

PROJECT NO. 50322

**ALTERNATIVE RATEMAKING
MECHANISMS FOR WATER AND
SEWER UTILITIES**

§
§
§
§

**PUBLIC UTILITY COMMISSION
OF TEXAS**

**PROPOSAL FOR PUBLICATION OF REPEAL OF §24.75, REPLACEMENT WITH
PROPOSED NEW §24.75, AND ADOPTION OF NEW §24.76
AS APPROVED AT THE MAY 21, 2021 OPEN MEETING**

The Public Utility Commission of Texas (commission) proposes repeal of existing 16 Texas Administrative Code (TAC) §24.75 and adoption of new 16 TAC §24.75, relating to Alternative Rate Methods. The commission also proposes new 16 TAC §24.76, relating to System Improvement Charge. These proposed rules will implement Texas Water Code (TWC) §13.183(c) enacted by the 86th Texas Legislature by establishing alternative ratemaking methodologies for water and sewer rates and establishing the requirements for a system improvement charge.

Growth Impact Statement

The agency provides the following governmental growth impact statement for the proposed rule, as required by Texas Government Code §2001.0221. The agency has determined that for each year of the first five years that the proposed rule is in effect, the following statements will apply:

- (1) the proposed rule will not create a government program and will not eliminate a government program;
- (2) implementation of the proposed rule will not require the creation of new employee positions and will not require the elimination of existing employee positions;
- (3) implementation of the proposed rule will not require an increase and will not require a decrease in future legislative appropriations to the agency;

- (4) the proposed rule will not require an increase and will not require a decrease in fees paid to the agency;
- (5) the proposed rule will not create a new regulation;
- (6) the proposed rule will not expand, limit, or repeal an existing regulation;
- (7) the proposed rule will not change the number of individuals subject to the rule's applicability; and
- (8) the proposed rule will not affect this state's economy.

Fiscal Impact on Small and Micro-Businesses and Rural Communities

There is no adverse economic effect anticipated for small businesses, micro-businesses, or rural communities as a result of implementing the proposed rule. Accordingly, no economic impact statement or regulatory flexibility analysis is required under Texas Government Code §2006.002(c).

Takings Impact Analysis

The commission has determined that the proposed rule will not be a taking of private property as defined in chapter 2007 of the Texas Government Code.

Fiscal Impact on State and Local Government

Emily Sears, Financial Analyst, Rate Regulation Division, has determined that for the first five-year period the proposed rule is in effect, there will be no fiscal implications for the state or for units of local government under Texas Government Code §2001.024(a)(4) as a result of enforcing or administering the sections.

Public Benefits

Ms. Sears has also determined that for each year of the first five years the proposed section is in effect, the anticipated public benefits expected as a result of the adoption of the proposed rule will be higher quality, more affordable, and more reliable water or sewer service for customers; increased regionalization; and, more financially stable and technically sound water and sewer utilities. There will be no probable economic cost to persons required to comply with the rule under Texas Government Code §2001.024(a)(5).

Local Employment Impact Statement

For each year of the first five years the proposed section is in effect, there should be no effect on a local economy; therefore, no local employment impact statement is required under Texas Government Code §2001.022.

Costs to Regulated Persons

Texas Government Code §2001.0045(b) does not apply to this rulemaking because the commission is expressly excluded under subsection §2001.0045(c)(7).

Public Hearing

The commission staff will conduct a public hearing on this rulemaking on July 16, 2021, if requested in accordance with Texas Government Code §2001.029. In light of the pending public emergency related to the coronavirus disease (COVID-19), this public hearing will be conducted remotely. The request for a public hearing must be received by July 9, 2021. If no request for public hearing is received and the commission staff cancels the hearing, it will file in this project

a notification of the cancellation of the hearing prior to the scheduled date for the hearing. If a request for public hearing is received, commission staff will file in this project instructions on how a member of the public can participate in the hearing remotely.

Public Comments

At the time of this filing, the commission's rules requiring that pleadings or documents be physically filed are suspended. See Project Number 50664, *Issues Related to the State of Disaster for Coronavirus Disease 2019*, Second Order Suspending Rules filed on July 16, 2020. As long as this suspension remains in effect, comments may be filed through the interchange on the commission's website. If the suspension of these rules is lifted during the pendency of this project, comments may be filed by submitting 16 copies to the Filing Clerk, Public Utility Commission of Texas, 1701 North Congress Avenue, P.O. Box 13326, Austin, Texas 78711-3326. Comments may be filed by June 25, 2021. Reply comments may be filed by July 9, 2021. Comments should be organized in a manner consistent with the organization of the proposed rules. The commission invites specific comments regarding the costs associated with, and benefits that will be gained by, implementation of the proposed rule. The commission will consider the costs and benefits in deciding whether to modify the proposed rules on adoption. All comments should refer to Project Number 50322.

