

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

### Subchapter H. CERTIFICATES OF CONVENIENCE AND NECESSITY.

#### §24.238. Fair Market Valuation.

- (a) **Applicability.** This section applies to a voluntary arm's length transaction between an acquiring utility and a retail public utility under TWC §13.305 for which approval is required under TWC §13.301. This section does not apply to a transaction between a utility and its affiliate.
- (b) **Definitions.** In this section, the following words and terms have the following meanings, unless the context indicates otherwise.
- (1) **Acquiring utility** -- A Class A or Class B utility that is acquiring a selling utility, or the facilities of a selling utility.
  - (2) **Allowance for funds used during construction (AFUDC)** -- An accounting practice that recognizes the capital costs, including debt and equity funds, that are used to finance a transferee's construction costs of an improvement to a purchased asset.
  - (3) **Fair market value** -- The average of the three appraisals conducted under subsection (f) of this section.
  - (4) **Ratemaking rate base** -- The dollar value of the selling utility or the sold facilities of a selling utility that is incorporated into the rate base of the acquiring utility for post-acquisition purposes. The ratemaking rate base is the lesser of the purchase price negotiated by an acquiring utility and a selling utility or the fair market value. The ratemaking rate base does not include transaction and closing costs.
  - (5) **Selling utility** -- A retail public utility that is being purchased by an acquiring utility or is selling facilities to an acquiring utility.
- (c) **List of qualified utility valuation experts.** The commission will maintain a list of qualified utility valuation experts to perform appraisals to determine a fair market value of a selling utility or facilities of a selling utility.
- (1) A utility valuation expert may request to be included on the commission's list by submitting, under the control number designated for that purpose, the required information.
  - (2) The request filed by the utility valuation expert must include:
    - (A) The expert's name, mailing address, telephone number, and email address;
    - (B) The name of the company with which the expert is employed or associated, or the name under which the expert conducts business;
    - (C) The names of the principal officers of the company with which the expert is employed or associated, if applicable;
    - (D) The name and mailing addresses of any affiliates of the company with which the expert is employed or associated, if applicable; and
    - (E) A detailed description of the utility valuation expert's qualifications, such as professional licensing, certifications, training or past experience conducting economic evaluations of water and sewer utilities.
  - (3) The utility valuation expert must update the information in its request on file with the commission within ten business days of a material change to the information.
  - (4) A utility valuation expert who wishes to be removed from the list maintained by the commission under this subsection must file a letter with the commission requesting to be removed from the list. This letter must be filed under the control number designated for that purpose. The commission will acknowledge the removal request in writing.
- (d) **Notice of intent to determine fair market value.**
- (1) A selling utility and an acquiring utility that agree to use the fair market valuation process described in subsection (f) of this section must file a notice of intent to determine fair market value in the control number designated for that purpose.
  - (2) The notice of intent must include the following:
    - (A) The name and certificate of convenience and necessity (CCN) number of the acquiring utility. If the acquiring utility holds multiple CCN numbers, the acquiring utility must provide all the CCN numbers.

- (B) The name and contact information of the acquiring utility's representative.
  - (C) The number of connections served by the acquiring utility.
  - (D) The name and CCN number of the selling utility.
  - (E) The name and contact information of the selling utility's representative.
  - (F) The number of connections served by the selling utility.
  - (G) The estimated closing date of the planned acquisition.
  - (H) A list of the utility valuation experts on the commission's list of qualified experts who, as of the date of the notice of intent, are precluded under subsection (e)(2)(B) of this section from performing an appraisal of the transaction.
- (3) The notice of intent must not include the purchase price agreed upon by the acquiring utility and the selling utility.

