

# **Comparative Analysis of PUC Ratemaking Authority As Required By House Bill 1600**

## **Background and Purpose**

House Bill (HB) 1600<sup>1</sup> and Senate Bill (SB) 567<sup>2</sup> transferred the economic regulation of water and sewer utilities from the Texas Commission on Environmental Quality (TCEQ) to the Public Utility Commission (PUC). The authority transferred includes water and wastewater utility ratemaking; wastewater utility submetering; certificates of convenience and necessity; certain financial, managerial, and technical practices; reporting requirements; and consumer assistance and complaints and sales, transfers and mergers. TCEQ maintains responsibility for ensuring that utilities meet drinking water standards, sewage treatment requirements, and review of investor-owned utility drought contingency plans. Furthermore, the bill ends the one-size-fits-all treatment for these utilities by establishing three utility classifications based on connection count. As prescribed in HB 1600, Class A utilities have 10,000 connections or more and follow a rate-setting process similar to the process used for electric rate increases. Class B utilities have 500 to 9,999 connections and will file an condensed rate filing package, similar in scope to the rate filing package utilities filed at TCEQ. Class C utilities have fewer than 500 connections and will be allowed the option to request an annual rate adjustment based on a predetermined index, which may not exceed a 5 percent increase. The bill requires the PUC and TCEQ to complete the transfer by September 1, 2014. The PUC is required to adopt rules to implement the regulatory changes by September 1, 2015.

This report is provided pursuant to section 2.97 of HB 1600 which requires the PUC to:

conduct a comparative analysis of the ratemaking authority of the commission before the effective date of this Act and the ratemaking authority of the commission after the transition described in Section 2.96 of this article, to identify potential for procedural standardization. The [PUC] shall issue a report of the

---

<sup>1</sup> Acts 2013, 83<sup>rd</sup> Leg., R.S., ch. 170 (HB 1600), 2013 Tex. Gen. Laws 771.

<sup>2</sup> Acts 2013, 83<sup>rd</sup> Leg., R.S., ch. 171 (SB 567), 2013 Tex. Gen. Laws 772.

analysis, with recommendations regarding rate standardization, for consideration by the 84<sup>th</sup> Legislature.<sup>3</sup>

This report provides a comparative analysis of statutory ratemaking provisions under the PUC's authority and discusses opportunities for standardization. The first two sections of the report provide an overview of the PUC's ratemaking process and the actions taken thus far to incorporate water ratemaking into that process. The final section of the report provides recommended statutory changes necessary for achieving an appropriate level of standardization between the electric and water ratemaking processes.

## **Current PUC Ratemaking Procedures**

The State Office of Administrative Hearings (SOAH) continues to hear cases related to water and sewer regulation as it did when this program was at TCEQ. SOAH also presides over electric rate cases for the PUC. Following is an explanation of the current electric ratemaking process at the PUC.

Rates for investor-owned, vertically-integrated utilities (IOUs), investor-owned transmission and distribution utilities (TDUs)<sup>4</sup> and transmission-only utilities (TSPs) (collectively referred to as electric utilities) at the PUC are set based on cost-of-service ratemaking principles. Under these longstanding principles, IOUs and TDUs are allowed a reasonable opportunity to earn a reasonable rate of return on property that is used and useful in providing service to their customers in excess of the utility's reasonable and necessary operating expenses. IOU and TDU rates are established using an historical test year. Historical test year expenses may be adjusted by known and measurable changes. The test year is the historic 12-month period deemed reasonable by the PUC, ending either December 31, at the end of a calendar quarter, or at the end of the utility's fiscal year.

---

<sup>3</sup> Acts 2013, 83<sup>rd</sup> Leg., R.S. Ch. 170 (HB 1600), sec. 2.97, 2013 Tex. Gen. Laws 771. As noted above, SB 567 also transferred economic regulation of water and sewer utilities to the PUC. However, unlike HB 1600, SB 567 did not include a requirement for the PUC to prepare a comparative analysis of PUC ratemaking for the Legislature.

<sup>4</sup> In Texas, vertically integrated IOUs are electric utilities that operate in the areas outside of ERCOT that are not subject to retail competition. As part of retail competition in ERCOT that began in January 2002, the former investor-owned utilities operating in ERCOT were required to unbundle into transmission and distribution utilities (TDUs), generation companies, and retail companies. The TDUs remain subject to full cost-of-service rate regulation by the PUC.

