Purchased water or sewage treatment provisions may not apply to contracts or transactions between affiliated interests.

(i) **Effective date.** The effective date of a tariff change is the date of approval by the commission, unless otherwise specified in a commission order or rule. The effective date of a proposed rate increase under TWC §13.187 or §13.1871 is the proposed date on the notice to customers and the commission, unless suspended by the commission.

(j) **Tariffs filed by water supply or sewer service corporations.** Every water supply or sewer service corporation shall file, for informational purposes only, three complete copies of its tariff showing all rates that are subject to the appellate jurisdiction of the commission and that are in force for any utility service, product, or commodity offered. The tariff must include all rules and regulations relating to or affecting the rates, utility service or extension of service or product, or commodity furnished and shall specify the certificate of convenience and necessity number and in which counties or cities it is effective.

(k) **Surcharge**.

(1) A surcharge is an authorized rate to collect revenues over and above the usual cost of service.

(2) If specifically authorized for the utility in writing by the commission or the municipality exercising original jurisdiction over the utility, a surcharge to recover the actual increase in costs to the utility may be collected over a specifically authorized time period without being listed on the approved tariff for:

(A) sampling fees not already included in rates;

(B) inspection fees not already included in rates;

(C) production fees or connection fees not already included in rates charged by a groundwater conservation district; or

(D) other governmental requirements beyond the control of the utility.

(3) A utility shall use the revenues collected pursuant to a surcharge only for the purposes noted and handle the funds in the manner specified according to the notice or application submitted by the utility to the commission. The utility may redirect or use the revenues for other purposes only after first obtaining the approval of commission.

(l) **Temporary water rate provision for mandatory water use reduction**.

(1) A utility's tariff may include a temporary water rate provision that will allow the utility to increase its retail customer rates during periods when a court, government agency, or other authority orders mandatory water use reduction measures that affect the utility customers' use of water service and the utility's water revenues. Implementation of the temporary water rate provision will allow the utility to recover from customers' revenues that the utility would otherwise have lost due to mandatory water use reductions in accordance with the temporary water rate provision approved by the commission. If a utility obtains a portion of its water supply from another unrestricted water source or water supplier during the time the temporary water rate is in effect, the rate resulting from implementation of the temporary water rate provision must be adjusted to account for the supplemental water supply and to limit over recovery of revenues from customers. A temporary water rate provision may not be implemented by a utility

if there exists an available, unrestricted, alternative water supply that the utility can use to immediately replace, without additional cost, the water made unavailable because of the action requiring a mandatory reduction of use of the affected water supply.

(2) The temporary water rate provision must be approved by the commission in a rate proceeding before it may be included in the utility's approved tariff or implemented as provided in this subsection. A proposed change in the temporary water rate must be approved in a rate proceeding. A utility that has filed a rate change within the last 12 months may file a request for the limited purpose of obtaining a temporary water rate provision.

(3) A utility may request a temporary water rate provision for mandatory water use reduction using the formula in this paragraph to recover 50% or less of the revenues that would otherwise have been lost due to mandatory water use reductions through a limited rate proceeding. The formula for a temporary water rate provision for mandatory water use reduction under this paragraph is:

TGC = Temporary gallonage charge

cgc = current gallonage charge

r = water use reduction expressed as a decimal fraction (the pumping restriction)

prr = percentage of revenues to be recovered expressed as a decimal fraction (i.e., 50% = 0.5)

$$TGC = cgc + [(prr)(cgc)(r)/(1.0-r)]$$

(A) The utility shall file a temporary water rate provision for mandatory water use reduction application and provide customer notice as required by the commission, but is not required to provide complete financial data to support its existing rates. Notice must include a statement of when the temporary water rate provision would be implemented, the customer class(es) affected, the rates affected, information on how to protest the rate change, the address of the commission, the time frame for protests, and any other information that is required by the commission in the temporary water rate application. The utility's existing rates are not subject to review in the proceeding and the utility is only required to support the need for the temporary rate. A request for a temporary water rate provision for mandatory water use reduction under this paragraph is not considered a statement of intent to increase rates subject to the 12-month limitation in §24.23 of this title (relating to Time Between Filings).

(B) The utility shall establish that the projected revenues that will be generated by the temporary water rate provision are required by the utility to pay reasonable and necessary expenses that will be incurred by the utility during the time mandatory water use reductions are in effect.

(4) A utility may request a temporary water rate provision for mandatory water use reduction using the formula in paragraph (3) of this subsection or any other method acceptable to the commission to recover up to 100% of the revenues that would otherwise have been lost due to mandatory water use reductions.

(A) If the utility requests authorization to recover more than 50% of lost revenues, it shall submit financial data to support its existing rates as well as the temporary water rate provision for mandatory water use reduction even if no other rates are proposed to be changed. The utility's existing rates are subject to review in addition to the temporary water rate provision for mandatory water use reduction.

(B) The utility shall establish that the projected revenues that will be generated by the temporary water rate provision for mandatory water use reduction are required by the utility to pay reasonable and necessary expenses that will be incurred by the utility during the time mandatory water use reductions are in effect; that the rate of return granted by the commission in the utility's last rate case does not adequately compensate the utility for the foreseeable risk that mandatory water use reductions will be ordered; and that revenues generated by existing rates do not exceed reasonable cost of service.

(5) The utility may place the temporary water rate into effect only after:

(A) the temporary water provision has been approved by the commission and included in the utility's approved tariff in a prior rate proceeding;

(B) there is an action by a court, government agency, or other authority requiring mandatory water use reduction measures that affect the utility's customers' use of utility services; and

(C) issuing notice as required by paragraph (7) of this subsection.

(6) The utility may readjust its rates using the temporary water rate provision for mandatory water use reduction as necessary to respond to modifications or changes to the original order requiring mandatory water use reductions by reissuing notice as required by paragraph (7) of this subsection. Only the commission or the utility may request a hearing on the proposed implementation.

(7) A utility that wishes to place a temporary water rate for mandatory water use reduction into effect shall take the following actions prior to the beginning of the billing period in which the temporary water rate for mandatory water use reduction takes effect:

(A) submit a written notice, including a copy of the notice received from the court, government agency, or other authority requiring the reduction in water use, to the commission; and

(B) e-mail, if the customer has agreed to receive communications electronically, or mail notice to the utility's customers. Notice may be in the form of a billing insert and must contain the effective date of the implementation and the new rate the customers will pay after the temporary water rate is implemented. The notice must include the following language: "This rate change is being implemented in accordance with the temporary water rate provision approved by the Public Utility Commission of Texas to recognize the loss of revenues due to mandatory water use reduction ordered by (name of entity issuing order). The new rates will be effective on (date) and will remain in effect until the mandatory water use reductions are lifted or expired. The purpose of the

rate is to ensure the financial integrity of the utility. The utility will recover through the rate (the percentage authorized by the temporary rate) % of the revenues the utility would otherwise have lost due to mandatory water use reduction by increasing the volume charge from ($ per 1,000 gallons to $ per 1,000 gallons)."

(8) A utility shall stop charging a temporary water rate as soon as is practical after the order that required mandatory water use reduction is ended, but in no case later than the end of the billing period that was in effect when the order was ended. The utility shall notify its customers of the date that the temporary water rate ends and that its rates will return to the level authorized before the temporary water rate was implemented.

(9) If the commission initiates an inquiry into the appropriateness or the continuation of a temporary water rate, it may establish the effective date of its decision on or after the date the inquiry is filed.

(m) **Multiple system consolidation**. Except as otherwise provided in subsection (o) of this section, a utility may consolidate its tariff and rate design for more than one system if:

(1) the systems included in the tariff are substantially similar in terms of facilities, quality of service, and cost of service; and

(2) the tariff provides for rates that promote water conservation for single- family residences and landscape irrigation.

(n) **Regional rates**. The commission, where practicable, shall consolidate the rates by region for applications submitted under TWC §13.187 or §13.1871 with a consolidated tariff and rate design for more than one system.

(o) **Exemption**. Subsection (m) of this section does not apply to a utility that provided service in only 24 counties on January 1, 2003.

(p) **Energy cost adjustment clause**.

(1) A utility that purchases energy (electricity or natural gas) that is necessary for the provision of water or sewer service may request the inclusion of an energy cost adjustment clause in its tariff to allow the utility to adjust its rates to reflect increases and decreases in documented energy costs.

(2) A utility that requests the inclusion of an energy cost adjustment clause in its tariff shall file an application with the commission. The utility shall also give notice of the proposed energy cost adjustment clause by mail, either separately or accompanying customer billings, e-mail or by hand delivery to all affected utility customers at least 60 days prior to the proposed effective date. Proof of notice in the form of an affidavit stating that proper notice was delivered to affected customers and stating the dates of such delivery shall be filed with the commission by the applicant utility as part of the application. Notice must be provided on the notice form included in the commission's application package and must contain the following information:

(A) the utility name and address, a description of how the increase or decrease in energy costs will be calculated, the effective date of the proposed change, and the classes of utility customers affected. The effective date of the proposed energy cost adjustment clause must be the first day of a billing period, which should correspond to the day of the month when meters are typically read, and the clause may not apply to service received before the effective date of the clause;

(B) information on how to submit comments regarding the energy cost adjustment clause, the address of the commission, and the time frame for comments; and

(C) any other information that is required by the application form.

(3) The commission's review of the utility's application is an uncontested matter not subject to a contested case hearing. However, the commission shall hold an uncontested public meeting on the application if requested by a member of the legislature who represents the area served by the utility or if the commission determines that there is substantial public interest in the matter.

(4) Once an energy cost adjustment clause has been approved, documented changes in energy costs must be passed through to the utility's customers within a reasonable time. The pass through, whether an increase or decrease, shall be implemented on at least an annual basis, unless the commission determines a special circumstance applies. Anytime changes are being made using this provision, notice shall be provided as required by paragraph (5) of this subsection.

(5) Before a utility implements a change in its energy cost adjustment clause as required by paragraph (4) of this subsection, the utility shall take the following actions prior to the beginning of the billing period in which the implementation takes effect:

(A) submit written notice to the commission, which must include a copy of the notice sent to the customers, proof that the documented energy costs have changed by the stated amount; and

(B) e-mail, if the customer has agreed to receive communications electronically, mail either separately or accompanying customer billings, or hand deliver notice to the utility's affected customers. Notice must contain the effective date of change and the increase or decrease in charges to the utility for documented energy costs. The notice must include the following language: "This tariff change is being implemented in accordance with the utility's approved energy cost adjustment clause to recognize (increases) (decreases) in the documented energy costs. The cost of these charges to customers will not exceed the (increase) (decrease) in documented energy costs."

(6) The commission may suspend the adoption or implementation of an energy cost adjustment clause if the utility has failed to properly complete the application or has failed to comply with the notice requirements or proof of notice requirements. If the utility cannot clearly demonstrate how the clause is calculated, the increase or decrease in documented energy costs or how the increase or decrease in documented energy costs will affect rates, the commission may suspend the

adoption or implementation of the clause until the utility provides additional documentation requested by the commission. If the commission suspends the adoption or implementation of the clause, the adoption or implementation will be effective on the date specified by the commission

(7) Energy cost adjustment clauses may not apply to contracts or transactions between affiliated interests.

