

SUBJECT: Revising the powers and duties of the TCEQ and related entities

COMMITTEE: Natural Resources — committee substitute recommended

VOTE: 9 ayes — Ritter, Callegari, Corte, Creighton, Frost, T. King, Lucio, D. Miller, Smithee

0 nays

2 absent — Laubenberg, Martinez Fischer

SENATE VOTE: On final passage, April 20 — 30-0

WITNESSES: For — (*Registered, but did not testify:* David Frederick, Texans Against Monarch’s Excessive Rates)

Against — Tatiana Olea, Southwest Water Company

On — Todd Chenoweth, Texas Commission on Environmental Quality

BACKGROUND: Water Code, ch. 13 governs water rates and services among public retail utilities. Subch. F, which does not apply to municipalities, counties, districts, or water supply or sewer service corporations, requires a utility making a change in its rates to deliver a statement of intent to each ratepayer and with the appropriate regulatory authority at least 60 days before the effective date of the proposed change. The comment period of a rate proceeding is a total of 150 days from the date of the statement of intent. When a case is appealed to the State Office of Administrative Hearings (SOAH), SOAH can set an interim rate on a motion by the executive director or a rate payer. The executive director can file a motion with the Texas Commission on Environmental Quality (TCEQ) commission, and the commission can set the interim rate.

The executive director of the TCEQ can suspend a rate increase for defective notice or if the application was filled out incorrectly, but these suspensions are effective only until the applicant corrects the deficiency, which may only take a few days. The TCEQ commissioner may suspend a

rate increase for a maximum of 150 days if the TCEQ has received the minimum number of protests to trigger a hearing.

Water Code Section 13.187(f) requires investor-owned utility rate hearings to be held locally if more than half of the customers reside in a county with a population of more than 2.5 million (Harris County).

Under Water Code, section 5.1175, the length of payment plans for civil or administrative penalties for small businesses is a maximum of 12 months.

Water Code, sec. 13.145 states that a utility may consolidate more than one utility system under a single tariff only if:

- the systems under the tariff are substantially similar in terms of facilities, quality of service, and cost of service; and
- the tariff provides for rates that promote water conservation for single-family residences and landscape irrigation.

Water Code, sec. 13.242(c) authorizes small water utilities with fewer than 15 connections to be exempt from obtaining a Certificate of Convenience and Necessity. However, they must register with the TCEQ and are allowed to operate under simplified rate and service rule requirements. The law currently does not allow an exemption for small sewer utilities.

SB 3 by Averitt, enacted by the 80th Legislature in 2007, inadvertently negated a portion of the 2001 TCEQ Sunset legislation, HB 2912 by Bosse, relating to the Clean Rivers Program (CRP). The Sunset legislation consolidated the CRP dedicated fee with the wastewater treatment inspection fee. The primary purpose for the CRP fee was to pay for water quality monitoring and assessments conducted by river authorities. The Sunset legislation also enacted other changes to effectuate the fee consolidation, including deletion of the following provisions from sec. 26.0135(h) of the Water Code: a \$5,000,000 annual limit on recovery of costs; a requirement that revenue be deposited in the Water Resource Management Account and that it be used only for the purposes of sec. 26.0135(h); a limit of 10 percent of annual recovered costs to be applied to overhead related to implementation of sec. 26.0135(h) and regional water quality assessments; and a provision requiring the commission to file a written report with the governor, the lieutenant governor, and the speaker accounting for costs recovered.

The purpose behind the Sunset legislation's consolidation of the water quality fee funds was to provide the agency with the flexibility necessary to manage best its limited funding resources to meet the needs of its water quality programs. The limitations that were necessary for the stand-alone CRP fee were struck when the funds were consolidated, but were inadvertently reinstated without any change being made to the consolidated fee fund structure.

DIGEST:

CSSB 1846 would amend current law to address the powers and duties of Texas Commission on Environmental Quality (TCEQ) and related entities. The bill would grant the executive director of TCEQ certain authority held by the agency, including the authority to establish interim rates, issue administrative orders assessing penalties, and issue orders for corrective measures. The bill would extend the length of time that a rate could be suspended and would remove the requirement that rate hearings be held locally. The bill would require a person who owned or operated a water well under certain conditions to ensure that the well water was treated by an approved chlorination system. The bill would authorize a person, rather than a small business, to pay a penalty in periodic installments. The bill also would add provisions regarding utility facilities construction and improvement charges, the use of a single tariff, rates of depreciation, approval of certain entities to render sewer service without a certificate of public convenience and necessity, and watershed and water quality monitoring. The bill also would repeal provisions relating to the setting of public hearing dates.