Statutory Authority

These new rules are proposed under Texas Water Code §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, §13.183(c), which allows the commission to adopt rules related to specific alternative ratemaking methodologies for water and sewer rates.

Cross reference to statutes: Texas Water Code §§ 13.041(b) and 13.184(c).

§24.75. Alternative Ratemaking Methodologies. (REPEAL)**§24.75. Alternative Ratemaking Methodologies.**

- (a) **Purpose and application.** This section establishes alternative ratemaking methodologies for utilities that provide water or sewer service. The commission may prescribe modified rate filing packages for these alternative ratemaking methodologies.
- (b) **Multi-step rates.** Multi-step rates allow a utility to implement one or more rates over time without filing multiple rate applications. Multi-step rates must be established in accordance with this subsection.
- (1) Multi-step rates must be established in a comprehensive rate proceeding under Texas Water Code (TWC) §13.187, 13.1871, 13.18715, or 13.1872.
- (2) The commission may establish multi-step rates on its own motion or at the request of a utility or any other interested party.
- (3) Rates established in a comprehensive rate case under TWC §13.187, 13.1871, 13.18715, or 13.1872 will replace any multi-step rates already in effect or previously approved by the commission to go into effect for that utility.
- (4) Multi-step rates may be established when a utility transitions from use of flat rates for unmetered service to use of volumetric rates for metered service.
- (A) Multi-step rates for a utility's transition to metered service must not be effective before the date that meters are installed and in operation for all of the utility's connections.
- (B) If the utility is seeking multi-step rates to transition to the use of volumetric rates for metered service, the utility must state in its notice of intent to

change rates that it is seeking permission to use multi-step rates to transition to metered service with volumetric usage rates.

(C) The utility must provide notice to its customers at least 30 days before the utility begins charging its volumetric usage rate for metered service and at least 30 days before implementation of each step of its commission-approved multi-step rate.

(5) Multi-step rates may be established when a utility transitions from multiple rate schedules for different systems or service areas to consolidated rate schedules for regional or system-wide rates.

(A) Different rates and a different timeline may be established for each step in the multi-step rates of each system or service area that is transitioning to a consolidated rate schedule provided that the final step for each system or service area is the same consolidated rate.

(B) If the utility is seeking multi-step rates to transition to consolidated rate schedules, the utility must state in its notice of intent to change rates that it is seeking permission to use multi-step rates to transition from multiple rate schedules for different systems or service areas to consolidated rate schedules for regional or system-wide rates.

(C) The utility must provide notice to its customers at least 30 days before implementation of each step of its commission-approved multi-step rate.

(6) Multi-step rates may be established to moderate the effects of a rate increase on customers or if other good cause exists.

- (A) Different rates and a different timeline may be established for each step in the multi-step rates for each of a utility's systems or service areas provided that the final step for each system or service area is the same final rate.
- (B) If the utility is seeking multi-step rates under this paragraph, the utility must state in its notice of intent to change rates that it is seeking permission to use multi-step rates.
- (C) The utility must provide notice to its customers at least 30 days before implementation of each step of its commission-approved multi-step rate.
- (7) The notice requirements in paragraphs (4)-(6) of this subsection do not replace the standard statement of intent notice requirements under TWC §13.187, 13.1871, 13.18715, or 13.1872.
- (8) The commission may place conditions on the implementation of a multi-step rate or on any step of a multi-step rate. For the purpose of ensuring just and reasonable rates, the commission may terminate a multi-step rate in a rate proceeding before completion of all steps of the multi-step rate.
- (c) **Cash needs method.** The commission may approve use of the cash needs method to establish a utility's revenue requirement in a comprehensive rate proceeding for a Class C or Class D utility under TWC §13.18715 or 13.1872 if use of the method is necessary for the utility to provide continuous and adequate service or other good cause exists to support the use of the cash needs method. Under the cash needs method, the allowable components of cost of service are operating expenses, debt service costs, and an additional margin consisting of either an operating margin or an incremental revenue amount.

