PROJECT NO. 53924

WATER AND SEWER UTILITY RATES AFTER ACQUISITION	**§**	**PUBLIC UTILITY COMMISSION**
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	§	**OF TEXAS**

ORDER ADOPTING 16 TAC §24.240

The Public Utility Commission of Texas (commission) adopts new 16 Texas Administrative Code (TAC) §24.240, relating to Water and Sewer Utility Rates After Acquisition with changes to the proposed text as published in the September 29, 2023 issue of the *Texas Register* (48 TexReg 5599). The new rule implements Texas Water Code (TWC) §13.3011, added by House Bill (HB) 1484, enacted by the 87th Texas Legislature (R.S.). It allows an acquiring water and sewer utility (transferee) to apply rates from an existing tariff to the customers of an acquired system without initiating a new rate proceeding. To be eligible to apply, an existing tariff must be currently in force and filed with a regulatory authority for another water and sewer system owned by the transferee. The rule is adopted under Project No. 53924.

The commission received comments on the proposed rule from CSWR-Texas Utility Operating Company, (CSWR), Double Diamond Entities (Double Diamond), the Office of Public Utility Counsel (OPUC), Texas Association of Water Companies (TAWC), and Texas Water Utilities (TWU).

A public hearing was requested by TAWC and was held on January 23, 2024. AQUA Texas, Inc. (AQUA), CSWR, TAWC, TWU, OPUC and Mr. David Miller (on behalf of The Retreat, which filed written comments with the Double Diamond) provided comments.

General Comments

TAWC commented that the proposed rule does not apply the "filed rate doctrine" legal principle as intended by the statute and, as drafted, would create obstacles for a transferee in extending its pre-existing rates to acquired customers. TAWC recommended that the commission extend previously approved tariff and the rates selected by the transferee to new customers without further examination in the Sale, Transfer, and Merger (STM) proceeding to achieve the goals of TWC §13.3011.

Commission Response

The commission disagrees that the filed rate doctrine is relevant to the outcome of this rulemaking proceeding. Neither the statutory text of TWC §13.3011 – the statute being implemented in this rulemaking proceeding – nor the bill analysis for HB 1484 refer to the "filed rate doctrine." Accordingly, analyzing the similarities between a common law legal principle, and TAWC's interpretation of this principle, and the statutory text being implemented in this rulemaking proceeding is unnecessary. The commission interprets the statutory text directly.

The commission declines to modify the rule to extend previously approved rates to new customers without further examination for reasons discussed below.

TAWC, TWU, and CSWR opposed the proposed rule on the grounds that the rate review process it establishes is inconsistent with HB 1484. Both TAWC and CSWR recommended that no additional criteria should be used to evaluate an initial rate request beyond what is contemplated under TWC §13.3011.

TWU stated that the proposed rule goes beyond the two statutory criteria for approving an initial rate request and uses the just and reasonable standard provided by TWC §13.182(a) as the benchmark for evaluating an initial rate requested under TWC §13.3011. TWU further stated that while the commission uses the criteria under TWC §13.182(a), it ignores TWC §13.182(b) which requires rates to not be unreasonably preferential, prejudicial, or discriminatory, and instead must be sufficient, equitable, and consistent in application to each class of consumers. Rates must recover a level of revenue that permits the utility an opportunity to earn a reasonable return on its invested capital and preserves the utility's financial integrity. TWU stated that the proposed approval process would introduce uncertainty regarding the approval of initial rates and may lead to unintended consequences of discouraging acquisitions.

TWU asserted that initial rates that are filed with a regulatory authority and are in effect for another water or sewer system owned by the transferee automatically meet all four statutory requirements under TWC §§13.182(a), 13.182(b), 13.183(a) and 13.190(a). Most significantly, TWC §13.182(a) is satisfied because the rates in a tariff filed with a regulatory authority for another system have already been reviewed and found just and reasonable by the regulatory authority.

CSWR stated that the proposed rule is inconsistent with TWC §13.3011 and creates a vague and potentially complicated rate review procedure in an STM proceeding that will delay approval of acquisitions of substandard systems.

In contrast, OPUC and Double Diamond supported the proposed rule and argued that the requested authorized acquisition rates must be scrutinized by the commission to ensure that they are just and

reasonable. OPUC and Double Diamond stated that applying a pre-existing water or sewer tariff that is not tailored to customers of an acquired system could routinely lend itself to rate shock for affected ratepayers. OPUC commented that TWC §13.3011 provides the commission with the authority to approve or deny adoption of an in-force rate taken from an existing tariff. Additionally, OPUC opined that without proper safeguards in place, application of HB 1484 could result in the imposition of a higher tariff on the customers of the acquired system without an adequate prudence review from which rates should be derived. OPUC supported commission staff's efforts to ensure that there are adequate safeguards to mitigate rate shock to customers of the acquired system.