Interim rates. TCEQ or the executive director could fix interim rates at any time during the pendency of the rate proceeding no later than the 120th day after the proposed effective date of the proposed rate change. The interim rates established by the executive director could not be lower than the rates on the utility's approved tariff or higher than those in the application of the utility. The executive director would be required to consider only representative operating data for the test year proposed in the application of the utility and could request additional data or information for the test year. The executive director would be required to consider:

- whether the interim rate would preserve the financial integrity of the utility;
- whether the interim rate would provide sufficient money for necessary capital improvements;

- whether the interim rate distributed equitably costs to customers; and
- any other factors to balance the public's and utility's interests.

If the executive director established an interim rate, the director would be required to issue an order that stated the basis on which the interim rate was established.

CSSB 1846 would require a retail public utility to refund or credit the difference between the interim rate and the final rate plus interest if TCEQ set a final rate that was lower than the interim rate, unless otherwise agreed to by the parties to the proceeding. If TCEQ set a final rate that was higher than the interim rate, the retail public utility could collect the difference between the interim rate and the final rate.

Suspending rates. CSSB 1846 would extend the length of time that a rate could be suspended once TCEQ had received the minimum number of protests to trigger a hearing from 150 days to 250 days.

Enforcement authority. The TCEQ could delegate to the executive director the authority to issue an administrative order, including the authority to assess penalties or order corrective measures to ensure compliance with provisions of the Water Code and Health and Safety Code within TCEQ's jurisdiction.

Rate hearings. CSSB 1846 would remove the requirement that rate hearings be held locally if more than half of the ratepayers of the utility received service in a county with a population of more than 2.5 million (Harris County).

Treatment and testing of well water. A person who owned or operated a water well that, for compensation, provided water to three to 14 residences would be required to ensure that the well water was treated with chlorine or a chlorine compound. The chlorination system for the well water would have to be designed by a professional water engineer and plans would have to be submitted to the TCEQ for approval before use. The chlorination system would have to be maintained and kept in functional operating condition.

The owner or operator of the well, in coordination with the local health department, would have to test for foreign organisms every six months and provide TCEQ and the recipients of water from the well with the results.

Extending the payment period for penalties. CSSB 1846 would amend Water Code, sec. 5.1175, to authorize TCEQ to allow a person who owed a monetary penalty for a violation of law within TCEQ's jurisdiction to pay the penalty, and would change the period to 36 months. The bill would disallow a small business to pay a penalty by installment.

Utility facilities construction and improvement charge. CSSB 1846 would amend Water Code, ch. 13, subch. F to allow a utility to assess a facilities construction and improvement charge to recover the depreciation and return on investment of a project that:

- was completed and placed into service between two consecutive statements of intent to change the utility's rates; and
- served the utility's service area, including a facility used for managing potable water or sewage.

TCEQ would make rules to require a utility that proposed to assess a facilities construction and improvement charge to file a schedule of rates establishing a method for calculating the charge and to receive the approval of the TCEQ. In adopting rules, TCEQ would have to ensure that at least 60 days before a utility's proposed charge increased, the utility would have to submit a notice that contained:

- the amount of the proposed charge or increase of a charge;
- the proposed implementation date;
- a list of completed, eligible capital projects, and related depreciation and return on investment for which the utility sought reimbursement; and
- a calculation of the projected total annual increase in revenue.

The rules would have to provide that the TCEQ could audit annually the total amount the utility would be authorized to recover and the amount the utility actually recovered through the charge. The requested charge would also be based on the amount necessary to ensure that the charge yielded a rate of return on invested capital equal to either the rate of return approved for the utility, or the rate of return the utility proposed if the most recent change was approved by a settlement. TCEQ also, by rule, would have to

ensure that utility charges would be subject to additional constraints, including:

- the cumulative annual amount to be recovered could not exceed 10 percent of the utility's annual revenue;
- the utility could not implement an increase more than twice a year;
- the charge would be applied to each customer;
- the utility would provide notice of the charge to each customer; and
- the charge would be subject to a "true-up" at the utility's next rate case.