(8) A proceeding under this subsection is not a rate case pursuant to TWC §13.187, §13.1871, or §13.1872.

§24.22. Notice of Intent and Application to Change Rates. (REPEAL)

§24.22. Notice of Intent and Application to Change Rates Pursuant to Texas Water Code §13.187 or §13.1871.

(a) **Purpose.** This section describes the requirements for the contents of an application to change rates and the requirements for the provision of notice pursuant to TWC §13.187 or §13.1871.

(b) **Contents of the application**. An application to change rates pursuant to TWC §13.187 or §13.1871 is initiated by the filing of a rate filing package, a statement of intent to change rates, and the proposed form and method of notice to customers and other affected entities pursuant to subsection (c) of this section.

(1) The application shall include the commission's rate filing package form and include all required schedules.

(2) The application shall be based on a test year as defined in §24.3(71) of this title (relating to Definitions of Terms).

(3) For an application filed pursuant to TWC §13.187, the rate filing package, including each schedule, shall be supported by pre-filed direct testimony. The pre-filed direct testimony shall be filed at the same time as the application to change rates.

(4) For an application filed pursuant to TWC §13.1871, the rate filing package, including each schedule, shall be supported by affidavit. The affidavit shall be

filed at the same time as the application to change rates. The utility may file pre-filed direct testimony at the same time as the application to change rates. If the application is set for a hearing, the presiding officer may require the filing of pre-filed direct testimony at a later date.

(5) **Proof of notice.** Proof of notice in the form of an affidavit stating that proper notice was mailed, e-mailed, or delivered to customers and affected municipalities and stating the date(s) of such delivery shall be filed with the commission by the applicant utility as part of the rate change application.

(c) **Notice requirements specific to applications filed pursuant to TWC §13.187.**

(1) **Notice of the application.** In order to change rates pursuant to TWC §13.187, a utility must comply with the following requirements at least 35 days before the effective date of the proposed change.

(A) The utility must file a statement of intent (notice) with the commission and provide a copy of the notice to all customers of the utility affected by the proposed rate change, to the appropriate offices of each municipality affected by the proposed rate change, and to the Office of Public Utility Counsel.

(B) Notice shall be provided using the commission-approved form and shall include a description of the process by which a ratepayer may intervene in the proceeding.

(C) This notice shall state the docket number assigned to the rate application. Prior to the provision of notice, the utility shall file a request for the assignment of a docket number for the rate application.

(D) Notices to affected ratepayers may be mailed separately, e-mailed if the customer has agreed to receive communications electronically, or may accompany customer billings.

(E) Notice is considered to be completed upon mailing, e-mailing (if the customer has agreed to receive communications electronically), or hand delivery.

(2) **Notice of the hearing.** After the rate application is set for a hearing, the commission shall give reasonable notice of the hearing, including notice to the governing body of each affected municipality and county. The commission may require the utility to complete this notice requirement.

(d) **Notice requirements specific to applications filed pursuant to TWC §13.1871.**

(1) **Notice of the application.** In order to change rates pursuant to TWC §13.1871, a utility must comply with the following requirements at least 35 days before the effective date of the proposed change.

(A) The utility must file a notice with the commission and provide a copy of the notice to all customers of the utility affected by the proposed rate change and to the appropriate offices of each municipality affected by the proposed rate change, and to the Office of Public Utility Counsel.

(B) Notice shall be provided using the commission-approved form and shall include a description of the process by which a ratepayer may file a protest pursuant to TWC §13.1871(i).

(C) For Class B utilities, the notice shall state the docket number assigned to the rate application. Prior to providing notice, Class B utilities shall file a request for the assignment of a docket number for the rate application.

(D) Notices to affected ratepayers may be mailed separately, e-mailed if the customer has agreed to receive communications electronically, or may accompany customer billings.

(E) Notice is considered to be completed upon mailing, e-mailing (if the customer has agreed to receive communications electronically), or hand delivery.

(2) **Notice of the hearing.** After the rate application is set for a hearing, the following notice requirements shall apply.

(A) The commission shall give reasonable notice of the hearing, including notice to the governing body of each affected municipality and county. The commission may require the utility to complete this notice requirement.

(B) The utility shall mail notice of the hearing to each affected ratepayer at least 20 days before the hearing. The notice must include a description of the process by which a ratepayer may intervene in the proceeding.

(e) **Line extension and construction policies.** A request to approve or amend a utility's line extension and construction policy shall be filed in a rate change application under TWC §13.187 or §13.1871. The application filed under TWC §13.187 or §13.1871 must include the proposed tariff and other information requested by the commission. The request may be made with a request to change one or more of the utility's other rates.

(f) **Capital improvements surcharge**. In a rate proceeding pursuant to TWC §13.187 or TWC §13.1871, the commission may authorize collection of additional revenues from the customers pursuant to a surcharge to provide funds for capital improvements necessary to provide facilities capable of providing continuous and adequate utility service, and for the preparation of design and planning documents.

(g) **Debt repayments surcharge**. In a rate proceeding pursuant to TWC §13.187 or TWC §13.1871, the commission may authorize collection of additional revenues from customers pursuant to a surcharge to provide funds for debt repayments and associated costs, including funds necessary to establish contingency funds and reserve funds. Surcharge funds may be collected to meet all of the requirements of the Texas Water Development Board in regard to financial assistance from the Safe Drinking Water Revolving Fund.

§24.23. Time Between Filings.

(a) **Application**. The following provisions are applicable to utilities, including those with consolidated or regional tariffs, under common control or ownership with any utility that has filed a statement of intent to increase rates pursuant to TWC §13.187 or §13.1871.

(b) A utility or two or more utilities under common control and ownership may not file a statement of intent to increase rates pursuant to TWC §13.187 or §13.1871 more than once in a 12-month period except:

(1) to implement an approved purchase water pass through provision;

(2) to adjust the rates of a newly acquired utility system;

(3) to comply with a commission order;

(4) to adjust rates authorized by §24.21(b)(2) of this title (relating to Form and Filing of Tariffs);

(5) when the regulatory authority requires the utility to deliver a corrected statement of intent; or

(6) when the regulatory authority determines that a financial hardship exists. A utility may be considered to be experiencing a financial hardship if revenues are insufficient to:

(A) cover reasonable and necessary operating expenses;

(B) cover cash flow needs which may include regulatory sampling requirements, unusual repair and maintenance expenses, revenues to

finance required capital improvements or, in certain instances, existing debt service requirements specific to utility operations; or

(C) support a determination that the utility is able to provide continuous and adequate service to its existing service area.

(c) A Class C utility under common control or ownership with a utility that has filed an application to change rates pursuant to TWC §13.187 or §13.1871 within the preceding 12 months may not file an application to change rates pursuant to TWC §13.187 or §13.1871 unless it is filed pursuant to an exception listed in subsection (b) of this section.

§24.25. Rate Change Applications, Testimony, and Exhibits. (REPEAL)

§24.26. Suspension of Rates. (REPEAL)

§24.26. Suspension of the Effective Date of Rates.

(a) Regardless of, and in addition to, any period of suspension ordered pursuant to subsection (b) of this section, after written notice to the utility, the commission may suspend the effective date of a rate change for not more than:

(1) 150 days from the date the proposed rates would otherwise be effective for an application filed pursuant to TWC §13.187; or

(2) 265 days from the date the proposed rates would otherwise be effective for an application filed pursuant to TWC §13.1871.

(b) Regardless of, and in addition to, any period of suspension ordered pursuant to subsection (a) of this section, the commission may suspend the effective date of a change in rates requested pursuant to TWC §13.187 or §13.1871 if the utility:

(1) has failed to properly complete the rate application as required by §24.22 of this title (relating to Notice of Intent and Application to Change Rates Pursuant to Texas Water Code §13.187 or §13.1871), has failed to comply with the notice requirements and proof of notice requirements, or has for any other reason filed a request to change rates that is not deemed administratively complete until a properly completed request to change rates is accepted by the commission;

(2) does not have a certificate of convenience and necessity or a completed application pending with the commission to obtain or to transfer a certificate of convenience and necessity until a completed application to obtain or transfer a certificate of convenience and necessity is accepted by the commission; or

(3) is delinquent in paying the regulatory assessment fee and any applicable penalties or interest required by TWC §5.701(n) until the delinquency is remedied.

(c) If the commission suspends the effective date of a requested change in rates pursuant to subsection (b) of this section, the requirement under §24.28(b)(1) of this title (relating to Processing and Hearing Requirements for an Application Filed Pursuant to Texas Water Code §13.187 or §13.1871**)** to begin a hearing within 30 days of the effective date does not apply and the utility may not notify its customers of a new proposed effective date until the utility receives written notification from the commission that all deficiencies have been corrected.

(d) A suspension ordered pursuant to subsection (a) of this section shall be extended two days for each day a hearing on the merits exceeds 15 days.

(e) If the commission does not make a final determination on the proposed rate before the expiration of the suspension period described by subsections (a) and (d) of this section, the proposed rate shall be considered approved. This approval is subject to the authority of the commission thereafter to continue a hearing in progress.

(f) The effective date of any rate change may be suspended at any time during the pendency of a proceeding, including after the date on which the proposed rates are otherwise effective.

(g) For good cause shown, the commission may at any time during the proceeding require the utility to refund money collected under a proposed rate before the rate was suspended to the extent the proposed rate exceeds the existing rate.

§24.27. Request for a Review of a Rate Change by Ratepayers Pursuant to the Texas Water Code §13.187(b). (REPEAL)

§24.28. Action on Notice of Rate Change Pursuant to Texas Water Code, §13.187(b). (REPEAL)

§24.28. Processing and Hearing Requirements for an Application Filed Pursuant to Texas Water Code §13.187 or §13.1871.

(a) **Purpose.** This section describes requirements for the processing of applications to change rates filed pursuant to TWC §13.187 or §13.1871.

(b) **Proceedings pursuant to TWC §13.187.** The following criteria apply to applications to change rates filed by Class A utilities pursuant to TWC §13.187.

(1) Not later than the 30th day after the effective date of the change, the commission shall begin a hearing to determine the propriety of the change.

(2) The matter may be referred to the State Office of Administrative Hearings and the referral shall be deemed to be the beginning of the hearing required by paragraph (1) of this subsection.

(3) If the matter is not referred to the State Office of Administrative Hearings, an order establishing a date for a prehearing conference shall be deemed to be the beginning of the hearing required by paragraph (1) of this section.

(c) **Proceedings pursuant to TWC §13.1871.** The following criteria apply to applications to change rates filed by a Class B utility or a Class C utility pursuant to TWC §13.1871.

(1) The commission may set the matter for hearing on its own motion at any time within 120 days after the effective date of the rate change.