Commission Response

The commission disagrees that the only criteria the commission should consider are the two criteria provided in TWC §13.3011. The two criteria listed – (i) shown in a tariff filed with a regulatory authority, and (ii) in force for the other water and sewer system on the date the STM application is filed – are not characterized in the statute as considerations. They are a description of the type of initial rates the transferee is permitted to request authorization to charge. This is plain from the statutory phrasing "may request…initial rates for the service *that are…*". TWC has many instances of the Legislature indicating that the commission "shall consider" certain criteria when evaluating a certain decision. TWC §13.3011 contains no such language. The most straightforward reading of TWC §13.3011's use of descriptive language is that paragraphs (1) and (2) are necessary, but not sufficient conditions for authorization of a requested rate. Moreover, TWC §13.182(a) unambiguously requires that the commission "shall ensure that every rate made, demanded, or received by any

utility…shall be just and reasonable." Without specific language countermanding this directive in TWC §13.3011, the commission cannot approve a request for authorized acquisition rates without ensuring that the requested rates are just and reasonable.

The commission also disagrees with TWU that a rate contained in an in-force tariff that is filed with a regulatory authority is, for that reason alone, just and reasonable as applied to all customers or water systems. In response to proposed subsection (d)(1), which would require the transferee to provide a revenue comparison using existing and requested authorized acquisition rates, TWU stated "a comparison of revenues generated at the existing rates to the revenues generated at the requested initial rates has no bearing on the just and reasonableness of the requested initial rates *because these rates were derived from two totally separate costs of service, {emphasis added}.*" TWU further contended that such an approach is "antithetical to the concept of cost of service ratemaking." While TWU was not addressing the immediate point, its analysis perfectly captures why an approved rate for one system is not necessarily just and reasonable for another: because the two systems have two distinct costs of service. As addressed further below, the statutory prohibition against requiring a rate case – which would be necessary to conduct a full cost of service analysis – requires the commission to use a more general facts-and-circumstances analysis to determine whether a proposed rate is just and reasonable under this section. It does not, as argued by TWU, CSWR, and TAWC, mean that the commission must accept that a rate deemed just and reasonable for one system is automatically just and reasonable for another.

The commission also disagrees with TWU's argument that the commission's focus on just

and reasonable rates ignores TWC §13.182(b), which TWU interprets to require that rates must recover a level of revenue that permits the utility an opportunity to earn a reasonable return on its invested capital and preserves the utility's financial integrity. Regarding the financial integrity of the utility, the adopted rule requires the commission to consider whether the rates are just and reasonable for the customer *and the transferee.* Furthermore, every STM proceeding requires an evaluation of the financial wellbeing of the transferee and its ability to provide continuous and adequate service. With regards to TWU's claim that the transferee must be provided an opportunity to earn a reasonable return on its invested capital, the commission notes that – unlike the customers of the acquired system – the transferee has complete discretion over whether to complete the transaction or request authorized acquisition rates. The transferee also has the option to initiate a rate case to ensure it is receiving an appropriate rate of return on its invested capital. Outside of the context of a rate case, the commission cannot adjust a rate to, among other things, ensure the transferee is earning a reasonable rate of return.

The commission agrees with CSWR that the proposed rule creates a vague and potentially complicated rate review that could delay the approval of acquisitions of substandard systems. Accordingly, the commission modifies the rule to clarify how the commission will review requests for authorized acquisition rates. These modifications are designed to provide procedural clarity on how the commission will process requests for authorized acquisition rates, provide certainty on the outcome of the request for authorized acquisition rates before the transferee closes on the transaction, limit the scope of the commission's rate review to ensure the statutory prohibition on requiring a rate case is fully captured in the

rule, and provide general guidance on the criteria the commission may consider when reviewing the request.

The commission adds new (c)(5) to clarify that the commission will take the transferee's request to charge authorized acquisition rates into account as part of the public interest determination on whether the proposed transaction serves the public interest under §24.239(h). The rates that a customer will be charged, and that the transferee will be able to collect, could potentially influence several of the public interest criteria contained in §24.239(h)(5). To facilitate this determination, the commission also modifies the requirements of proposed subsection (d) to require the applicant to include an explanation of how granting the request to charge authorized acquisition rates would change the public interest analysis under any of the criteria in §24.239(h)(5).

The commission further modifies the rule to include a new subsection (f), that codifies how the commission will conduct its review. Under subsection (f)(1), which is modeled after the hearing provisions of §24.239, the commission will determine whether a hearing on the requested rates is necessary to determine if those rates are just and reasonable. If the commission elects to hold a hearing, the commission will not approve the requested rates unless they are found to be just and reasonable. However, if the commission determines that a hearing is unnecessary and that the transferee has complied with the applicable notice requirements, the request will be approved in the commission's final order approving the transaction.

The commission also adds subsection (f)(2) to clarify the scope of the commission's rate

review. Because the commission is statutorily prohibited from requiring a rate case, the commission will determine whether the requested rates are just and reasonable based on the relevant facts and circumstances. Subsection (f)(2)(A) lists several restrictions on the scope of the commission's rate review that address commenters' concerns that this rate review will function as a de facto rate case. Specifically, the transferee is not required to support its request for authorized acquisition rates by initiating a rate proceeding; establishing the cost of service for the acquired water or sewer system; establishing substantial similarity between the acquired system and the system to which the rates already apply; or defending the reasonableness of the requested rates, or any individual component of those rates, with respect to any water or sewer system to which the rates already apply.

Subsection (f)(2)(B) provides further clarification on the restrictions in subsection (f)(2)(A) by providing examples of factors the commission may consider without violating the above restrictions. These considerations include whether any charges or significant components of the requested rates would be unjust or unreasonable if applied to the acquired water or sewer system. In many instances, a system-specific or local pass through charge will be either explicitly listed on a tariff or rolled directly into rates. Such a charge may provide evidence that the requested rates should not be applied to another system to which the identified charge does not apply. Because investigating such charges does not require a rate proceeding or cost of service determination for the acquired system, it is within the scope of the commission's rate review.