- (1) Operating expenses. Only those operating expenses that are reasonable and necessary to provide service may be recovered, and these amounts must be based on the utility's test year expenses, adjusted for known and measurable changes.
- (2) Debt-service costs. Debt service costs include principal and interest payments on the utility's debt.
 - (A) The debt must have reasonable terms and must finance facilities that will be used and useful in the provision of utility service.
 - (B) If required by the commission, Texas Water Development Board, other state or federal agency, or financial institution, debt-service costs may include amounts placed in a debt-service reserve account or an escrow account.
 - (C) Debt-service costs may include owner-financed assets. Debt-service costs related to these assets must include debt repayments using a reasonable amortization schedule and must use the prime interest rate in effect at the time the application is filed.
- (3) Additional margin. An additional margin consists of either an operating margin or an incremental revenue amount. A utility requesting an additional margin must provide an explanation for the magnitude of the additional margin it requests.
 - (A) If a utility requesting an additional margin in the form of an operating margin has filed its most recent required annual report and has a net plant (original cost of plant in service less accumulated depreciation) of less than 25 percent of the original cost of plant, an operating margin of up to five percent of operating expenses approved by the commission will be

presumed reasonable and may be included in the utility's revenue requirement.

(B) An additional margin consisting of an incremental revenue amount is calculated by adding an incremental amount to the debt service costs described in paragraph (c)(2)(A) of this section to achieve a reasonable total debt service coverage level above 1.0.

(4) **Restrictions.** Rates established using the cash needs method under this subsection may not be subsequently set using cost of service calculated under §24.41 of this title (related to Cost of Service) for any comprehensive rate change application filed within five years after the date of the commission's order establishing rates using the cash needs method. If, after this five-year period, the utility has a comprehensive rate change proceeding based on a cost of service calculated under §24.41 of this title, the utility's rate base must exclude an amount equal to the principal paid on the debt service during the time that rates based on the cash needs method were in effect.

(5) **Subsequent acquisition.** If a utility with rates established using the cash needs method is acquired by another utility while such rates are in effect, the acquiring utility is not subject to the restriction in paragraph (4) of this subsection on calculating cost of service. If the acquiring utility files a comprehensive rate change application based on a cost of service calculated under §24.41 of this title, the acquiring utility must exclude from rate base an amount equal to the principal paid on the debt service that was related to the acquired utility during the time that rates based on the cash needs method were in effect.

(d) **New customer classes.** A utility may request the addition of a new customer class or classes as provided by this subsection.

(1) **Application.** An application for new customer classes under this section must include:

(A) a cost-of-service and rate design study;

(B) a definition for each proposed new customer class;

(C) demonstration that the characteristics of each proposed new customer class are sufficiently different from the characteristics of all existing and other proposed new customer classes for different rate treatment;

(D) a request for service from a customer in each proposed new customer class; and

(E) if the utility wants to extend the 18 month deadline to file a comprehensive rate case under paragraph (3) of this subsection, documentation that the revenues to be recovered from each new customer class will be less than ten percent of the utility's total annual revenue.

(2) **Rates for new customer classes.**

(A) The rates for each new customer class must be based on cost-of-service and rate design studies.

(B) On the effective date of the rates for each new customer class, common costs assigned to and recovered from the new customer classes must be removed from the rates of existing customer classes.

(3) **Rate case requirement.**

- (A) A utility that has received commission approval for the creation of a new customer class or classes under this subsection must file a comprehensive rate case by filing a statement of intent under TWC §13.187, 13.1871, 13.18715, or 13.1872 not later than 18 months from the date service begins to the new customer class or classes unless the utility has submitted documentation under subparagraph (1)(E) of this subsection demonstrating that each new customer class represents less than ten percent of the utility's total annual revenue required.
- (B) If the utility demonstrates to the commission that each new customer class represents less than ten percent of the utility's total annual revenue by submitting documentation under subparagraph (1)(E) of this subsection, a comprehensive rate case is not required until the earlier of six months following the date on which the revenues of any of the new the customer classes equals or exceeds ten percent of the utility's total annual revenue or five years following the date service to the new customer class or classes begins. The utility must, as an attachment to its annual report filed under §24.129 (relating to Water and Sewer Utilities Annual Reports), annually update its demonstration to show that the revenues of each new customer class remain less than ten percent of the utility's total annual revenue.
- (C) If a utility fails to provide an annual update that shows the annual revenue of each new customer class remains less than ten percent of the utility's total annual revenue, the utility must file a comprehensive rate case within the earlier of six months from the date its annual report was due under

§24.129(a) or five years from the date service to the new customer class or classes began.