(2) The commission shall set the matter for a hearing if it receives a complaint from any affected municipality or protests from the lesser of 1,000 or 10 percent of the affected ratepayers of the utility over whose rates the commission has original jurisdiction, during the first 90 days after the effective date of the proposed rate change.

(A) Ratepayers may file individual protests or joint protests. Each protest must contain the following information:

(i) a clear and concise statement that the ratepayer is protesting a specific rate action of the water or sewer service utility in question; and

(ii) the name and service address or other identifying information of each signatory ratepayer. The protest shall list the address of the location where service is received if it differs from the residential address of the signatory ratepayer.

(B) For the purposes of this subsection, each person receiving a separate bill is considered a ratepayer, but one person may not be considered more than one ratepayer regardless of the number of bills the person receives. The protest is properly signed if signed by a person, or the spouse of a person, in whose name utility service is carried.

(3) Referral to SOAH at any time during the pendency of the proceeding is deemed to be setting the matter for hearing as required by paragraphs (1) and (2) of this subsection.

(4) If the matter is not referred to the State Office of Administrative Hearings, an order establishing a date for a prehearing conference shall be deemed to be the beginning of the hearing required by paragraph (2) of this section.

(d) If, after hearing, the regulatory authority finds the rates currently being charged or those proposed to be charged are unreasonable or in violation of the law, the regulatory authority shall determine the rates to be charged by the utility and shall fix the rates by order served on the utility.

(e) The utility may begin charging the proposed rates on the proposed effective date, unless the proposed rate change is suspended by the commission pursuant to §24.26 of this title (relating to Suspension of the Effective Date of Rates) or interim rates are set by the presiding officer pursuant to §24.29 of this title (relating to Interim Rates). Rates charged under a proposed rate during the pendency of a proceeding are subject to refund to the extent the commission ultimately approves rates that are lower than the proposed rates.

§24.31. Cost of Service.

(a) **Components of cost of service.** Rates are based upon a utility's cost of rendering service. The two components of cost of service are allowable expenses and return on invested capital.

(b) **Allowable expenses.** Only those expenses that are reasonable and necessary to provide service to the ratepayers may be included in allowable expenses. In computing a utility's allowable expenses, only the utility's test year expenses as adjusted for known and measurable changes may be considered. A change in rates must be based on a test year as defined in §24.3(71) of this title (relating to Definitions of Terms).

(1) Components of allowable expenses. Allowable expenses, to the extent they are reasonable and necessary, and subject to this section, may include, but are not limited to, the following general categories:

(A) operations and maintenance expense incurred in furnishing normal utility service and in maintaining utility plant used by and useful to the utility in providing such service (payments to affiliated interests for costs of service, or any property, right, or thing, or for interest expense are not allowed as an expense for cost of service except as provided in TWC §13.185(e));

(B) depreciation expense based on original cost and computed on a straight line basis over the useful life of the asset as approved by the commission. Depreciation is allowed on all currently used depreciable utility property owned by the utility except for property provided by explicit customer

agreements or funded by customer contributions in aid of construction. Depreciation on all currently used and useful developer or governmental entity contributed property is allowed in the cost of service. On all applications, the depreciation accrual for all assets must account for expected net salvage value in the calculation of the depreciation rate and actual net salvage value related to retired plant. The depreciation rate and expense must be calculated on a straight line basis over the expected or remaining life of the asset. Utilities must calculate depreciation on a straight line basis, but are not required to use the remaining life method if salvage value is zero. When submitting an application that includes salvage value in depreciation calculations, the utility must submit sufficient evidence with the application establishing that the estimated salvage value, including removal costs, is reasonable. Such evidence will be included for the asset group in deprecation studies for those utilities practicing group accounting while such evidence will relate to specific assets for those utilities practicing itemized accounting;

(C) assessments and taxes other than income taxes;

(D) federal income taxes on a normalized basis (federal income taxes must be computed according to the provisions of TWC §13.185(f), if applicable);

(E) funds expended in support of membership in professional or trade associations, provided such associations contribute toward the professionalism of their membership; and

(F) advertising, contributions and donations. The actual expenditures for ordinary advertising, contributions, and donations may be allowed as a cost of service provided that the total sum of all such items allowed in the cost of service shall not exceed three-tenths of 1.0% (0.3%) of the gross receipts of the water or wastewater utility for services rendered to the public. The following expenses are the only expenses that shall be included in the calculation of the three-tenths of 1.0% (0.3%) maximum:

(i) funds expended advertising methods of conserving water;

(ii) funds expended advertising methods by which the consumer can effect a savings in total water or wastewater utility bills; and

(iii) funds expended advertising water quality protection.

(2) Expenses not allowed. The following expenses are not allowed as a component of cost of service:

(A) legislative advocacy expenses, whether made directly or indirectly, including, but not limited to, legislative advocacy expenses included in professional or trade association dues;

(B) funds expended in support of political candidates;

(C) funds expended in support of any political movement;

(D) funds expended in promotion of political or religious causes;

(E) funds expended in support of or membership in social, recreational, fraternal, or religious clubs or organizations;

(F) funds promoting increased consumption of water;

(G) additional funds expended to mail any parcel or letter containing any of the items mentioned in subparagraphs (A) - (F) of this paragraph;

(H) costs, including, but not limited to, interest expense of processing a refund or credit of sums collected in excess of the rate finally ordered by the commission;

(I) any expenditure found by the commission to be unreasonable, unnecessary, or not in the public interest, including, but not limited to, executive salaries, advertising expenses, rate case expenses, legal expenses, penalties and interest on overdue taxes, criminal penalties or fines, and civil penalties or fines; and

(J) the costs of purchasing groundwater from any source if:

(i) the source of the groundwater is located in a priority groundwater management area; and

(ii) a wholesale supply of surface water is available.

(c) **Return on invested capital.** The return on invested capital is the rate of return times invested capital.

(1) Rate of return. The commission shall allow each utility a reasonable opportunity to earn a reasonable rate of return, which is expressed as a percentage of invested capital, and shall fix the rate of return in accordance with the following principles. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical

management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

(A) The commission shall consider the efforts and achievements of the utility in the conservation of resources, the quality of the utility's services, the efficiency of the utility's operations, and the quality of the utility's management, along with other relevant conditions and practices.

(B) The commission may, in addition, consider inflation, deflation, the growth rate of the service area, and the need for the utility to attract new capital. In each case, the commission shall consider the utility's cost of capital, which is the composite of the cost of the various classes of capital used by the utility.

(i) Debt capital. The cost of debt capital is the actual cost of debt.

(ii) Equity capital. The cost of equity capital must be based upon a fair return on its value. For companies with ownership expressed in terms of shares of stock, equity capital commonly consists of the following classes of stock.

(I) Common stock capital. The cost of common stock capital must be based upon a fair return on its value.

(II) Preferred stock capital. The cost of preferred stock capital is its annual dividend requirement, if any, plus an adjustment for premiums, discounts, and cost of issuance.

(2) Invested capital, also referred to as rate base. The rate of return is applied to the rate base. Components to be included in determining the rate base are as follows:

(A) Original cost, less accumulated depreciation, of utility plant, property, and equipment used by and useful to the utility in providing service;

(B) Original cost, less net salvage and accumulated depreciation at the date of retirement, of depreciable utility plant, property and equipment retired by the utility; and

(i) For original cost under subparagraph (A) of this paragraph or this subparagraph, cost of plant and equipment allowed in the cost of service that has been estimated by trending studies or other means, which has no historical records for verification purposes, may receive an adjustment to rate base and/or an adjustment to the rate of return on equity.

(ii) Original cost under subparagraph (A) of this paragraph or this subparagraph is the actual money cost, or the actual money value of any consideration paid other than money, of the property at the time it was dedicated to public use, whether by the utility that is the present owner or by a predecessor. Assets may be booked in itemized or group accounting, but all accounting for assets and their retirements must be supported by an approved accounting system. On all assets retired from service after June 19, 2009, the original cost of an asset must be the book cost less net salvage value. If a utility calculates annual depreciation expense for an asset with allowance for salvage value, then it must account for the actual salvage amounts when the asset is actually retired. The

utility must include the actual salvage calculation(s) in its net plant calculation(s) in the first full rate change application (excluding alternative rate method applications as described in §24.34 of this title (relating to Alternative Rate Methods)) it files after the date on which the asset was removed from service, even if it was not retired during the test year. Recovery of investment on assets retired from service before the estimated useful life or remaining life of the asset shall be combined with over accrual of depreciation expense for those assets retired after the estimated useful life or remaining life and the net amount shall be amortized over a reasonable period of time taking into account prudent regulatory principles. The following list shall govern the manner by which depreciation will be accounted for.

(I) Accelerated depreciation is not allowed.

(II) For those utilities that elect a group accounting approach, all mortality characteristics, both life and net salvage, must be supported by an engineering or economic based depreciation study for which the test year for the depreciation is no more than five years old in comparison to the rate case test year. The engineering or economic based depreciation study must include:

(-a-) investment by homogenous category;

(-b-) expected level of gross salvage by category;

(-c-) expected cost of removal by category;

(-d-) the accumulated provision for depreciation as appropriately reflected on the company's books by category;

(-e-) the average service life by category;

(-f-) the remaining life by category;

(-g-) the Iowa Dispersion Pattern by category; and

(-h-) a detailed narrative identifying the specific factors, data, criteria and assumptions that were employed to arrive at the specific mortality proposal for each homogenous group of property.

(iii) Reserve for depreciation under subparagraph (A) of this paragraph or this subparagraph is the accumulation of recognized allocations of original cost, representing recovery of initial investment, over the estimated useful life or remaining life of the asset. If individual accounting is used, a utility must continue booking depreciation expense until the asset is actually retired, and the reserve for depreciation shall include any additional depreciation expense accrued past the estimated useful or remaining life of the asset. If salvage value is zero, depreciation must be computed on a straight line basis over the expected useful life or remaining life of the item or facility. If salvage value is not zero, depreciation must also be computed on a straight line basis over the expected useful life or

the remaining life. For an asset removed from service after June 19, 2009, accumulated depreciation will be calculated on book cost less net salvage of the asset. The retirement of a plant asset from service is accounted for by crediting the book cost to the utility plant account in which it is included. Accumulated depreciation must also be debited with the original cost and the cost of removal and credited with the salvage value and any other amounts recovered. Return may be allowed for assets removed from service after June 19, 2009, that result in an increased rate base through recognition in the reserve for depreciation if the utility proves that the decision to retire the asset was financially prudent, unavoidable, necessary because of technological obsolescence, or otherwise reasonable. The utility must also provide evidence establishing the original cost of the asset, the cost of removal, salvage value, any other amounts recovered, the useful life of the asset (or remaining life as may be appropriate), the date the asset was taken out of service, and the accumulated depreciation up to the date it was taken out of service. Additionally, the utility must show that it used due diligence in recovering maximum salvage value of a retired asset. The requirements relating to the accounting for the reasonableness of retirement decisions for individual assets and the net salvage value calculations for individual assets only apply to those utilities using itemized

accounting. For those utilities practicing group accounting, the depreciation study will provide similar information by category. TWC §13.185(e) relating to dealings with affiliated interests, will apply to business dealings with any entity involved in the retirement, removal, or recovery of assets. Assets retired subsequent to June 19, 2009, will be included in a utility's application for a rate change if the application is the first application for a rate change filed by the utility after the date the asset was retired and specifically identified if the utility uses itemized accounting. Retired assets will be reported for the asset group in depreciation studies for those utilities practicing group accounting, while retired assets will be specifically identified for those utilities practicing itemized accounting;

(iv) the original cost of plant, property, and equipment acquired from an affiliated interest may not be included in invested capital except as provided in TWC §13.185(e);

(v) utility property funded by explicit customer agreements or customer contributions in aid of construction such as surcharges may not be included in original cost or invested capital; and

(C) Working capital allowance to be composed of, but not limited to the following:

(i) reasonable inventories of materials and supplies, held specifically for purposes of permitting efficient operation of the utility in

providing normal utility service. This amount excludes inventories found by the commission to be unreasonable, excessive, or not in the public interest;

(ii) reasonable prepayments for operating expenses. Prepayments to affiliated interests are subject to the standards set forth in TWC §13.185(e); and

(iii) a reasonable allowance for cash working capital. The following shall apply in determining the amount to be included in invested capital for cash working capital:

(I) Cash working capital for water and wastewater utilities shall in no event be greater than one-eighth of total annual operations and maintenance expense, excluding amounts charged to operations and maintenance expense for materials, supplies, fuel, and prepayments.