(e) **Selection of utility valuation experts.**

- (1) The commission's executive director or the executive director's designee will select three utility valuation experts from the list maintained under subsection (c) of this section no later than 30 days after the filing of a notice of intent to determine fair market value that meets the requirements of subsection (d) of this section.
- (2) The utility valuation experts selected under paragraph (1) of this subsection may not:
- (A) derive material or financial benefit from the sale other than fees for services rendered;
  - (B) be or have been within the year preceding the date the service contract is executed a director, officer, or employee of the acquiring utility or the selling utility or an immediate family member of a director, officer, or employee of the acquiring utility or the selling utility; or
  - (C) have received compensation under a contract for consulting or other services with the acquiring or selling utility, or executed a contract for consulting or other services with the acquiring or selling utility, within the year preceding the date the utility valuation expert is selected.
- (3) The commission's executive director or the executive director's designee will base the selection of utility valuation experts on the following:
- (A) Qualifications of the utility valuation expert.
  - (B) Availability of the utility valuation expert during the required time frame.
  - (C) Absence of conflicts of interest described in paragraph (2) of this subsection.
  - (D) Other factors relevant to a utility valuation expert's ability to perform an appraisal under this section.
- (4) The acquiring utility must contract directly with the selected utility valuation experts and the commission will not be a party to the contract. Subsection (k)(2) of this section, which limits the amount of transaction and closing costs that may be recovered in rates, does not apply to the fees for service agreed to in the contract. If the acquiring utility and any of the utility valuation experts selected under subsection (e)(1) of this subsection are unable to reach agreement on the terms and conditions for performing the appraisal, including the amount of the service fee, the acquiring utility or utility valuation expert may submit a request for selection of a different utility valuation expert under the control number designated for that purpose. If the commission's executive director or the executive director's designee selects a different utility valuation expert, the time period for all utility valuation expert to submit a report under subsection (f)(5) of this section begins when the different utility valuation expert is selected.

(f) **Determination of fair market value.**

- (1) The three utility valuation experts selected under subsection (e) of this section jointly must retain a licensed engineer to conduct an assessment of the tangible assets of the selling utility or the facilities to be sold to the acquiring utility.
- (A) The engineer may not be or have been within one year preceding the date the service contract is executed a director, officer, or employee of the acquiring utility or the selling utility or an immediate family member of a director, officer, or employee of the acquiring utility or the selling utility.
  - (B) The engineer must provide the following information to the valuation experts:

- (i) Qualifications that demonstrate the engineer's ability to provide the requested assessment;
      - (ii) The engineer's fees for other similar assessments; and
      - (iii) Other relevant information requested by the utility valuation experts.
    - (C) The engineer's assessment must include a separate assessment for each type of facility based on the applicable National Association of Regulatory Utility Commissioners (NARUC) account for the facility.
    - (D) The fee charged by the engineer must be shared and paid equally by the three utility valuation experts and may be included as part of the utility valuation expert compensation under subsection (k) of this section.
  - (2) Each utility valuation expert must perform an independent appraisal of the selling utility, including the valuation of intangible assets as appropriate, in compliance with Uniform Standards of Professional Appraisal Practice, using the cost, market, and income approaches in accordance with subsections (g) through (i) of this section.
  - (3) The appraisal must not take into account the original sources of funding, including developer contributions or customer contributions in aid of construction, for any of the utility plant that is assessed by the engineer or the utility valuation experts.
  - (4) The appraisal must not take into account the purchase price negotiated by the acquiring utility and the selling utility or methodologies or process used to arrive at the purchase price.
  - (5) Each utility valuation expert must submit a completed report to the acquiring utility and the selling utility no later than 120 days after the date the commission's executive director or the executive director's designee selects the utility valuation expert under subsection (e) of this section. Before the submission of the report, the acquiring and selling utilities must review the report for mathematical and factual errors, and notify the utility valuation expert of any mathematical any factual errors they identify. The utility valuation expert may promptly revise the report in response to the utilities' notification.
  - (6) The ratemaking rate base established under this section will be the rate base for the system or facilities acquired in the transaction. Nothing in this section alters the requirements for multiple system consolidation in §24.25(k) of this title, relating to Form and Filing of Tariffs.
- (g) **Cost approach.**
- (1) A cost approach appraisal performed under this section must be based on one of the following:
    - (A) the investment required to replace or reproduce future service capability; or
    - (B) the original cost of the facilities as adjusted for depreciation.
  - (2) A cost approach appraisal performed under this section must:
    - (A) incorporate the results of the assessment performed by the engineer selected under subsection (f)(1) of this section;
    - (B) exclude from consideration overhead costs, future improvements, and going concern value; and
    - (C) use a consistent rate of inflation for all classes of assets unless use of different rates is reasonably justified.
- (h) **Income approach.**
- (1) An income approach appraisal performed under this section must be based on one of the following:
    - (A) capitalization of earnings or cash flow; or
    - (B) the discounted cash flow method.
  - (2) An income approach appraisal performed under this section must exclude consideration of the following:
    - (A) going concern value;
    - (B) future capital improvements; and
    - (C) erosion of cash flow or erosion on return.
  - (3) An income approach appraisal performed under this section must be supported by the following:
    - (A) an explanation of how the capitalization rate was calculated, if a capitalization rate was used;
    - (B) an explanation of the basis for the discount rates used; and