§24.76. System Improvement Charge.

- (a) **Purpose.** This section establishes the requirements for a system improvement charge to ensure timely recovery of infrastructure investment.
- (b) **Definitions.** In this section, the following words and terms have the following meanings unless the context indicates otherwise.
- (1) Eligible plant -- Plant properly recorded in the National Association of Regulatory Utility Commissioners System of Accounts, accounts 304 through 339 for water utility service or accounts 354 through 389 for sewer utility service.
- (2) System improvement charge -- A charge to recover the cost of a utility's eligible plant that is used and useful and the costs of which are not already included in the utility's rates.
- (c) **System improvement charge.**
- (1) A utility must have only one system improvement charge in effect for water and one system improvement charge in effect for sewer for each of its rate schedules at any time.
- (2) A utility may apply to establish or amend one or more system improvement charges in accordance with the requirements of this section. A utility must not adjust its rates under this section more than once each calendar year. A utility that is applying to establish or amend multiple system improvement charges in a calendar year must do so in a single application.
- (3) A utility may not apply to establish or amend a system improvement charge while it has a comprehensive rate proceeding under TWC §13.187, 13.1871, 13.18715, or 13.1872 pending before the commission.

- (4) A utility may not apply to establish or amend a system improvement charge until 12 months after a commission order establishing rates in a proceeding under TWC §13.187, 13.1871, 13.18715, or 13.1872 is final and appealable.
- (5) If a utility with a pending application to establish or amend a system improvement charge files an application to change rates under TWC §13.187, 13.1871, 13.18715, or 13.1872, or the commission initiates a rate change review under TWC §13.186, the utility will be deemed to have withdrawn its application to establish or amend a system improvement charge and the presiding officer must dismiss the application.
- (6) The filing of applications as allowed by this section is limited to a specific quarter of the calendar year, and is 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 quarter. For a utility holding multiple CCNs, the utility may file an application in any quarter for which any of its CCN numbers is eligible.
- (A) Quarter 1 (January-March): CCNs ending in 00 through 27;
- (B) Quarter 2 (April-June): CCNs ending in 28 through 54;
- (C) Quarter 3 (July-September): CCNs ending in 55 through 81; and
- (D) Quarter 4 (October-December): CCNs ending in 82 through 99.
- (7) On its own motion or at the request of the utility or any other interested party, the commission may approve a system improvement charge as a multi-step rate increase if a multi-step rate increase is already in effect or if necessary to limit the utility's annual total revenue increase to no more than 10 percent.

(d) **Application for a system improvement charge.** An application to establish or amend a system improvement charge must include the following:

- (1) a description of the eligible plant for which cost recovery is sought through the system improvement charge, including the project or projects included in the request and an explanation of how each project has improved or will improve service;
- (2) a calculation of the system improvement charge in accordance with subsection (f) of this section and all supporting calculations and assumptions for each component of the system improvement charge;
- (3) information that sufficiently supports the eligible cost, such as invoices, receipts, and direct testimony, and that sufficiently addresses the exclusion of costs for plant provided by explicit customer agreements or funded by customer contributions in aid of construction;
- (4) the utility's most recent annual report filed with the commission, which must be the annual report most recently due for filing; and
- (5) an affidavit confirming that the application meets the requirements of this section.

(e) **Calculation of the system improvement charge.** The system improvement charge must be calculated using the following formula:

$$\text{SIC} = (\text{Eligible Cost} * \text{ROR}) + \text{Federal Income Taxes} + \text{Depreciation} + \text{ad valorem taxes} + \text{other revenue related taxes.}$$

Where:

- (1) **SIC** = the system improvement charge.