(II) For Class C utilities, one-eighth of operations and maintenance expense excluding amounts charged to operations and maintenance expense for materials, supplies, expenses recovered through a pass through provision or through charges other than base rate and gallonage charges, prepayments will be considered a reasonable allowance for cash working capital.

(III) For Class B utilities, one-twelfth of operations and maintenance expense excluding amounts charged to

operations and maintenance expense for materials, supplies, expenses recovered through a pass through provision or charges other than base rate and gallonage charges, and prepayments will be considered a reasonable allowance for cash working capital.

(IV) For Class A utilities, a reasonable allowance for cash working capital, including a request of zero, will be determined by the use of a lead-lag study. A lead-lag study will be performed in accordance with the following criteria:

(-a-) The lead-lag study will use the cash method; all non-cash items, including but not limited to depreciation, amortization, deferred taxes, prepaid items, and return (including interest on long-term debt and dividends on preferred stock), will not be considered.

(-b-) Any reasonable sampling method that is shown to be unbiased may be used in performing the lead-lag study.

(-c-) The check clear date, or the invoice due date, whichever is later, will be used in calculating the lead-lag days used in the study. In those cases where multiple due dates and payment terms are

offered by vendors, the invoice due date is the date corresponding to the terms accepted by the water or wastewater utility.

(-d-) All funds received by the water or wastewater utility except electronic transfers shall be considered available for use no later than the business day following the receipt of the funds in any repository of the water or wastewater utility (e.g., lockbox, post office box, branch office). All funds received by electronic transfer will be considered available the day of receipt.

(-e-) For water and wastewater utilities the balance of cash and working funds included in the working cash allowance calculation shall consist of the average daily bank balance of all noninterest bearing demand deposits and working cash funds.

(-f-) The lead on federal income tax expense shall be calculated by measurement of the interval between the mid-point of the annual service period and the actual payment date of the water or wastewater utility.

(-g-) If the cash working capital calculation results in a negative amount, the negative amount shall be included in rate base.

(V) If cash working capital is required to be determined by the use of a lead-lag study under subclause (VI) of this clause and either the water or wastewater utility does not file a lead-lag study or the utility's lead-lag study is determined to be unreliable, in the absence of persuasive evidence that suggests a different amount of cash working capital, zero will be presumed to be the reasonable level of cash working capital.

(VI) A lead lag study completed within five years of the application for rate/tariff change shall be deemed adequate for determining cash working capital unless sufficient persuasive evidence suggests that the study is no longer valid.

(VII) Operations and maintenance expense does not include depreciation, other taxes, or federal income taxes, for purposes of subclauses (I), (II), (III) and (V) of this clause.

(3) **Deduction of certain items from rate base, which include, but are not limited to, the following.** Unless otherwise determined by the commission, for good cause shown, the following items will be deducted from the overall rate base in the consideration of applications filed pursuant to TWC §13.187 or §13.1871:

(A) accumulated reserve for deferred federal income taxes;

(B) unamortized investment tax credit to the extent allowed by the Internal Revenue Code;

(C) contingency and/or property insurance reserves;

(D) contributions in aid of construction; and

(E) other sources of cost-free capital, as determined by the commission.

(4) **Construction work in progress (CWIP).** The inclusion of construction work in progress is an exceptional form of relief. Under ordinary circumstances, the rate base consists only of those items that are used and useful in providing service to the public. Under exceptional circumstances, the commission may include construction work in progress 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. However, construction work in progress may not be allowed for any portion of a major project that the utility has failed to prove was efficiently and prudently planned and managed.

(5) **Requirements for post-test year adjustments.**

(A) A post-test year adjustment to test year data for known and measurable rate base additions may be considered only if:

(i) the addition represents plant which would appropriately be recorded for investor-owned water or wastewater utilities in NARUC account 101 or 102;

(ii) the addition comprises at least 10% of the water or wastewater utility's requested rate base, exclusive of post-test year adjustments and CWIP;

(iii) the addition is in service before the rate year begins; and

(iv) the attendant impacts on all aspects of a utility's operations (including but not limited to, revenue, expenses and invested capital) can with reasonable certainty be identified, quantified and matched. Attendant impacts are those that reasonably result as a consequence of the post-test year adjustment being proposed.

(B) Each post-test year plant adjustment described by subparagraph (A) of this paragraph will be included in rate base at the reasonable test year-end CWIP balance, if the addition is constructed by the utility or the reasonable price, if the addition represents a purchase, subject to original cost requirements, as specified in TWC §13.185.

(C) Post-test year adjustments to historical test year data for known and measurable rate base decreases will be allowed only if:

(i) the decrease represents:

(I) plant which was appropriately recorded in the accounts set forth in subparagraph (A) of this paragraph;

(II) plant held for future use;

(III) CWIP (mirror CWIP is not considered CWIP); or

(IV) an attendant impact of another post-test year adjustment.

(ii) the decrease represents plant that has been removed from service, sold, or removed from the water or wastewater utility's books prior to the rate year; and

(iii) the attendant impacts on all aspects of a utility's operations (including but not limited to, revenue, expenses and invested capital) can with reasonable certainty be identified, quantified and matched. Attendant impacts are those that reasonably result as a consequence of the post-test year adjustment being proposed.

(d) **Recovery of positive acquisition adjustments.**

(1) For utility plant, property, and equipment acquired by a utility from another retail public utility as a sale, merger, etc. of utility service area for which an application for approval of sale has been filed with the commission on or after September 1, 1997, and that sale application closed thereafter, a positive acquisition adjustment will be allowed to the extent that the acquiring utility proves that:

(A) the property is used and useful in providing water or sewer service at the time of the acquisition or as a result of the acquisition;

(B) reasonable, prudent, and timely investments will be made if required to bring the system into compliance with all applicable rules and regulations;

(C) as a result of the sale, merger, etc.:

(i) the customers of the system being acquired will receive higher quality or more reliable water or sewer service or that the acquisition was necessary so that customers of the acquiring

utility's other systems could receive higher quality or more reliable water or sewer service;

(ii) regionalization of retail public utilities (meaning a pooling of financial, managerial, or technical resources that achieve economies of scale or efficiencies of service) was achieved; or

(iii) the acquiring system will become financially stable and technically sound as a result of the acquisition, or the system being acquired that is not financially stable and technically sound will become a part of a financially stable and technically sound utility;

(D) any and all transactions between the buyer and the seller entered into as a part or condition of the sale are fully disclosed to the commission and were conducted at arm's length;

(E) the actual purchase price is reasonable in consideration of the condition of the plant, property, and equipment being acquired; the impact on customer rates if the acquisition adjustment is granted; the benefits to the customers; and the amount of contributions in aid of construction in the system being acquired;

(F) in a single or multi-stage sale, the owner of the acquired retail public utility and the final acquiring utility are not affiliated. A multi-stage sale is where a stock transaction is followed by a transfer of assets in what is essentially a single sales transaction. A positive acquisition adjustment is allowed only in those cases where the multi-stage transaction was fully disclosed to the commission in the application for approval of the initial

stock sale. Any multi-stage sale occurring between September 1, 1997 and February 4, 1999 is exempt from the requirement for commission notification at the time of the approval of the initial sale, but must provide such notification by April 5, 1999; and

(G) the rates charged by the acquiring utility to its pre-acquisition customers will not increase unreasonably because of the acquisition.

(2) The amount of the acquisition adjustment approved by the regulatory authority must be amortized using a straight line method over a period equal to the weighted average remaining useful life of the acquired plant, property, and equipment, at an interest rate equal to the rate of return determined under subsection (c) of this section. The acquisition adjustment may be treated as a surcharge and may be recovered using non-system-wide rates.

(3) The authorization for and the amount of an acquisition adjustment can only be determined as a part of a rate change application.

(4) The acquisition adjustment can only be included in rates as a part of a rate change application.

(e) **Negative acquisition adjustment.** When a retail public utility acquires plant, property, or equipment pursuant to §24.109 of this chapter (relating to Report of Sale, Merger, Etc.; Investigation; Disallowance of Transaction) and the original cost of the acquired property less depreciation exceeds the actual purchase price, the utility shall record the negative acquisition adjustment separately from the original cost of the acquired property. For purposes of ratemaking, the following shall apply:

(1) If a utility acquires plant, property, or equipment from a nonfunctioning retail public utility through a sale, transfer, or merger, receivership, or the utility is acting as a temporary manager, a negative acquisition adjustment shall be recorded and amortized on the utility's books with no effect on the utility's rates.

(2) If a utility acquires plant, property, or equipment from a retail public utility through a sale, transfer, or merger and paragraph (1) of this subsection does not apply, the commission may, at its sole discretion, recognize the negative acquisition adjustment in the ratemaking proceeding, by amortizing the negative acquisition adjustment through a bill credit for a defined period of time or by other means determined appropriate by the commission. Except for good cause found by the commission, the negative acquisition adjustment shall not be used to reduce the balance of invested capital.

(3) Notwithstanding paragraph (2) of this subsection, the acquiring utility may show cause as to why the commission should not account for the negative acquisition adjustment in the ratemaking proceeding.

(f) Intangible assets shall not be allowed in rate base unless:

(1) The amount requested has been verified by documentation as to amount and exact nature;

(2) Testimony has been submitted as to reasonableness and necessity and benefit of the expense to the customers; and

(3) The testimony must further show how the amount is properly considered as part of an actual asset purchased or installed, or a source of supply, such as water rights.