Similarly, the commission may consider whether the customers of the acquired system are

receiving continuous and adequate service. This is a potentially important consideration for the customers and the transferee. If customers are not receiving continuous and adequate service, that may suggest that either the existing rates are insufficient to ensure such service or that the transferee will have to operate at a loss to make the necessary improvements. This is especially relevant in situations where there are identified improvements that will lead to known and measurable increases in the cost of serving the acquired system. Conversely, if a system is fully functioning and providing a high level of service, that may suggest that authorized acquisition rates that are significantly higher than the existing rates would not be just and reasonable. These considerations are appropriately within the scope of the commission's rate review, because evaluating specific costs associated with system improvements necessary to provide continuous and adequate service does not require a rate proceeding or a comprehensive evaluation of the system's cost of service.

This new subparagraph also clarifies that the commission may consider evidence regarding whether the requested rates are generally consistent with the rates charged to similar systems. In other words, the commission will not require that the two specific systems in question be similar to each other (i.e., substantial similarity), but the commission can consider macro-level data, if available and appropriate, on the rates that are generally charged to systems with similar characteristics. This factor is not, in itself, determinative of whether the rates are just and reasonable. But, if there is evidence that the requested rates are relatively high or that the existing rates are relatively low, that may be indicative of whether the requested rates are just and reasonable.

Finally, the commission modifies the rule to clarify that the commission is not limited to the

factors enumerated in subsection (f)(2)(B). The commission may consider any pertinent facts and circumstances that are not proscribed by subsection (f)(2)(A). The commission also notes, without modifying the rule, that the list of factors is permissive and each enumerated factor may not be relevant in each proceeding under this section.

§24.239 — Merge 16 TAC §24.240 with 16 TAC §24.239

TAWC, TWU, and AQUA suggested the commission should implement TWC §13.3011 in the existing STM rule, 16 TAC §24.239, rather than adopting a new rule.

Commission Response

Section 24.239 was not noticed in this project and is, therefore, beyond the scope of this proceeding. The commission may consider combining these sections in a future rulemaking project.

Proposed §24.240(a) – Applicability

Proposed §24.240(a) limits the application of the rule to a person who files an application with the commission under Texas Water Code (TWC) §13.301(a) and a request for authorized acquisition rates under TWC §13.3011.

TWU recommended modifying subsection (a) to use the term “initial rates” instead of “authorized acquisition rates.” to conform to its recommended definitions.

Commission Response

The commission declines to accept the modifications recommended by TWU, because the commission did not accept TWU's recommendation to delete the definition of "authorized acquisition rates." Refer to commission response under "Proposed §24.240(b) – Definitions."

Proposed §24.240(b) – Definitions

Proposed §24.240(b) defines "authorized acquisition rates" as initial rates that are in force and shown in a tariff filed with a regulatory authority by an acquiring utility for another water or sewer system owned by it. "Initial rates" are defined as rates charged by an acquiring utility to the customers of an acquired system upon acquisition.

TWU recommended modifying the definitions in the proposed rule to use the terms "transferor" and "transferee" that are found in §24.239 to promote uniformity between these rules.

Commission Response

The commission agrees with TWU's recommendation and modifies the rule to use the terms "transferor" and "transferee." The commission also modifies the rule to use the term "transaction" in place of "acquisition" where necessary to align with use of the term "transaction" in §24.239.

The commission also re-sequences the definitions to appear in alphabetical order.

TWU recommended deleting the definition of "authorized acquisition rate" to minimize use of confusing phrases like "requested authorized acquisition rate" and to avoid having to use a defined term – "initial rates" – in the definition of another defined term. TWU opined that deleting this definition also allows for the use of simplified terms like "requested initial rates" and "approved initial rates." TWU provided recommended language for terms "initial rates" and "existing rates."

TAWC also stated that the definitions of "Initial rates" and "Authorized Acquisition Rates" are duplicative.

Commission Response

The commission declines to make the changes requested by TWU. The commission disagrees that "initial rates" and "authorized acquisition rates" are duplicative. "Initial rates" refers to the rates that are paid by the customers of the acquired system – regardless of whether such rates are the "existing rates" they previously paid or are "authorized acquisition rates." This is also consistent with the plain meaning of "initial" (i.e. first) and the statutory language allowing the transferee to request approval to charge "initial rates for the service *that* are:… *{emphasis added}."* The use of "that" sets off a restrictive adjective clause identifying which initial rates the utility may request (i.e., in force and shown in a filed tariff). The commission uses the term "authorized acquisition rates" to refer to this category of initial rates. The commission, however, modifies the definition of "initial rates" to reflect that an "initial rate" can be an existing rate, an authorized acquisition rate, or another rate authorized by law. This modification will provide clarity and prevent unintended consequences, such as reading the provisions of this rule to disallow a utility from retaining temporary rates after an STM,

as is permitted under §24.239.

Proposed §24.240(c)(1)

Proposed §24.240(c)(1) requires an acquiring utility to use existing rates as initial rates until the commission approves other rates.

TWU recommended minor clarifying changes to proposed subsection (c)(1) to conform with its proposal to delete the definition of "authorized acquisition rate" and continue the use of terms "transferor" and "transferee."