As part of an application to change rates, an IOU or TDU is required to submit detailed cost information and pre-filed direct testimony to support its request. The PUC has a detailed rate filing package which outlines the type of cost information required to be submitted as part of a rate change application. The rate filing package specifies all cost information that must be provided, including information on cost of service, rate base (invested capital), rate of return, operation and maintenance expenses, income taxes, cost allocation, and rate design. Unless otherwise indicated, the information required in a rate application is taken from the utility's accounts and records as prescribed in the Federal Energy Regulatory Commission (FERC) chart of accounts. All schedules are required to be filed electronically in Excel format with all formulas, cell references, etc. intact.

Under Public Utility Regulatory Act (PURA) §36.102,<sup>5</sup> an electric utility seeking to change its rates must file a statement of intent with the regulatory authority having original jurisdiction (either cities or the PUC) over those rates at least 35 days before the effective date of the proposed rate change. PURA § 36.108 allows the PUC to further suspend the effective date of the proposed rates for not longer than 150 days. Under PURA § 36.108, a rate application must be processed before the expiration of the suspension period. This means that the PUC must enter an order approving or denying the rate application within 185 days (35 day effective date + 150 day suspension period= 185 days). Under PURA § 36.108, if an order approving or denying the rate application is not entered within 185 days,<sup>6</sup> the rate request is deemed approved by operation of law. Under PUC practice, an electric utility may voluntarily agree to extend the effective date to give the PUC more time to consider and rule on a rate application.

Generally, once a rate case is filed, interested parties, including the PUC Staff, affected ratepayer groups (such as cities, industrial and commercial customers), and the Office of Public Utility Counsel (which is charged with representing residential and small commercial customers) will intervene and begin sending discovery requests to the applicant. The discovery requests are designed to help affected parties better understand the rate application and develop their positions and recommendations.

---

<sup>5</sup> TEX. UTIL. CODE §36.102 (West 2007 & Supp. 2014).

<sup>6</sup> Under PURA § 36.108(b), the 150 day suspension period shall be extended two days for each day of the actual hearing on the merits in the case exceeds 15 days. This extension of the suspension period rarely occurs in PUC rate cases.

IOU and TDU rate cases are almost always referred to SOAH for processing and hearing. The SOAH Administrative Law Judge (ALJ), with input from the parties, will establish a procedural schedule that will enable the PUC to decide the case within 185 days. All intervenors have an opportunity to file written testimony on the rate application. The IOU or TDU, as the party with the burden of proof, has an opportunity to file testimony rebutting any intervenor testimony. Hearings in IOU and TDU rate cases typically begin on or around the 100<sup>th</sup> day after filing. Over the past decade, approximately 70% of IOU and TDU rate cases have settled without a hearing. If there is no settlement or if the settlement is non-unanimous, a hearing will be held.

The SOAH ALJ will issue a proposal for decision (PFD) (if the case is contested and has gone to hearing) or a proposed order (if the case has settled) and will then refer the case back to the PUC for a final decision. After reviewing the PFD or proposed order, briefs of the parties, and any evidence the PUC commissioners may need to reach a decision, the PUC will issue a final order on the application.

Parties that believe they are aggrieved by the PUC's ultimate decision in a rate case may file a motion for rehearing. If the PUC denies a motion for rehearing or declines to act on such a motion, the PUC's order becomes final and is subject to appeal to state district court. Rate cases appealed to the courts can take several years or more to move through the appellate process. If a court overturns a decision of the PUC it typically remands the case back to the Commission to conduct proceedings and enter an order consistent with the court's ruling.

## **Water-Related Activities Update**

During Phase I of implementing water ratemaking, the PUC adopted language from TCEQ rules in Title 30, Texas Administrative Code (TAC), Chapter 291. These rules cover the processing of applications related to water and sewer utility rates, service area matters including Certificates of Convenience and Necessity (CCNs), Sale/Transfer or Mergers (STMs), and submetering and allocated billing program for dwelling units and multiple use facilities. The PUC made minor changes to the language in TCEQ's rules to better correspond and fit into PUC's existing processes for electric and telecommunication matters. These rules can be found in new Title 16, TAC, Chapter 24. The new rules were adopted by the PUC on July 29, 2014,

and are currently being used to process water and sewer rate and CCN related matters. On December 18, 2014, the PUC adopted a new administrative review process timeline to match the PUC's processes for electric and telecommunication matters.

As part of the transfer, TCEQ's application forms and regulatory guidance documents specific to water and sewer utility rates, submetering and allocated billing, and service area matters were amended to reflect PUC processes; however, no substantive changes were made to either the forms or rules as part of Phase I of the transfer. In addition, the PUC assumed the responsibility of maintaining the Water and Sewer Retail Public Utility CCN Map Viewer for use by the public.