(4) If the requirements in paragraphs (1) and (2) of this subsection are met, but the requirement in paragraph (3) of this subsection is not met, the amount shall be amortized over a reasonable period and the amortization shall be allowed in the cost of service. The amount shall be considered a non-recurring expense. Unamortized amounts shall not be included in rate base for purposes of calculating return on equity.

§24.32. Rate Design.

(a) **General**. In fixing the rates of a utility, the commission shall fix its overall revenues at a level which will permit such 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 (unless an alternative rate method is used as set forth in §24.34 of this title (relating to Alternative Rate Methods), and preserve the financial integrity of the utility.

(b) **Conservation**.

(1) In order to encourage the prudent use of water or promote conservation, water and sewer utilities shall not apply rate structures which offer discounts or encourage increased usage within any customer class.

(2) After receiving final authorization from the regulatory authority through a rate change proceeding, a utility may implement a water conservation surcharge using an inclining block rate or other conservation rate structure. A utility may not implement such a rate structure to avoid providing facilities necessary to meet the TCEQ's minimum standards for public drinking water systems. A water conservation rate structure may generate revenues over and above the utility's usual cost of service:

(A) to reduce water usage or promote conservation either on a continuing basis or in specified restricted use periods identified in the utility's approved drought contingency plan required by 30 TAC §288.20 (TCEQ rules

relating to Drought Contingency Plans for Municipal Uses by Public Water Suppliers) included in its tariff in order to:

(i) comply with mandatory reductions directed by a wholesale supplier or underground water district; or

(ii) conserve water supplies, maintain acceptable pressure or storage, or other reasons identified in its approved drought contingency plan;

(B) to generate additional revenues necessary to provide facilities for maintaining or increasing water supply, treatment, production, or distribution capacity.

(3) All additional revenues over and above the utility's usual cost of service collected under paragraph (2) of this subsection:

(A) must be accounted for separately and reported to the commission, as requested; and

(B) are considered customer contributed capital unless otherwise specified in a commission order.

(c) **Volume charges**. Charges for additional usage above the base rate shall be based on metered usage over and above any volume included in the base rate rounded up or down as appropriate to the nearest 1,000 gallons or 100 cubic feet, or the fractional portion of the usage.

§24.33. Rate-case Expenses Pursuant to Texas Water Code §13.187 and §13.1871.

(a) A utility may recover rate-case expenses, including attorney fees, incurred as a result of filing a rate-change application pursuant to TWC §13.187 or TWC §13.1871, only if the expenses are just, reasonable, necessary, and in the public interest.

(b) A utility may not recover any rate-case expenses if the increase in revenue generated by the just and reasonable rate determined by the commission after a contested case hearing is less than 51% of the increase in revenue that would have been generated by a utility's proposed rate.

(c) A utility may not recover any rate-case expenses incurred after the date of a written settlement offer by all ratepayer parties if the revenue generated by the just and reasonable rate determined by the commission after a contested case hearing is less than or equal to the revenue that would have been generated by the rate contained in the written settlement offer.

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

§24.34. Alternative Rate Methods.

(a) **Alternative rate methods.** To ensure that retail customers receive a higher quality, more affordable, or more reliable water or sewer service, to encourage regionalization, or to maintain financially stable and technically sound utilities, the commission may utilize alternate methods of establishing rates. The commission shall assure that rates, operations, and service are just and reasonable to the consumers and to the utilities. The commission may prescribe modified rate filing packages for these alternate methods of establishing rates.

(b) **Phased and multi-step rate changes.** In a rate proceeding under TWC §13.187 or §13.1871, the commission may authorize a phased, stepped, or multi-year approach to setting and implementing rates to eliminate the requirement that a utility file another rate application.

(1) A utility may request to use the phased or multi-step rate method:

(A) to include the capital cost of installation of utility plant items that are necessary to improve service or achieve compliance with TCEQ or commission regulations in the utility's rate base and operating expenses in the revenue requirement when facilities are placed in service;

(B) to provide additional construction funds after major milestones are met;

(C) to provide assurance to a lender that rates will be immediately increased when facilities are placed in service;

(D) to allow a utility to move to metered rates from unmetered rates as soon as meters can be installed at all service connections;

(E) to phase in increased rates when a utility has been acquired by another utility with higher rates;

(F) to phase in rates when a utility with multiple rate schedules is making the transition to a system-wide rate structure; or

(G) when requested by the utility.

(2) Construction schedules and cost estimates for new facilities that are the basis for the phased or multi-step rate increase must be prepared by a licensed professional engineer.

(3) Unless otherwise specified in the commission order, the next phase or step cannot be implemented without verification of completion of each step by a licensed professional engineer, agency inspector, or agency subcontractor.

(4) At the time each rate step is implemented, the utility shall review actual costs of construction versus the estimates upon which the phase-in rates were based. If the revenues received from the phased or multi-step rates are higher than what the actual costs indicate, the excess amount must be reported to the commission prior to implementing the next phase or step. Unless otherwise specified in a commission order, the utility may:

(A) refund or credit the overage to the customers in a lump sum; or

(B) retain the excess to cover shortages on later phases of the project. Any revenues retained but not needed for later phases must be proportioned and

refunded to the customers at the end of the project with interest paid at the rate on deposits.

(5) The original notice to customers must include the proposed phased or multi-step rate change and informational notice must be provided to customers and the commission 30 days prior to the implementation of each step.

(6) A utility that requests and receives a phased or multi-step rate increase cannot apply for another rate increase during the period of the phase-in rate intervals unless:

(A) the utility can prove financial hardship; or

(B) the utility is willing to void the next steps of the phase-in rate structure and undergo a full cost of service analysis.

(c) **Cash needs method.** The cash needs method of establishing rates allows a utility to recover reasonable and prudently incurred debt service, a reasonable cash reserve account, and other expenses not allowed under standard methods of establishing rates.

(1) A utility may request to use the cash needs method of setting rates if:

(A) the utility is a nonprofit corporation controlled by individuals who are customers and who represent a majority of the customers; or

(B) the utility can demonstrate that use of the cash needs basis:

(i) is necessary to preserve the financial integrity of the utility;

(ii) will enable it to develop the necessary financial, managerial, and technical capacity of the utility; and

(iii) will result in higher quality and more reliable utility service for customers.

(2) Under the cash needs method, the allowable components of cost of service are: allowable operating and maintenance expenses; depreciation expense; reasonable and prudently incurred debt service costs; recurring capital improvements, replacements, and extensions that are not debt-financed; and a reasonable cash reserve account.

(A) **Allowable operating and maintenance expenses.** Only those expenses that are reasonable and necessary to provide service to the ratepayers may be included in allowable operations and maintenance expenses and they must be based on the utility's test year expenses as adjusted for known and measurable changes and reasonably anticipated, prudent projected expenses.

(B) **Depreciation expense.** Depreciation expense may be included on any used and useful depreciable plant, property, or equipment that was paid for by the utility and that has a positive net book value on the effective date of the rate change in the same manner as described in §24.31(b)(1)(B) of this title (relating to Cost of Service).

(C) **Debt service costs.** Debt service costs are cash outlays to an unaffiliated interest necessary to repay principal and interest on reasonably and prudently incurred loans. If required by the lender, debt service costs may also include amounts placed in a debt service reserve account in escrow or as required by the commission, Texas Water Development Board, or other

state or federal agency or other financial institution. Hypothetical debt service costs may be used for:

(i) self-financed major capital asset purchases where the useful life of the asset is ten years or more. Hypothetical debt service costs may include the debt repayments using an amortization schedule with the same term as the estimated service life of the asset using the prime interest rate at the time the application is filed; and

(ii) prospective loans to be executed after the new rates are effective. Any pre-commitments, amortization schedules, or other documentation from the financial institution pertaining to the prospective loan must be presented for consideration.

(D) **Recurring capital improvements, replacements, and extensions that are not debt-financed.** Capital assets, repairs, or extensions that are a part of the normal business of the utility may be included as allowable expenses. This does not include routine capital expenses that are specifically debt-financed.

(E) **Cash reserve account**. A reasonable cash reserve account, up to 10% of annual operation and maintenance expenses, must be maintained and revenues to fund it may be included as an allowable expense. Funds from this account may be used to pay expenses incurred before revenues from rates are received and for extraordinary repair and maintenance expenses and other capital needs or unanticipated expenses if approved in writing by the commission. The utility shall account for these funds separately and

report to the commission. Unless the utility requests an exception in writing and the exception is explicitly allowed by the commission in writing, any funds in excess of 10%, shall be refunded to the customers each year with the January billing either as a credit on the bill or refund accompanied by a written explanation that explains the method used to calculate the amounts to be refunded. Each customer must receive the same refund amount. These reserves are not for the personal use of the management or ownership of the utility and may not be used to compensate an owner, manager, or individual employee above the amount approved for that position in the most recent rate change request unless authorized in writing by the commission.

(3) If the revenues collected exceed the actual cost of service, defined in paragraph (2) of this subsection, during any calendar year, these excess cash revenues must be placed in the cash reserve account described in paragraph (2)(E) of this subsection and are subject to the same restrictions.

(4) If the utility demonstrates to the commission that it has reduced expenses through its efforts, and has improved its financial, managerial, and technical capability, the commission may allow the utility to retain 50% of the savings that result for the personal use of the management or ownership of the utility rather than pass on the full amount of the savings through lower rates or refund all of the amounts saved to the customers.

(5) If a utility elects to use the cash needs method, it may not elect to use the utility method for any rate change application initiated within five years after beginning

to use the cash needs method. If after the five-year period, the utility does elect to use the utility method, it may not include in rate base, or recover the depreciation expense, for the portion of any capital assets paid for by customers as a result of including debt service costs in rates. It may, however, include in rate base, and recover through rates, the depreciation expense for capital assets that were not paid for by customers as a result of including debt service costs in rates. The net book value of these assets may be recovered over the remaining useful life of the asset.

§24.36. Application for a Rate Adjustment by a Class C Utility Pursuant to Texas Water Code §13.1872.

(a) **Purpose**. This section establishes procedures for a Class C utility to apply for an adjustment to its water or wastewater rates pursuant to TWC §13.1872.

(b) **Definitions**. The following words and terms when used in this section shall have the following meaning unless the context clearly indicates otherwise:

(1) **Application--**An application for a rate adjustment filed pursuant to this section and TWC §13.1872.

(2) **Price index--**a price index established annually by the commission for the purposes of this section.

(c) **Requirements for filing of the application**. Subject to the limitations set out in subsection (f) of this section, a Class C utility may file an application with the commission.

(1) The utility may request to increase its tariffed monthly fixed customer or meter charges and monthly gallonage charges by the lesser of:

(A) five percent; or

(B) the percentage increase in the price index between the year preceding the year in which the utility requests the adjustment and the year in which the utility requests the adjustment.

(2) The application shall be on the commission's form and shall include:

(A) a proposal for the provision of notice that is consistent with subsection (e) of this section; and

(B) a copy of the relevant pages of the utility's currently approved tariff showing its current monthly fixed customer or meter charges and monthly gallonage charges.