Commission Response

The commission modifies the proposed rule and replaces the terms "acquiring utility" and "acquired utility" with "transferee" and "transferor" as recommended by TWU but declines to make other changes to subsection (c)(1) because the commission did not accept TWU's recommendation to delete the definition of "authorized acquisition rates."

The commission uses these updated terms, as applicable, throughout this order.

TAWC argued that proposed subsection (c)(1) contemplates a gap period between STM approval and approval of the request to charge authorized acquisition rates after STM approval. TAWC and CSWR recommended that the commission must approve initial rates simultaneously with approval of the STM transaction to provide certainty to the STM applicants about the rates that will be in place after an STM transaction is completed. TAWC noted that certainty about rates prior to completing a system acquisition will allow sufficient time to the transferee to prepare to

switch customers to new rates.

Commission Response

The commission agrees with TAWC that the commission should review the STM and the request for approval to charge authorized acquisition rates simultaneously. Further, the commission agrees that, if approved, the transferee is required to begin charging the authorized acquisition rates after the commission has approved the transaction in its final order. The commission modifies the rule accordingly.

Proposed §24.240 (c)(3)

Proposed §24.240(c)(3) clarifies that an authorized acquisition rate must be in force and shown in a tariff filed with a regulatory authority by the transferee for another water and sewer system on the date an STM application is filed.

TWU recommended deleting proposed subsection (c)(3) because it will be redundant with the new definition of "initial rates" recommended by TWU.

TAWC stated that subsection (c)(3) aligns with the language in TWC §13.3011 and recommended that this language be added to 16 TAC §24.239.

Commission Response

The commission declines to delete subsection (c)(3) as recommended by TWU, because the commission did not adopt the corresponding definition of "initial rates" proposed by TWU.

The commission also declines to move the language of subsection (c)(3) to §24.239 as recommended by TAWC, because §24.239 was not noticed in this proceeding and modifications to that section are, therefore, beyond the scope of this rulemaking.

Proposed §24.240(c)(4) – Multiple in-force tariffs

Proposed §24.240(c)(4) establishes that if the transferee has multiple in-force tariffs filed with regulatory authorities, there is a rebuttable presumption that authorized acquisition rates should be based upon an in-force tariff that was approved by the regulatory authority that has original jurisdiction over the rates charged to the acquired customers.

TAWC recommended deleting proposed subsection (c)(4), stating that the utility should be permitted to choose the approved tariff rates to use regardless of which regulatory authority has approved them. TAWC opined that proposed subsection (c)(4) would create the possibility of disparate rate treatment using in-force tariffs not selected by the utility.

TWU recommended modifying subsection (c)(4) to require a showing of good cause to approve an initial rate that is shown in a tariff on file with a regulatory authority that does not have original jurisdiction over the rates for the systems that will be transferred as part of an STMs.

Commission Response

The commission agrees with TAWC that the transferee may choose which in-force tariff to use for its request for authorized acquisition rates but declines to remove from the rule the presumption that the in-force tariff should be one approved by the same regulatory

authority. Each regulatory authority with ratemaking authority in Texas has its own practices, preferences, and tendencies with regards to ratemaking outcomes. All else being equal, using a rate that has been previously approved by the commission is more likely to reflect an outcome that the commission would find just and reasonable than a rate approved by a different regulatory authority. However, this is a rebuttable presumption because many other factors more directly contribute to the justness and reasonableness of a rate. Furthermore, because the commission must consider all of the relevant facts and circumstances in determining whether the requested rates are just and reasonable, the commission does not require a showing of good cause to use rates approved by a different regulatory authority as requested by TWU.

OPUC recommended adding language under §24.240(c) that would expand the scope of the rebuttable presumption and provided language that specifies that if the transferee has multiple in-force tariffs filed with the regulatory authority, an in-force tariff within the same geographic area or county as the acquired system would be used as the authorized acquisition rates when deemed to be in the public interest.

Commission Response

The commission declines to accept OPUC's recommendation to create a rebuttable presumption that the authorized acquisition rates should be based on a tariff within the same geographic area or county as the acquired system. An underlying premise behind the included rebuttable presumption is that the commission, in virtually all cases, will be more familiar with its own ratemaking processes and therefore possess a better ability to assess if

rates it previously approved are appropriate for the acquired system than rates approved by a different regulatory authority. A similar premise does not apply to geographic area. For example, in many counties there are dense urban areas situated only a few miles away from sparsely populated rural areas, or there are large disparities in terms of existing quality of service, customer class profile, or access to surface water. When relevant, the commission will consider the geographic area as part of its just and reasonable determination, but this may not be a relevant factor in every situation.

Proposed §24.240(c)(5) – Phased-in rates

Proposed §24.240(c)(5) states if the in-force tariff contains rates that are phased in over time, any step of the phase-in rates included in the tariff may be considered an authorized acquisition rate if it is in the public interest.

TWU recommended clarifying that a request for an initial rate that has a phased-in rate should be construed as a request for the phase that is in place at the time the application under TWC §13.301 is filed, all subsequent phases, and the final rate.

TAWC commented that subsection (c)(5) is "unclear and somewhat contradictory" as it "seems to contemplate simultaneously using both a selected step of a set of phased rates in an in-force tariff and the same phase-in schedule from an in-force tariff." TAWC argued that transferees should be allowed to select rates from any current phase of an in-force tariff as an authorized acquisition rate as there is "no such prohibition in TWC §13.3011."