- (2) Eligible Cost = the original costs of eligible plant that have not been included in the calculation of a rate other than the system improvement charge, less any accumulated depreciation and costs for plant provided by explicit customer agreements or funded by customer contributions in aid of construction.
- (3) Accumulated depreciation = depreciation accumulated for eligible plant after the date the eligible plant was placed in service.
- (4) ROR = after-tax rate of return as defined in paragraph (9) of this subsection.
- (5) Federal Income Taxes = current annual federal income tax, as related to eligible costs.
- (6) Depreciation = current annual depreciation expense for the eligible plant.
- (7) Ad Valorem Taxes = taxes based on the assessed value of the eligible plant.
- (8) Other Revenue Related Taxes = any additional taxes resulting from the utility's increased revenues related to the SIC.
- (9) The after-tax rate of return is one of the following:
- (A) if the final order approving the rate of return was filed less than three years before the application for a system improvement charge was filed, the after-tax rate of return is the one approved by the commission in the utility's last base-rate case; or
- (B) if the final order approving the rate of return was filed three years or more before the application for a system improvement charge was filed, the after-tax rate of return for settled and fully litigated rate cases is the average of the commission's approved rates of return for water and sewer utilities over

the three years immediately preceding the filing of the system improvement charge application.

(f) **Notice.** By the first business day after it files its application, the utility must send notice of its system improvement charge application to all affected ratepayers by first class mail, e-mail (if the customer has agreed to receive communications electronically), bill insert, or hand delivery. The utility must include in the notice the docket number for the utility's system improvement charge proceeding, the intervention deadline, and a brief explanation of how an affected ratepayer can intervene in the system improvement charge proceeding and how intervention differs from protesting a rate increase. The intervention deadline is 25 days from the date service of notice is complete.

(g) **Commission processing of application.** Upon the filing of an application to establish a system improvement charge, the presiding officer must set a procedural schedule that will enable the commission to issue a final order within 120 days after the application is determined to be sufficient, if no hearing is requested.

(1) For good cause or by agreement of the parties, the presiding officer may set a schedule that will not enable issuance of a final order within 120 days after the application is determined to be sufficient. The deadlines established by the presiding officer will be extended as provided in this subsection.

(2) After an application is determined to be sufficient, the applicant must respond to requests for information within 10 days. An applicant's failure to timely respond to requests for information constitutes good cause for extending the deadline for final action one day for each day that a response exceeds 10 days.

- (3) A request by an intervenor for hearing must be filed within 25 days after the application is determined to be sufficient. A request for hearing must state with specificity the issues to be addressed.
- (4) Unless an intervenor requests a hearing, commission staff must submit a recommendation on the application or request a hearing not later than 45 days after the application is determined to be sufficient unless commission staff requests additional time, not to exceed another 15 days unless good cause exists for a later date. If commission staff is granted additional time, the deadline for final action is extended day for day for each day of additional time.
- (5) If a hearing on the application is requested, the application will be referred to the State Office of Administrative Hearings (SOAH) for an evidentiary hearing. The presiding officer must set a procedural schedule that will enable the commission to issue a final order within 120 days after the application is referred to SOAH. For good cause, the presiding officer may set a procedural schedule that will not enable the commission to issue a final order within 120 days after the application is determined to be sufficient.
- (h) **Scope of proceeding.** The issue of whether eligible costs included in an application for a system improvement charge or an amendment to a system improvement charge are prudent, reasonable, or necessary, will not be addressed in a proceeding under this section unless the presiding officer finds that good cause exists to address these issues.
- (i) **System improvement charge reconciliation.** Costs recovered through a system improvement charge are subject to reconciliation in the utility's next comprehensive rate case. Any amounts recovered through the system improvement charge that are found to

have been unreasonable, unnecessary, or imprudent, plus the corresponding return and taxes, must be refunded with carrying costs. The utility must pay to its customers carrying costs on these amounts calculated using the same rate of return that was applied to the recovered costs in establishing the system improvement charge until the date the rates approved utility's next comprehensive rate case are effective. Thereafter, carrying costs must be calculated using the utility's rate of return authorized in the comprehensive rate case.

- (j) **Requirement to file a rate case.** A utility must file a comprehensive rate case under TWC §13.187, 13.1871, 13.18715, or 13.1872 within the following times from the date the commission files an order approving the system improvement charge.
- (1) Four years for a utility that was a Class A utility at the time of the order.
 - (2) Six years for a utility that was a Class B utility at the time of the order.
 - (3) Eight years for a utility that was a Class C or Class D utility at the time of the order.

This agency certifies that the proposal has been reviewed by legal counsel and found to be within the agency's legal authority to adopt.

**ISSUED IN AUSTIN, TEXAS ON THE 21st DAY OF MAY 2021 BY THE
PUBLIC UTILITY COMMISSION OF TEXAS
ANDREA GONZALEZ**