(d) **Processing of the application.** The following criteria apply to the processing of an application.

(1) **Determining whether the application is administratively complete.**

(A) If commission staff requires additional information in order to process the application, commission staff shall file a notification to the utility within 10 days of the filing of the application requesting any necessary information.

(B) An application may not be deemed administratively complete pursuant to §24.8 of this title (relating to Administrative Completeness) until after the utility has responded to commission staff's request under subparagraph (A) of this paragraph.

(2) Within 30 days of the filing of the application, Staff shall file a recommendation stating whether the application should be deemed administratively complete pursuant to §24.8 of this title. If Staff recommends that the application should be deemed to be administratively complete, Staff shall also file a recommendation on final disposition, including, if necessary, proposed tariff sheets reflecting the requested rate change.

(e) **Notice of Approved Rates.** After the utility receives a written order by the commission approving or modifying the utility's application, including the proposed notice of approved rates, and at least 30 days before the effective date of the proposed change established in the commission's order, the utility shall send by mail, or by e-mail if the ratepayer has agreed to receive communications electronically, the approved or modified notice to each ratepayer describing the proposed rate adjustment. The notice must include:

(1) a statement that the utility requested a rate adjustment based on the commission's approved price index and must state the percentage change in the price index during the previous year;

(2) the existing rate;

(3) the approved rate; and

(4) a statement that the rate adjustment was requested pursuant to TWC §13.1872 and that a hearing will not be held for the request.

(f) **Time between filings**. The following criteria apply to the timing of the filing of an application.

(1) A Class C utility may adjust its rates pursuant to this section not more than once each calendar year and not more than four times between rate proceedings described by TWC §13.1781.

(2) Effective January 1, 2016, the filing of applications pursuant to this section is limited to a specific month based on the last two digits of a utility's certificate of

convenience and necessity (CCN) number as outlined below unless good cause is shown for filing in a different month. For a utility holding multiple CCNs, the utility may file an application in any month for which any of its CCN numbers is eligible.

(A) January: CCNs ending in 00 through 09;

(B) February: CCNs ending in 10 through 18;

(C) March: CCNs ending in 19 through 27;

(D) April: CCNs ending in 28 through 36;

(E) May: CCNs ending in 37 through 45.

(F) June: CCNs ending in 46 through 54;

(G) July: CCNs ending in 55 through 63;

(H) August: CCNs ending in 64 through 72;

(I) September: CCNs ending in 73 through 81;

(J) October: CCNs ending in 82 through 90; and

(K) November: CCNs ending in 91 through 99.

(g) **Establishing the price index.** The commission shall, on or before December 1 of each year, establish a price index as required by TWC §13.1872(b) based on the following criteria. The price index will be established in an informal project to be initiated by commission staff.

(1) The price index shall be equal to Gross Domestic Product Implicit Price Deflator index published by the Bureau of Economic Analysis of the United States Department of Commerce for the prior 12 months ending on September 30 unless

the commission finds that good cause exists to establish a different price index for that year.

(2) For calendar year 2015, until the commission adopts its first order establishing a price index pursuant to this subsection, applications for an annual rate adjustment will use a price index percentage difference of 1.57%. The percentage difference of 1.57% is calculated using indices set in paragraph (3) of this subsection.

(3) For the purpose of implementing this section, the initial indices are equal to:

(A) 106.923 for 2014; and

(B) 108.603 for 2015.

§24.41. Appeal of Rate-making Decision, Pursuant to the Texas Water Code §13.043.

(a) Any party to a rate proceeding before the governing body of a municipality may appeal the decision of the governing body to the commission. This subsection does not apply to a municipally owned utility, but does include privately owned utilities operating within the corporate limits of a municipality. An appeal under this subsection may be initiated by filing with the commission a petition signed by a responsible official of the party to the rate proceeding or its authorized representative and by serving a copy of the petition on all parties to the original proceeding. The appeal must be initiated within 90 days after the date of notice of the final decision of the governing body, or within 30 days if the appeal relates to the rates of a Class A utility, by filing a petition for review with the commission and by serving copies on all parties to the original rate proceeding.

(b) An appeal under TWC §13.043(b) must be initiated within 90 days after the effective date of the rate change or, if appealing under §13.043(b)(2) or (5), within 90 days after the date on which the governing body of the municipality or affected county makes a final decision. An appeal is initiated by filing a petition for review with the commission and by sending a copy of the petition to the entity providing service and with the governing body whose decision is being appealed if it is not the entity providing service. The petition must be signed by the lesser of 10,000 or 10% of the ratepayers whose rates have been changed and who are eligible to appeal under subsection (c) of this section.

(c) Retail ratepayers of the following entities may appeal the decision of the governing body of the entity affecting their water or sewer utility rates to the commission:

(1) a nonprofit water supply or sewer service corporation created and operating under TWC, Chapter 67;

(2) a utility under the jurisdiction of a municipality inside the corporate limits of the municipality;

(3) a municipally owned utility, if the ratepayers reside outside the corporate limits of the municipality;

(4) a district or authority created under the Texas Constitution, Article III, §52, or Article XVI, §59, that provides water or sewer service to household users; and

(5) a utility owned by an affected county, if the ratepayers' rates are actually or may be adversely affected. For the purposes of this subchapter, ratepayers who reside outside the boundaries of the district or authority shall be considered a separate class from ratepayers who reside inside those boundaries; and

(6) in an appeal under this subsection, the retail public utility shall provide written notice of hearing to all affected customers in a form prescribed by the commission.

(d) In an appeal under TWC §13.043(b), each person receiving a separate bill is considered a ratepayer, but one person may not be considered more than one ratepayer regardless of the number of bills the person receives. The petition for review is considered properly signed if signed by a person, or the spouse of the person, in whose name utility service is carried.

(e) The commission shall hear an appeal under this section de novo and fix in its final order the rates the governing body should have fixed in the action from which the appeal was taken. The commission may:

(1) in an appeal under the TWC §13.043(a), include reasonable expenses incurred in the appeal proceedings;

(2) in an appeal under the TWC §13.043(b), included reasonable expenses incurred by the retail public utility in the appeal proceedings;

(3) establish the effective date;

(4) order refunds or allow surcharges to recover lost revenues;

(5) consider only the information that was available to the governing body at the time the governing body made its decision and evidence of reasonable expenses incurred in the appeal proceedings; or

(6) establish interim rates to be in effect until a final decision is made.

(f) A retail public utility that receives water or sewer service from another retail public utility or political subdivision of the state, including an affected county, may appeal to the commission, a decision of the provider of water or sewer service affecting the amount paid for water or sewer service. An appeal under this subsection must be initiated within 90 days after notice of the decision is received from the provider of the service by filing a petition by the retail public utility.

(g) An applicant requesting service from an affected county or a water supply or sewer service corporation may appeal to the commission a decision of the county or water supply or sewer service corporation affecting the amount to be paid to obtain service other than the regular membership or tap fees. An appeal under TWC §13.043(g) must be initiated within 90 days after written notice of the amount to be paid to obtain service is provided to the service applicant or member of the decision of an affected county or water supply or sewer service corporation affecting the amount to be paid to obtain service as requested in the applicant's initial request for that service.

(1) If the commission finds the amount charged to be clearly unreasonable, it shall establish the fee to be paid and shall establish conditions for the applicant to pay any amounts due to the affected county or water supply or sewer service corporation. Unless otherwise ordered, any portion of the charges paid by the applicant that exceed the amount determined in the commission's order shall be repaid to the applicant with interest at a rate determined by the commission within 30 days of the signing of the order.

(2) In an appeal brought under this subsection, the commission shall affirm the decision of the water supply or sewer service corporation if the amount paid by the applicant or demanded by the water supply or sewer service corporation is consistent with the tariff of the water supply or sewer service corporation and is reasonably related to the cost of installing on-site and off-site facilities to provide service to that applicant, in addition to the factors specified under subsection (i) of this section.

(3) A determination made by the commission on an appeal from an applicant for service from a water supply or sewer service corporation under this subsection is binding on all similarly situated applicants for service, and the commission may not consider other appeals on the same issue until the applicable provisions of the tariff of the water supply or sewer service corporation are amended.

(h) The commission may, on a motion by the commission staff or by the appellant under subsection (a), (b), or (f) of this section, establish interim rates to be in effect until a final decision is made.

(i) In an appeal under this section, the commission shall ensure that every rate made, demanded, or received by any retail public utility or by any two or more retail public utilities jointly is just and reasonable. Rates must not be unreasonably preferential, prejudicial, or discriminatory but must be sufficient, equitable, and consistent in application to each class of customers. The commission shall use a methodology that preserves the financial integrity of the retail public utility. To the extent of a conflict between this subsection and TWC §49.2122, TWC §49.2122 prevails.

(j) A customer of a water supply corporation may appeal to the commission a water conservation penalty. The customer shall initiate an appeal under TWC §67.011(b) within 90 days after the customer receives written notice of the water conservation penalty amount from the water supply corporation per its tariff. The commission shall approve the water supply corporation's water conservation penalty if:

(1) the penalty is clearly stated in the tariff;

(2) the penalty is reasonable and does not exceed six times the minimum monthly bill in the water supply corporation's current tariff; and

(3) the water supply corporation has deposited the penalty in a separate account dedicated to enhancing water supply for the benefit of all of the water supply corporation's customers.

§24.44. Seeking Review of Rates for Sales of Water Under the Texas Water Code §12.013.

(a) Ratepayers seeking commission action under TWC §12.013 should include in a written petition to the commission, the following information:

(1) the petitioner's name;

(2) the name of the water supplier from which water supply service is received or sought;

(3) the specific section of the code under which petitioner seeks relief, with an explanation of why petitioner is entitled to receive or use the water;

(4) that the petitioner is willing and able to pay a just and reasonable price for the water;

(5) that the party owning or controlling the water supply has water not contracted to others and available for the petitioner's use; and

(6) that the party owning or controlling the water supply fails or refuses to supply the available water to the petitioner, or that the price or rental demanded for the available water is not just and reasonable or is discriminatory.

(b) Water suppliers seeking commission action under TWC §12.013 should include in a written petition for relief to the commission, the following information:

(1) petitioner's name;

(2) the name of the ratepayers to whom water supply service is rendered;

(3) the specific section of the code under which petitioner seeks relief, with an explanation of why petitioner is entitled to the relief requested;

(4) that the petitioner is willing and able to supply water at a just and reasonable price; and

(5) that the price demanded by petitioner for the water is just and reasonable and is not discriminatory.

§24.72. Financial Records and Reports -- Uniform System of Accounts.

Every public utility, except a utility operated by an affected county, shall keep uniform accounts as prescribed by the commission of all business transacted. The classification of utilities, index of accounts, definitions, and general instructions pertaining to each uniform system of accounts, as amended from time to time, shall be adhered to at all times, unless provided otherwise by these sections or by rules of a federal regulatory body having jurisdiction over the utility, or unless specifically permitted by the commission.