On the other hand, OPUC supported the proposed rule that allows a phased-in approach if the in-

force tariff contains rates that are phased-in over time. OPUC recommended that any rate in a multi-phased tariff may be deemed a rate in-force – by virtue of its inclusion in the tariff and may be given effect by the commission subject to certain exceptions like pass-through rates.

Commission Response

The commission generally agrees with TWU that authorized acquisition rates should use rates that are in effect at the time the application is filed, and that the applicable rates will proceed through each subsequent phase, including the final phase. The commission modifies the rule to state that, unless determined by the commission, the schedule in the tariff for the effective period of each phase will be applied to the customer of the acquired water or sewer system. The commission also modifies the rule to clarify that the commission's review of whether the requested rates are just and reasonable will include an evaluation of whether the final phase of the requested rates are just and reasonable. To facilitate this evaluation, the commission further modifies the rule to clarify that the application must include financial projects, rate schedules, and billing comparisons for each phase in the tariff.

The commission also agrees with TAWC and OPUC that the transferee can request rates based on a phase other than the phase that is currently in place for customers to which the tariff already applies. The commission modifies the rule such that the commission may approve rates that use an earlier phase than is currently in place, or establish a different schedule for the effective period of each phase, if necessary to moderate the effects of a rate increase on customers.

This approach establishes an appropriate balance by ensuring that the final rates are just and reasonable while still offering the potential to mitigate rate shock when the in-force tariff contains a phased-in rate structure.

Proposed §24.240(d)(1)

Proposed §24.240(d)(1) requires an application for authorized acquisition rates to include a comparison of expected revenues under the acquired utility's existing rates and the requested authorized acquisition rates.

TAWC recommended that subsection (d)(1) should only require financial projections for expected revenues from the requested authorized acquisition rates, instead of the acquired utility's existing rates that the applicant is not seeking to use.

TWU stated that comparison of revenues generated at the existing rates with the revenues generated at the requested initial rates, as required under subsection (d)(1), has no bearing on the just and reasonableness of the requested initial rate because these rates are derived from two separate costs of service and is antithetical to the concept of cost-of-service ratemaking. TWU suggested that for revenue comparison, and for ascertaining if the initial rates could result in the transferee overearning, annual reports filed by the transferee would be more appropriate and ensure a holistic review of the transferee' s overall financial position.

Commission Response

The commission declines to accept the recommendations from both TAWC and TWU to

remove the revenue comparison between existing and authorized acquisition rates from the proposed rule. The commission agrees with TWU's argument that comparing rates derived from two separate costs of service has no bearing on the just and reasonableness of the requested rates under a conventional cost of service ratemaking. However, as noted by TWU and other commenters, a conventional, comprehensive cost of service ratemaking is statutorily prohibited in the context of requests for authorized acquisition rates. However, the change in expected revenues, if the requested rates are approved, is pertinent to a relevant-facts-and-circumstances analysis of the requested rates. If, for example, granting the request would result in an extremely large increase in expected revenues, but there is no corresponding evidence that any system improvements are necessary to provide continuous and adequate service, the commission may consider this indicative that the requested rates are not just and reasonable.

The commission also disagrees with TWU's argument that the commission should instead evaluate the transferee's annual reports. Annual reports may not provide a breakdown of the transferee's financial information by system. Furthermore, requiring a revenue comparison does not preclude the commission from considering the transferee's annual reports, when appropriate.

Proposed §24.240(d)(2) – Capital improvements plan

Proposed §24.240(d)(2) requires a capital improvements plan for the acquired system to be included in the application.

TAWC and TWU argued that the transferee should not be required to provide a capital improvements plan. TWU stated that the requirement to provide a capital improvements plan is broad and vague and the proposed rule also does not clarify what form or type of information may be considered sufficient to fulfil this requirement.

Commission Response

The commission does not agree with commenters that the requirement to provide a capital improvements plan is broad or vague. However, the commission removes the requirement for a transferee to include a capital improvements plan in an application, because the commission regularly requires a capital improvements plan as a part of all STM applications based on the requirements of TWC §13.244. Therefore, the proposed requirement is duplicative and unnecessary.

Proposed §24.240(d)(3) – Explanation for the Tariff

Proposed §24.240(d)(2) requires an explanation for the tariff or rate schedule the tranferee proposes to use as authorized acquisition rates if it has multiple eligible in-force tariffs or rate schedules.

TAWC recommended that proposed subsection (d)(3) be deleted, because it goes beyond the statutory requirements listed under TWC §13.3011.

Commission Response

The commission declines to modify the rule to remove the requirement that a transferee with

multiple in-force tariffs provide an explanation for which tariff it based its request for authorized acquisition rates on, as requested by TAWC. The primary policy justification for allowing a transferee to immediately begin charging different rates without the full scrutiny of a rate case is to expedite transactions necessary to ensure the customers of the acquired system are served by an entity capable of providing them with continuous and adequate service. In the interest of this pressing policy objective, the transferee is permitted to use rates that have been approved by a regulatory authority, because such rates are the only available rates that have been subject to the scrutiny of a formal rate case. However, if the transferee has multiple tariffed rates that could have been applied, the existence of these other rates are part of the facts and circumstances surrounding the request and may be relevant to the just and reasonable determination. The commission does, however, modify the proposed rule to clarify that this explanation must include a list of the eligible tariffs.