Phase I of the transition included 278 cases transferred over from the TCEQ to the PUC. The cases were scanned into the PUC Interchange (the PUC's internet-based filing system) and made available to the public. The PUC also conducted a filings workshop on October 10, 2014, to provide guidance and information to the public on how to submit and file documents and information properly with the PUC. In addition to the workshop, the PUC participated in various outreach activities including speaking about the transfer at the Independent Water and Sewer Companies of Texas (IWSCOT) meeting and speaking at the Texas Rural Water Association's Fall Management Workshops in San Antonio and Dallas. The PUC also became a member of the Texas Water Infrastructure Coordination Committee (TWICC) with other governmental and non-profit organizations such as the Texas Water Development Board (TWDB), the Texas Commission on Environmental Quality (TCEQ), the Texas Department of Agriculture (TDA), United States Rural Development (USRD), North American Development Bank (NAD Bank), Texas Rural Water Association and others.

During the first quarter of fiscal year 2015, the PUC processed 26 rate-related matters and 18 CCN-related matters, for a total of 54 applications. The PUC also established internal processes designed to complete work on water-related matters efficiently.

Through an interagency contract with the TCEQ, the PUC made 26 referrals for financial and/or managerial related assistance to water or sewer utilities, and met with the TCEQ on

numerous occasions to coordinate on various issues including receiverships, temporary managers, business plan reviews, and other matters.

During the second quarter of fiscal year 2015, the PUC began implementation of Phase II of the transfer by opening new projects to amend the PUC's rules, forms, and processes. The goal of Phase II of the transfer is to implement the Class A, B and C utility classifications as prescribed in Texas Water Code, Chapter 13, as amended by HB 1600 and Senate Bill 567. The projects are currently underway and a workshop is planned on January 27, 2015, to get input from the public.

### **PUC Recommended Statutory Changes**

The PUC recommends the following legislative changes to address water ratemaking issues:

1. Subchapter L of Chapter 5 of the Texas Water Code addresses emergency orders and emergency rates. Sections 5.507 & 5.508 were amended in 2013 to give the PUC authority to issue emergency orders and emergency rates. Procedural details are contained in §§ 5.501-.505 and for the most part do not apply to the PUC. Section 13.4132 also authorizes emergency rates and § 13.041 also addresses emergency orders. The PUC recommends that all PUC authority related to emergency orders and emergency rates be consolidated in Subchapter K of Chapter 13 and include the procedural requirements now found in Subchapter L of Chapter 5 of the Water Code.
2. Water Code § 13.042(c-1) addresses authority of the PUC to delegate authority to the State Office of Administrative Hearings (SOAH) to issue interim rate orders. Section 13.187(g-1) currently requires the PUC to provide notice of hearing. The PUC recommends that § 13.187(g-1) of the Water Code be amended to add language specifically allowing the PUC to delegate authority for SOAH to provide notice of hearings.
3. Section 13.1871(l) of the Texas Water Code requires a utility to mail notice of a rate hearing to each ratepayer before the hearing. Under PUC practice for electric cases, a ratepayer must request to intervene in the matter to participate as a party at the hearing. Only intervenors granted party status may participate in a hearing and only those parties

need notice of the hearing. It is too costly and time consuming to require notice to all ratepayers when they cannot participate at the hearing unless they have been granted party status. The PUC recommends that utilities be required to provide notice of a hearing as directed by the PUC through rule or order. Water utilities are already required under Water Code § 13.1871(b) to give notice of an application to change rates to each ratepayer.

4. Under Texas Water Code §§ 13.042-13.043, the PUC is given appellate jurisdiction over the rate actions of municipalities, non-profits, districts, and affected counties. Those entities must give notice of the rate action to ratepayers within 60 days. Ratepayers must file an appeal with the PUC within 90 days of the effective date of the rate or the date the entity acted, depending on the type of entity. If notice is not given, or if notice is untimely, ratepayers may not find out about the rate change until after it is too late to file an appeal. Appeals of electric rate actions are timed off the municipality giving notice (by issuing a report). The PUC recommends that Water Code § 13.043(c) be amended to allow the filing of a petition for review within 30 days of the entity issuing notice.
5. Under Texas Water Code § 13.043(c), a petition to appeal a rate must be signed by 10 percent or 10,000 of the ratepayers whose rates have been changed and are eligible to appeal. The entity that is changing rates has the best knowledge of how many individuals are eligible or have had their rates changed. Therefore, the PUC recommends that a provision similar to PURA § 33.102 that requires the entity to identify the number of eligible ratepayers that have had their rates changed be added to the Water Code.
6. Under Texas Water Code § 13.1871(g), Class B water utility rate cases must be processed within 240 days. This statutory deadline needs to be extended in order for the PUC to process these cases in a way that appropriately balances the interests of utilities and ratepayers.