(1) **System of accounts**. For the purpose of accounting and reporting to the commission, each public water and/or sewer utility shall maintain its books and records in accordance with the following prescribed uniform system of accounts:

(A) Class A Utility, as defined by §24.3(17) of this title (relating to Definitions of Terms); the uniform system of accounts as adopted and amended by the (NARUC) for a utility classified as a NARUC Class A utility.

(B) Class B Utility, as defined by §24.3(18) of this title; the uniform system of accounts as adopted and amended by NARUC for a utility classified as a NARUC Class B utility.

(C) Class C Utility, as defined by §24.3(19) of this title; the uniform system of accounts as adopted and amended by for a utility classified as a NARUC Class C utility.

(2) **Accounting period**. Each utility shall keep its books on a monthly basis so that for each month all transactions applicable thereto shall be entered in the books of the utility.

§24.73. Water and Sewer Utilities Annual Reports.

(a) Each utility, except a utility operated by an affected county, shall file a service, financial, and normalized earnings report by June 1 of each year.

(b) Contents of report. The annual report shall disclose the information required on the forms approved by the commission and may include any additional information required by the commission.

(c) A Class C utility's normalized earnings shall be equal to its actual earnings during the reporting period for the purposes of compliance with TWC §13.136.

§**24.102. Criteria for Considering and Granting Certificates or Amendments**.

(a) In determining whether to grant or amend a certificate of public convenience and necessity (CCN), the commission shall ensure that the applicant possesses the financial, managerial, and technical capability to provide continuous and adequate service.

(1) For water utility service, the commission shall ensure that the applicant has a TCEQ approved system that it is capable of providing drinking water that meets the requirements of Texas Health and Safety Code, Chapter 341 and TCEQ rules and has access to an adequate supply of water.

(2) For sewer utility service, the commission shall ensure that the applicant has a TCEQ approved system that it is capable of meeting the TCEQ's design criteria for sewer treatment plants, TCEQ rules, and the TWC.

(b) Where a new CCN is being issued for an area which would require construction of a physically separate water or sewer system, the applicant must demonstrate that regionalization or consolidation with another retail public utility is not economically feasible. To demonstrate this, the applicant must at a minimum provide:

(1) a list of all public drinking water supply systems or sewer systems within a two-mile radius of the proposed system;

(2) copies of written requests seeking to obtain service from each of the public drinking water supply systems or sewer systems or demonstrate that it is not economically feasible to obtain service from a neighboring public drinking water supply system or sewer system;

(3) copies of written responses from each of the systems from which written requests for service were made or evidence that they failed to respond;

(4) a description of the type of service that a neighboring public drinking water supply system or sewer system is willing to provide and comparison with service the applicant is proposing;

(5) an analysis of all necessary costs for constructing, operating, and maintaining the new system for at least the first five years, including such items as taxes and insurance;

(6) an analysis of all necessary costs for acquiring and continuing to receive service from the neighboring public drinking water supply system or sewer system for at least the first five years.

(c) The commission may approve applications and grant or amend a certificate only after finding that the certificate or amendment is necessary for the service, accommodation, convenience, or safety of the public. The commission may issue or amend the certificate as applied for, or refuse to issue it, or issue it for the construction of a portion only of the contemplated system or facility or extension thereof, or for the partial exercise only of the right or privilege and may impose special conditions necessary to ensure that continuous and adequate service is provided.

(d) In considering whether to grant or amend a certificate, the commission shall also consider:

(1) the adequacy of service currently provided to the requested area;

(2) the need for additional service in the requested area, including, but not limited to:

(A) whether any landowners, prospective landowners, tenants, or residents have requested service;

(B) economic needs;

(C) environmental needs;

(D) written application or requests for service; or

(E) reports or market studies demonstrating existing or anticipated growth in the area;

(3) the effect of the granting of a certificate or of an amendment on the recipient of the certificate or amendment, on the landowners in the area, and on any retail public utility of the same kind already serving the proximate area, including, but not limited to, regionalization, compliance, and economic effects;

(4) the ability of the applicant to provide adequate service, including meeting the standards of the commission, taking into consideration the current and projected density and land use of the area;

(5) the feasibility of obtaining service from an adjacent retail public utility;

(6) the financial ability of the applicant to pay for the facilities necessary to provide continuous and adequate service and the financial stability of the applicant, including, if applicable, the adequacy of the applicant's debt-equity ratio;

(7) environmental integrity;

(8) the probable improvement in service or lowering of cost to consumers in that area resulting from the granting of the certificate or amendment; and

(9) the effect on the land to be included in the certificated area.

(e) The commission may require an applicant for a certificate or for an amendment to provide a bond or other financial assurance to ensure that continuous and adequate utility service is provided. The commission shall set the amount of financial assurance. The form of the financial assurance will be as specified in §24.11 of this title (relating to Financial Assurance). The obligation to obtain financial assurance under this chapter does not relieve an applicant from any requirements to obtain financial assurance in satisfaction of another state agency's rules.

(f) Where applicable, in addition to the other factors in this section the commission shall consider the efforts of the applicant to extend service to any economically distressed areas located within the service areas certificated to the applicant. For purposes of this subsection, "economically distressed area" has the meaning assigned in TWC §15.001.

(g) For two or more retail public utilities that apply for a CCN to provide water or sewer utility service to an uncertificated area located in an economically distressed area as defined in TWC §15.001, the commission shall conduct an assessment of the applicants to determine which applicant is more capable financially, managerially and technically of providing continuous and adequate service. The assessment shall be conducted after the preliminary hearing and only if the parties are unable to resolve the service area dispute. The assessment shall be conducted using a standard form designed by the commission and will include:

(1) all criteria from subsections (a) - (f) of this section;

(2) source water adequacy;

(3) infrastructure adequacy;

(4) technical knowledge of the applicant;

(5) ownership accountability;

(6) staffing and organization;

(7) revenue sufficiency;

(8) credit worthiness;

(9) fiscal management and controls;

(10) compliance history; and

(11) planning reports or studies by the applicant to serve the proposed area.

(h) Except as provided by subsection (i) of this section, a landowner who owns a tract of land that is at least 25 acres and that is wholly or partially located within the proposed service area may elect to exclude some or all of the landowner's property from the proposed service area by providing written notice to the commission before the 30th day after the date the landowner receives notice of a new application for a CCN or for an amendment to an existing CCN. The landowner's election is effective without a further hearing or other process by the commission. If a landowner makes an election under this subsection, the application shall be modified so that the electing landowner's property is not included in the proposed service area. An applicant for a CCN that has land removed from its proposed certificated service area because of a landowner's election under this subsection may not be required to provide service to the removed land for any reason, including the violation of law or commission rules by the water or sewer system of another person.

(i) A landowner is not entitled to make an election under subsection (h) of this section but is entitled to contest the inclusion of the landowner's property in the proposed service area at a hearing regarding the application if the proposed service area is located within the boundaries or extraterritorial jurisdiction of a municipality with a population of more than 500,000 and the municipality or a utility owned by the municipality is the applicant.

§24.109. Report of Sale, Merger, Etc.; Investigation; Disallowance of Transaction.

(a) On or before the 120th day before the effective date of any sale, acquisition, lease, rental, merger, or consolidation of any water or sewer system required by law to possess a certificate of public convenience and necessity, the utility or water supply or sewer service corporation shall file a written application with the commission and give public notice of the action. The notification shall be on the form required by the commission and the comment period will not be less than 30 days. Public notice may be waived by the commission for good cause shown. The 120-day period begins on the last date of whichever of the following events occur:

(1) the date the applicant files an application under this section;

(2) if mailed notice is required, the last date the applicant mailed the required notice as stated in the applicant's affidavit of notice; or

(3) if newspaper notice is required, the last date of the publication of the notice in the newspaper as stated in the affidavit of publication.

(b) A person purchasing or acquiring the water or sewer system must demonstrate adequate financial, managerial, and technical capability for providing continuous and adequate service to the requested area and any areas currently certificated to the person.

(c) If the person purchasing or acquiring the water or sewer system cannot demonstrate adequate financial capability, the commission may require that the person provide financial assurance to ensure continuous and adequate utility service is provided. The

commission shall set the amount of financial assurance. The form of the financial assurance must be as specified in §24.11 of this title (relating to Financial Assurance). The obligation to obtain financial assurance under this chapter does not relieve an applicant from any requirements to obtain financial assurance in satisfaction of another state agency's rules.

(d) The commission shall, with or without a public hearing, investigate the sale, acquisition, lease, rental, merger or consolidation to determine whether the transaction will serve the public interest.

(e) Prior to the expiration of the 120-day notification period, the commission shall either approve the sale administratively or require a public hearing to determine if the transaction will serve the public interest. The commission may require a hearing if:

(1) the application filed with the commission or the public notice was improper;

(2) the person purchasing or acquiring the water or sewer system has not demonstrated adequate financial, managerial, and technical capability for providing continuous and adequate service to the service area being acquired and to any areas currently certificated to that person;

(3) the person or an affiliated interest of the person purchasing or acquiring the water or sewer system has a history of:

(A) noncompliance with the requirements of the TCEQ, the commission or the Texas Department of State Health Services; or

(B) continuing mismanagement or misuse of revenues as a utility service provider;

(4) the person purchasing or acquiring the water or sewer system cannot demonstrate the financial ability to provide the necessary capital investment to ensure the provision of continuous and adequate service to the customers of the water or sewer system;

(5) it is in the public interest to investigate the following factors:

(A) whether the seller has failed to comply with a commission order;

(B) the adequacy of service currently provided to the area;

(C) the need for additional service in the requested area;

(D) the effect of approving the transaction on the utility or water supply or sewer service corporation, the person purchasing or acquiring the water or sewer system, and on any retail public utility of the same kind already serving the proximate area;

(E) the ability of the person purchasing or acquiring the water or sewer system to provide adequate service;

(F) the feasibility of obtaining service from an adjacent retail public utility;

(G) the financial stability of the person purchasing or acquiring the water or sewer system, including, if applicable, the adequacy of the debt-equity ratio of the person purchasing or acquiring the water or sewer system if the transaction is approved;

(H) the environmental integrity; and

(I) the probable improvement of service or lowering of cost to consumers in that area resulting from approving the transaction.

(f) Unless the commission requires that a public hearing be held, the sale, acquisition, lease, or rental or merger or consolidation may be completed as proposed:

(1) at the end of the 120-day period;

(2) or may be completed at any time after the utility or water supply or sewer service corporation receives notice that a hearing will not be requested.

(g) Within 30 days after the actual effective date of the transaction, the utility or water supply or sewer service corporation must file a signed contract, bill of sale, or other appropriate documents as evidence that the transaction has been made final and documentation that customer deposits have been transferred or refunded to the customer with interest as required by these rules.

(h) If a hearing is requested or if the utility or water supply or sewer service corporation fails to make the application as required or to provide public notice, the sale, acquisition, lease, merger, consolidation, or rental may not be completed unless the commission determines that the proposed transaction serves the public interest.