Proposed §24.240(d)(5) – Acquiring Utility and Affiliated Entities

Proposed §24.240(d)(5) establishes a requirement for an "acquiring utility" to disclose in its initial rates application if the acquired and acquiring systems are affiliates or have been affiliates in the preceding five years.

Double Diamond stated that the statutory intent of TWC §13.3011 is to facilitate acquisition of underperforming water and sewer systems by utilities that can operate these systems effectively, not to allow acquiring utilities to merge their affiliated utilities under the umbrella of the affiliated system that has the highest tariffed rates. Further, Double Diamond argued that such an outcome would circumvent the statutory intent of TWC §13.3011 and would adversely impact ratepayers

because the rates being paid would be wholly disconnected from the cost of serving those ratepayers.

Double Diamond recommended adding a definition of the term "Acquiring Utility" that specifically excludes an entity that is seeking to merge with an affiliated entity. Double Diamond also recommended that the term "affiliate" be tied to the definition in §24.3(3) for "Affiliated Interest or Affiliate".

Alternatively, Double Diamond argued that a transferee requesting authorized acquisition rates for a transaction involving an affiliate be required to provide a cost of service or rates study to support its request.

Commission Response

The commission declines to tie the term "affiliate" to the definition of "affiliated interest or affiliate" in §24.3, because it is unnecessary. The definitions in §24.3 apply to the entirety of Chapter 24, including §24.240. The commission further declines to define "acquiring utility" as a term that specifically excludes a utility acquiring an affiliate, because this conflicts with the plain language of the statute. TWC §13.3011 provides that any "person" that files a request for the "purchase or acquisition" of a water or sewer system may request approval of authorized acquisition rates. As defined in both statute and commission rule, an affiliate relationship can be established with a little as a five percent interest. Accordingly, it is reasonable that even a person that already has such an ownership interest can still "purchase or {acquire}" the remainder of the system.

The commission also declines to require a cost of service study for all affiliate transactions requesting authorized acquisition rates. The commission agrees with Double Diamond that affiliates could attempt to use this rule to shift multiple systems to a higher rate without a rate case, and that requiring a cost of service study on known and measurable changes required to provide adequate service would not violate the statutory prohibition on requiring a rate proceeding. However, there is no statutory basis for imposing a materially higher mandatory requirement on affiliates than on nonaffiliates. Under the adopted rule, the commission will conduct a rate review of every request for authorized acquisition rates to ensure it results in just and reasonable rates. This review will consider the facts and circumstances involved in each case, and the applicant carries the burden to demonstrate that the rates are just and reasonable. Accordingly, an applicant may elect to provide such a study in support of its request.

In recognition of the risk of strategic transactions between affiliates designed to circumvent rate reviews, the commission does require requests for acquisition rates in transactions involving affiliates to include an explanation for why the transferee is requesting authorized acquisition rates instead of filing a rate case. This explanation will allow the commission to consider the reasoning in support of the request as part of the facts and circumstances assessed as part of its determination of whether the requested rates are just and reasonable.

Proposed §24.240(d)(7) - Documentation from most recent base rate case

Proposed §24.240(d)(7) requires an application for authorized acquisition rates to provide

documentation from the most recent base rate case in which the requested authorized acquisition rates were approved.

TWU commented that information required under subsection (d)(7) is vague and goes beyond what is required statutorily. TAWC commented that subsection (d)(7) should be limited to the order or other evidence of a regulatory decision approving the tariff that the transferee seeks to use. TAWC argued that "documentation" from the base rate case that resulted in the regulatory approval is publicly available and should not be required. Such a requirement could entail thousands of pages that would unreasonably burden the STM application record.

Commission Response

The commission agrees that proposed subsection (d)(7) should be clarified. The commission modifies the requirement – as adopted (d)(4) – to clarify that the documentation must be sufficient to allow the commission to evaluate what was included in the revenue requirement that was used to establish the authorized acquisition rates. This information is necessary to allow the commission to evaluate if there are any charges or components in the requested rates that would be unjust or unreasonable, such as a pass through or other local or system-specific charge, if applied to the acquired system.

The commission also agrees that this information is typically publicly available online, so the commission modifies the rule to allow the transferee to provide a website where the information can be located in lieu of the actual documents.

Proposed §24.240(d)(8) – Other information

Proposed §24.240(d)(8) requires the applicant to provide any other information necessary to demonstrate that the authorized acquisition rates are just and reasonable and that the request is in the public interest.

TWU commented that the information required under subsection (d)(8) is both vague and goes beyond what is required statutorily. Further, TWU and TAWC argued that such a requirement could lead to contention on what form or type of information may or may not be sufficient in an application.

TAWC commented that subsection (d)(8) is unnecessary because discussions around the public interest of a transaction are already prescribed by the STM rule and application form.

Commission Response

The commission makes several modifications to proposed subsection (d)(8). To address TWU's concerns that the vagueness of the requirement could lead to sufficiency challenges to the application, the commission modifies the proposed requirement to require "additional explanation, including any applicable documentation, supporting the request to charge authorized acquisition rates, including:…". This modification will allow the transferee to articulate the facts and circumstances that it believes supports its request.

