

CHAPTER 24. SUBSTANTIVE RULES APPLICABLE TO WATER AND SEWER SERVICE PROVIDERS.

Subchapter C. ALTERNATIVE RATE METHODS.

§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 for each new proposed customer class.
 - (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. A utility must continue to update its demonstration annually until the commission adopts a final order in a comprehensive rate case for that utility or the utility is no longer eligible to delay filing a comprehensive rate case under this paragraph.
 - (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.