(i) A sale, acquisition, lease, or rental of any water or sewer system, required by law to possess a certificate of public convenience and necessity that is not completed in accordance with the provisions of the TWC §13.301 is void.

(j) The requirements of the TWC §13.301 do not apply to:

(1) the purchase of replacement property;

(2) a transaction under the TWC §13.255; or

(3) foreclosure on the physical assets of a utility.

(k) If a utility facility or system is sold and the facility or system was partially or wholly constructed with customer contributions in aid of construction derived from specific surcharges approved by the regulatory authority over and above revenues required for normal operating expenses and return, the utility may not sell or transfer any of its assets, its certificate of convenience and necessity or controlling interest in an incorporated utility, unless the utility provides to the purchaser or transferee before the date of the sale or transfer a written disclosure relating to the contributions. The disclosure must contain, at a minimum, the total dollar amount of the contributions and a statement that the contributed property or capital may not be included in invested capital or allowed depreciation expense by the regulatory authority in rate-making proceedings.

(l) A utility or a water supply or sewer service corporation that proposes to sell, assign, lease, or rent its facilities shall notify the other party to the transaction of the requirements of this section before signing an agreement to sell, assign, lease, or rent its facilities.

§24.111. Purchase of Voting Stock in Another Utility.

(a) A utility may not purchase voting stock in and a person may not acquire a controlling interest in a utility doing business in this state unless the utility or person files a written application with the commission not later than the 61st day before the date on which the transaction is to occur. A controlling interest is defined as a person or a combination of a person and other family members possessing at least 50% of the voting stock of the utility; or a person that controls at least 30% of the stock and is the largest stockholder.

(b) A person acquiring a controlling interest in a utility may be required to demonstrate adequate financial, managerial, and technical capability for providing continuous and adequate service to the requested area and any areas currently certificated to the person.

(c) If the person acquiring a controlling interest cannot demonstrate adequate financial capability, the commission may require that the person provide financial assurance to ensure continuous and adequate utility service is provided. The commission shall set the amount of financial assurance. The form of the financial assurance must be as specified in §24.11 of this title (relating to Financial Assurance). The obligation to obtain financial assurance under this chapter does not relieve an applicant from any requirements to obtain financial assurance in satisfaction of another state agency's rules.

(d) The commission may require a public hearing on the transaction if a criterion prescribed by §24.110 of this title (relating to Foreclosure and Bankruptcy) applies.

(e) Unless the commission requires that a public hearing be held, the purchase or acquisition may be completed as proposed:

(1) at the end of the 60 day period; or

(2) at any time after the commission notifies the person or utility that a hearing will not be requested.

(f) The utility or person must notify the commission within 30 days after the date that the transaction is completed.

(g) If a hearing is required or if the person or utility fails to make the application to the commission as required, the purchase or acquisition may not be completed unless the commission determines that the proposed transaction serves the public interest. A purchase or acquisition that is not completed in accordance with the provisions of this section is void.

§24.114. Requirement to Provide Continuous and Adequate Service.

(a) Any retail public utility which possesses or is required by law to possess a certificate of convenience and necessity or a person who possesses facilities used to provide utility service must provide continuous and adequate service to every customer and every qualified applicant for service whose primary point of use is within the certificated area and may not discontinue, reduce or impair utility service except for:

(1) nonpayment of charges for services provided by the certificate holder or a person who possesses facilities used to provide utility service;

(2) nonpayment of charges for sewer service provided by another retail public utility under an agreement between the retail public utility and the certificate holder or a person who possesses facilities used to provide utility service or under a commission order;

(3) nonuse; or

(4) other similar reasons in the usual course of business without conforming to the conditions, restrictions, and limitations prescribed by the commission.

(b) After notice and hearing, the commission may:

(1) order any retail public utility that is required by law to possess a certificate of public convenience and necessity or any retail public utility that possesses a certificate of public convenience and necessity and is located in an affected county as defined in TWC §16.341, to:

(A) provide specified improvements in its service in a defined area if:

(i) service in that area is inadequate as set forth in §24.93 and §24.94 of this title (relating to Adequacy of Water Utility Service; and Adequacy of Sewer Service); or

(ii) is substantially inferior to service in a comparable area; and

(iii) it is reasonable to require the retail public utility to provide the improved service; or

(B) develop, implement, and follow financial, managerial, and technical practices that are acceptable to the commission to ensure that continuous and adequate service is provided to any areas currently certificated to the retail public utility if the retail public utility has not provided continuous and adequate service to any of those areas and, for a utility, to provide financial assurance of the retail public utility's ability to operate the system in accordance with applicable laws and rules as specified in §24.11 of this title (relating to Financial Assurance), or as specified by the commission. The obligation to obtain financial assurance under this chapter does not relieve an applicant from any requirements to obtain financial assurance in satisfaction of another state agency's rules;

(2) order two or more public utilities or water supply or sewer service corporations to establish specified facilities for interconnecting service after TCEQ approves the interconnecting service pursuant to 30 TAC Chapter 290 (relating to Public Drinking Water) or 30 TAC 217 (relating to Design Criteria for Domestic Wastewater Systems);

(3) order a public utility or water supply or sewer service corporation that has not demonstrated that it can provide continuous and adequate service from its drinking water source or sewer treatment facility to obtain service sufficient to meet its obligation to provide continuous and adequate service on at least a wholesale basis from another consenting utility service provider; or

(4) issue an emergency order, with or without a hearing, under §24.14 of this title (relating to Emergency Orders).

(c) If the commission has reason to believe that improvements and repairs to a water or sewer service system are necessary to enable a retail public utility to provide continuous and adequate service in any portion of its service area and the retail public utility has provided financial assurance under Texas Health and Safety Code, §341.0355, or under this chapter, the commission, after providing to the retail public utility notice and an opportunity to be heard by the commissioners at a commission meeting, may:

(1) immediately order specified improvements and repairs to the water or sewer system, the costs of which may be paid by the financial assurance in an amount determined by the commission not to exceed the amount of the financial assurance. The order requiring the improvements may be an emergency order if it is issued after the retail public utility has had an opportunity to be heard by the commissioners at a commission meeting; and

(2) require a retail public utility to obligate additional money to replace the financial assurance used for the improvements.

§24.131. Commission's Review of Petition or Appeal Concerning Wholesale Rate.

(a) When a petition or appeal is filed, the commission shall determine within 30 days of the filing of the petition or appeal whether the petition contains all of the information required by this subchapter. For purposes of this section only, the initial review of probable grounds shall be limited to a determination whether the petitioner has met the requirements §24.130 of this title (relating to Petition or Appeal). If the commission determines that the petition or appeal does not meet the requirements of §24.130 of this title, the commission shall inform the petitioner of the deficiencies within the petition or appeal and allow the petitioner the opportunity to correct these deficiencies. If the commission determines that the petition or appeal does meet the requirements of §24.130 of this title, the commission shall forward the petition or appeal to the State Office of Administrative Hearings for an evidentiary hearing.

(b) For a petition or appeal to review a rate that is charged pursuant to a written contract, the commission will forward the petition or appeal to the State Office of Administrative Hearings to conduct an evidentiary hearing on public interest.

(c) For a petition or appeal to review a rate that is not charged pursuant to a written contract, the commission will forward the petition or appeal to the State Office of Administrative Hearings to conduct an evidentiary hearing on the rate.

(d) If the seller and buyer do not agree that the protested rate is charged pursuant to a written contract, the administrative law judge shall abate the proceedings until the contract dispute over whether the protested rate is part of the contract has been resolved by a court of proper jurisdiction.

§24.150. Jurisdiction of Municipality: Surrender of Jurisdiction.

(a) The governing body of a municipality by ordinance may elect to have the commission exercise exclusive original jurisdiction over the utility rate, operation, and services of utilities, within the incorporated limits of the municipality. The governing body of a municipality that surrenders its jurisdiction to the commission may reinstate its jurisdiction by ordinance at any time after the second anniversary of the date on which the municipality surrendered its jurisdiction to the commission, except that the municipality may not reinstate its jurisdiction during the pendency of a rate proceeding before the commission. The municipality may not surrender its jurisdiction again until the second anniversary of the date on which the municipality reinstates jurisdiction.

(b) The commission shall post on its website a list of municipalities that surrendered original jurisdiction to the commission.

This agency hereby certifies that the adoption has been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority. It is therefore ordered by the Public Utility Commission of Texas that §§24.3 (relating to Definitions of Terms), 24.8 (relating to Administrative Completeness), 24.11 (relating to Financial Assurance), 24.14 (relating to Emergency Orders), 24.21 (relating to Form and Filing of Tariffs), 24.22 (relating to Notice of Intent and Application to Change Rates Pursuant to Texas Water Code §13.187 or §13.1871), 24.23 (relating to Time Between Filings), 24.26 (relating to Suspension of the Effective Date of Rates), 24.28 (relating to Processing and Hearing Requirements for an Application Filed Pursuant to Texas Water Code §13.187 and §13.1871), 24.31 (relating to Cost of Service), 24.32 (relating to Rate Design), 24.33 (relating to Rate-Case Expenses Pursuant to Texas Water Code §13.187 and §13.1871), 24.34 (relating to Alternative Rate Methods), 24.36 (relating to Application for a Rate Adjustment by a Class C Utility Pursuant to Texas Water Code §13.1872), 24.72 (relating to Financial Records and Reports--Uniform System of Accounts), 24.73 (relating to Water and Sewer Utilities Annual Reports), 24.102 (relating to Criteria for Considering and Granting Certificates or Amendments), 24.109 (relating to Report of Sale, Merger, Etc.; Investigation; Disallowance of Transaction), 24.114 (relating to Requirement to Provide Continuous and Adequate Service), 24.131 (relating to Commission's Review of Petition or Appeal), and 24.150 (relating to Jurisdiction of Municipality: Surrender of Jurisdiction) are hereby adopted with changes to the text as proposed. It is also ordered that 24.41 (relating to Appeal of Rate-making Pursuant to the Texas Water Code, §13.043), 24.44 (relating to Seeking Review of Rates for Sales of Water Under the Texas Water Code, §11.041 and §12.013), and 24.111 (relating to Purchase of Voting Stock in Another Utility), are hereby adopted without

changes to the text as proposed. In addition, it is ordered that §§24.11 (relating to Informal Proceedings), 24.22 (relating to Notice of Intent to Change Rates), 24.25 (relating to Rate Change Applications, Testimony and Exhibits), 24.26 (relating to Suspension of Rates), 24.27 (relating to Request for a Review of a Rate Change by Ratepayers Pursuant to the Texas Water Code §13.187(b)), and 24.28 (relating to Action on Notice of Rate Change Pursuant to Texas Water Code, §13.187(b)) are hereby repealed.

SIGNED AT AUSTIN, TEXAS the _____ day of _____ 2015.

PUBLIC UTILITY COMMISSION OF TEXAS

DONNA L. NELSON, CHAIRMAN

KENNETH W. ANDERSON, JR., COMMISSIONER

BRANDY MARTY MARQUEZ, COMMISSIONER