The commission also relocates the requirement that the transferee justify its choice of tariffs and the required explanations for affiliate transactions to this paragraph. This

appropriately groups the explanation-based application requirements together. As discussed previously, the commission also modifies this paragraph to include a requirement that the transferee include an explanation for how granting the request for authorized acquisition rates would change the public interest analysis regarding the proposed acquisition, according to any applicable criteria listed in §24.239(h)(5). Finally, the commission modifies the rule to more specifically reflect that the public interest determination is made under §24.239 on the transaction as a whole, whereas the commission's review of the request for authorized acquisition rates is primarily focused on whether the requested rates are just and reasonable as applied to the customers of the acquired system.

Proposed §24.240(e) – Notice

Proposed §24.240(e) contains the notice requirements an transferee must meet, in addition to the notice requirements for applications filed under §24.239. Specifically, it requires the notice to include an explanation of how intervention differs from protesting a rate increase, a rate schedule showing the existing rates and the authorized acquisition rates, and a billing comparison for usage of 5,000 and 10,000 gallons at existing rates and authorized acquisition rates.

TAWC disagrees with proposed subsection (e) in its entirety. TAWC stated that the commission-approved notices for STM applications using TWC §13.3011 should only include the initial rates that the transferee is requesting to charge post-acquisition in addition to standard STM application notice requirements. TWU agreed with TAWC's comments and recommended the commission change the notice requirements to focus on providing customers with information about the

requested initial rates in a form and manner that keeps it separate and distinct from the form and notice contents required for a rate case. TWU also recommended deleting paragraphs requiring information about the differences in intervening in and protesting a rate increase. TWU also included addition of a webpage address where a copy of the tariffs can be accessed by ratepayers.

Commission Response

The commission disagrees with TAWC's and TWU's comments about the contents of the notice. The requirement to provide an explanation of how intervening in an STM docket is different from protesting a rate increase is essential to ensure that an affected ratepayer understands the process before filing a motion to intervene.

The commission also disagrees with commenters that the notice should not provide information on the existing rates or comparisons between the existing and requested rates. The only reasoning provided by commenters in support of their position is that these notice requirements are too similar to the notice requirements for a rate case. While this is not a full rate case, ratepayers that are subject to a change in rates are entitled to fully understand the consequences of that rate change and be given an opportunity to make an informed decision on whether to intervene in the proceeding. Requiring the notice to include some information that is included in the notice requirements for a rate case does not, as commenters seem to imply, violate the statutory prohibition on requiring a transferee to initiate a rate case to request authorized acquisition rates.

The new rule is adopted under TWC §13.041(b), which provides the commission with the authority

to adopt and enforce rules reasonably required in the exercise of its powers and jurisdiction. The new rule is also adopted under TWC §13.301 which governs the Sale, Merger, etc.; Investigation; Disallowance of Transaction and TWC §13.3011 that relates to Initial Rates for Certain Water or Sewer Systems after Purchase or Acquisition.

Cross Reference to Statute: Texas Water Code §§13.041,13.301, and 13.3011.

§24.240. Water and Sewer Utility Rates After Acquisition

(a) **Applicability**. This section applies to a person who files an application with the commission under Texas Water Code (TWC) §13.301(a) and a request for authorized acquisition rates under TWC §13.3011. For purposes of this section, the term "transaction" is used to align with its usage in the procedural provisions of §24.239 of this title (relating to Sale, Transfer, Merger, Consolidation, Acquisition, Lease, or Rental).

(b) **Definitions**. In this section, the following definitions apply unless the context indicates otherwise.

(1) **Authorized acquisition rates** -- Initial rates that are in force and shown in a tariff filed with a regulatory authority for the transferee for another water or sewer system owned by the transferee on the date an application is filed for the acquisition of a water or sewer system under §24.239 of this title.

(2) **Existing rates** -- Rates a transferor charged its customers under a tariff filed with a regulatory authority prior to the water system or sewer system being acquired.

(3) **Initial rates** -- Rates charged by a transferee to the customers of an acquired water or sewer system upon approval of the transaction by the commission. An initial rate may be an existing rate, an authorized acquisition rate, or a rate authorized by other applicable law.

(c) **Initial Rates.**

(1) A transferee must use existing rates as initial rates unless the commission authorizes, under this section or other applicable law, the use of different initial

rates.

(2) A transferee may request commission approval to charge authorized acquisition rates to the customers of the water or sewer system for which the transferee seeks approval to acquire as part of an application filed in accordance with §24.239 of this title .

(3) If the transferee has in-force tariffs filed with multiple regulatory authorities, there is a rebuttable presumption that authorized acquisition rates should be based upon an in-force tariff that was approved by the same regulatory authority that has original jurisdiction over the rates charged to the acquired customers.

(4) **Phased-in rates.** If the in-force tariff contains rates that are phased in over time, the provisions of this paragraph apply.

(A) Unless determined otherwise by the commission, the schedule in the tariff for the effective period of each phase will be applied to the customers of the acquired water or sewer system. To moderate the effects of a rate increase on customers, the commission may approve authorized acquisition rates that start customers of the acquired water or sewer system on an earlier phase than is in place for the customers to which the tariff already applies or establish a different schedule for the effective period of each phase.

(B) The transferee's application must include financial projections, rate schedules, and billing comparisons, consistent with the requirements of subsection (d) of this section, for each phase in the in-force tariff.