(C) an explanation of the capital structure, cost of equity and cost of debt used.

(i) **Market approach.**

(1) A market approach appraisal performed under this section must be based on the following:

- (A) the current connection count of the selling utility at the time of the appraisal;
- (B) use of a proxy group that includes companies that have made acquisitions that were not based on a fair market valuation methodology; or
- (C) comparable sales that did not include the value of future capital improvement projects in the selling price.

(2) A market approach appraisal performed under this section must not consider the following:

- (A) a net book financials multiplier or speculative growth adjustments;
- (B) the value of future capital improvement projects; or
- (C) a value or adjustment for the goodwill of the selling utility.

(j) **Contents of utility valuation expert report.** A report submitted under paragraph (f)(5) of this section must include:

- (1) a copy of the service contract executed by the utility valuation expert and the acquiring and selling utilities;
- (2) the fee charged by the utility valuation expert along with documentation supporting the amount of the fee;
- (3) a copy of the engineer's report, including a detailed list of the utility plant assessed by the engineer;
- (4) an explanation of how the cost, market, and income approaches were incorporated into the calculation of the fair market value of the selling utility or the selling utility's facilities; and
- (5) a notarized affidavit stating that:
  - (A) the appraisals described in the report were conducted in compliance with the most recent edition of the Uniform Standards of Professional Appraisal Practice;
  - (B) the utility valuation expert will not derive material or financial benefit from the sale other than the fee for services rendered;
  - (C) the utility valuation expert is not currently and was not within the year preceding the date of the contract for service executed between the utility valuation expert and the acquiring and selling utilities, a director, officer, or employee of the acquiring utility or the selling utility or an immediate family member of a director, officer, or employee of the acquiring utility or the selling utility; and
  - (D) the utility valuation expert did not receive compensation under a contract for consulting or other services with the acquiring utility or selling utility, or execute a contract for consulting or other services with the acquiring or selling utility, within the year preceding the date the utility valuation expert was selected to perform the appraisal that is the subject of the report.

(k) **Transaction and closing costs.**

(1) A fee paid to a utility valuation expert to perform an appraisal under subsection (f) of this section may be included in the transaction and closing costs associated with a transaction approved under §24.239 of this title, relating to Sale, Transfer, Merger, Consolidation, Acquisition, Lease or Rental.

(2) The commission will review the transaction and closing costs, including fees paid to utility valuation experts, in the rate case in which the acquiring utility requests rate recovery of those costs. The fee amounts included in transaction and closing costs that are recoverable in the acquiring utility's rates may not exceed the lesser of:

- (A) five percent of the fair market value; or
- (B) the fee amounts approved by the commission in the rate case in which the acquiring utility requests rate recovery of the transaction and closing costs.