(C) The commission's review of whether the authorized acquisition rates are just and reasonable under subsection (f) of this section will include an

evaluation of whether the final phase of the requested rates are just and reasonable.

(5) **Public interest determination.** In determining whether to approve an acquisition under §24.239 of this title, the commission will consider whether approving the transferee's request to charge authorized acquisition rates under this section would change whether the proposed transaction would serve the public interest under §24.239(h)(5) of this title.

(d) **Application.** In addition to other applicable requirements, a request for authorized acquisition rates in a §24.239 proceeding must include the following:

(1) a rate schedule showing the existing rates and the requested authorized acquisition rates;

(2) financial projections including a comparison of expected revenues under the acquired water or sewer system's existing rates and the requested authorized acquisition rates;

(3) a billing comparison for usage of 5,000 and 10,000 gallons at existing rates and the requested authorized acquisition rates;

(4) documentation from the most recent base rate case in which the rates that the transferee is requesting to use as authorized acquisition rates were approved; this documentation must be sufficient to allow the commission to evaluate what was included in the revenue requirement for the requested rates and, if available online, may consist solely of a web address where the documentation can be located and the applicable docket number or any other information required to locate the

documentation;

(5) a disclosure of whether the transferor and transferee are or have been affiliates in the five-year period before the proposed acquisition, and the nature of each applicable affiliate relationship;

(6) additional explanation, including any applicable documentation, supporting the request to charge authorized acquisition rates, including:

(A) that the requested authorized acquisition rates would be just and reasonable rates for the customers of the acquired system and for the transferee;

(B) how approving the requested rates would change how the commission should evaluate whether the proposed transaction would serve the public interest, according to any applicable criteria listed in §24.239(h)(5) of this title;

(C) if the transferee has multiple eligible in-force tariffs or rate schedules, a list of eligible tariffs or rate schedules and an explanation for the tariff or rate schedules the transferee proposes to use for authorized acquisition rates;

(D) if the transferor and transferee are affiliates or have been affiliates in the five-year period before the proposed acquisition, the application must also include an explanation for why the transferee is requesting to charge authorized acquisition rates instead of using other available ratemaking proceedings.

(e) **Notice requirements.** Unless the commission waives notice in accordance with other applicable law, a transferee requesting approval to charge authorized acquisition rates

under this section must, as part of the notice provided under §24.239 of this title, also provide notice of the information outlined in this subsection. Commission staff must incorporate this information into the notice provided to the transferee for distribution after the application is determined to be administratively complete.

(1) How intervention differs from protesting a rate increase.

(2) A rate schedule showing the existing rates and the authorized acquisition rates.

(3) A billing comparison for usage of 5,000 and 10,000 gallons at existing rates and authorized acquisition rates.

(f) **Commission review.** The commission will, with or without a public hearing, investigate the request for authorized acquisition rates to determine whether the requested rates are just and reasonable for the acquired customers and the transferee. That a regulatory authority has determined that the requested rates are just and reasonable for a water or sewer system to which the rates already apply is not, in itself, sufficient to conclude that the requested rates are just and reasonable for the acquired water or sewer system.

(1) **Public hearing.** As part of its determination on whether to require a public hearing on the proposed transaction under §24.239(h) of this title, the commission will also consider whether a hearing is required to determine if the requested authorized acquisition rates are just and reasonable.

(A) If the commission requires a public hearing under this section or §24.239(h) of this title, the request to charge authorized acquisition rates will not be approved unless the commission determines that the requested rates are just and reasonable.

(B) If the commission does not require a public hearing under this section or §24.239(h) of this title, and the transferee has complied with the notice provisions of this section, the request to charge authorized acquisition rates will be approved in the commission's order approving the transaction. This subparagraph does not apply if the commission does not approve the transaction.

(2) **Scope of rate review.** The commission will determine whether the requested rates are just and reasonable based on the relevant facts and circumstances, subject to the limitations of subparagraph (A) of this paragraph.

(A) The transferee is not required to support its request for authorized acquisition rates by initiating a rate proceeding, establishing the cost of service for the acquired water or sewer system, or establishing substantial similarity between the acquired water or sewer system and the water or sewer system to which the requested rates already apply. The transferee is also not required to defend the reasonableness of the requested rates, or any individual component of those rates, with respect to any water or sewer system to which the rates already apply.

(B) The commission may consider whether any charges or significant components of the requested authorized acquisition rates (e.g., local or system-specific charges, pass throughs, etc.) would be unjust or unreasonable if applied to the acquired water or sewer system. The commission may also consider evidence of whether the customers of the acquired water or sewer system are currently receiving continuous and

adequate service. The commission may also consider evidence of whether the requested rates are generally consistent with the rates charged to similar water or sewer systems. The commission's review is not limited to the factors enumerated in this subparagraph.

This agency 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 §24.240, relating to Water and Sewer Utility Rates after Acquisition is hereby adopted with changes to the text as proposed.

Signed at Austin, Texas the _____ day of March 2024.

PUBLIC UTILITY COMMISSION OF TEXAS

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THOMAS J. GLEESON, CHAIRMAN

_____

KATHLEEN JACKSON, COMMISSIONER

_____

LORI COBOS, COMMISSIONER

_____

JIMMY GLOTFELTY, COMMISSIONER