The implementation of a facilities construction and improvement charge or an increase of the charge would not be subject to a contested case hearing.

The bill would not apply to a utility that had in place a negotiated stay-out agreement as of September 1, 2009.

Single tariff. CSSB 1846 would amend Water Code, sec. 13.145 to state that a utility could consolidate more than one system under a single tariff on a regional or statewide basis if the tariff provided for rates that promoted water conservation for single-family residences and landscape irrigation.

Rates of depreciation. The TCEQ would require, by rule, that the book cost, less net salvage of depreciable utility plant retired, be charged in its entirety to the accumulated depreciation account, consistent with accounting treatment for other TCEQ and Public Utility Commission-regulated electric and gas utilities.

Sewer service. CSSB 1846 would allow TCEQ to allow a municipality, utility, or water supply corporation to render sewer service without a Certificate Of Public Convenience And Necessity if a municipality had given notice, or if a utility or water supply corporation had less than 15 potential connections and was not within the certificated area of another utility.

Watershed and water quality monitoring. CSSB 1846 would remove language requiring TCEQ to apportion, assess, and recover reasonable costs of administering watershed and water quality monitoring programs from water and wastewater permit holders. The bill would remove language requiring water quality monitoring program funds to be

equitably apportioned among basins, provisions relating to rules concerning apportionment, assessment, and recovery of costs, and the requirement that the TCEQ, assisted by a river authority, file a written report accounting for the costs.

District dissolution and conversion. CSSB 1846 would repeal Water Code Sections 49.322 and 54.031, relating to setting a date for a hearing for a district dissolution and establishing a date for a hearing regarding conversion of a municipal utility district, respectively.

Effective date. The bill would take effect September 1, 2009, except that the provision relating to the treatment and testing of well water would take effect September 1, 2010.

**SUPPORTERS
SAY:**

Interim rates. CSSB 1846 would allow the executive director of the TCEQ to set an interim rate. Currently, the executive director must request that the commission set interim rates, resulting in a delay of six to nine months after a rate application has been filed. Allowing the executive director to set an interim rate would shorten significantly the time required for implementation, because the executive director could act shortly after the application was filed rather than waiting to get on the commission's busy calendar. If the executive director set an interim rate that the utility felt was not supported by the evidence of the application, they still would be able to file a motion to overturn with the TCEQ or go to SOAH to get an adjustment.

Utility facilities construction and improvement charge. CSSB 1846 would provide for the construction of necessary utility infrastructure in a more timely manner and would allow for charges for infrastructure to be assessed on a more gradual basis. Investor-owned utilities, of which there are approximately 600 in Texas, provide water and sewer services requiring massive capital expenditures to expand and update infrastructure. The current process for seeking a rate change to support an infrastructure project is unduly burdensome and time-consuming for utilities. The process can take months or years, may be costly in itself, and can discourage many utilities from pursuing necessary infrastructure improvements. The utility also may lose timely revenue through a rate suspension authorized as part of existing rate-change hearing and review processes.

CSSB 1846 would allow utilities to impose a system infrastructure improvement charge between rate charge review processes. The improvement charge would help offset actual expenses and opportunity costs incurred through the rate charge review process and would enhance a utility's ability to provide necessary infrastructure, such as water and sewer mains, system extensions, system cleaning and repair, and facility relocations, without having to wait for conclusion of the rate review process. The charge could be adjusted biannually based on changing project needs. The gradual increases would be a beneficial alternative to the current process, which requires the utility to seek large rate charge increases infrequently.

The bill would give TCEQ rulemaking and review authority necessary to ensure that improvement charges were reasonable and that they would approximate the cost of services they were collected to provide. TCEQ would provide an annual audit of the total amount authorized and the revenue the utility received. The amount of the charge would be limited to the rate of return proposed in a rate change application or a rate approved by a settlement and would have an ultimate cap of 10 percent of the utilities annual revenue. Further, any charges imposed could be adjusted through a "true-up" provided in the bill as part of the utility's next proposed rate change.

Single tariff. CSSB 1846 would allow water utilities that operated multiple water systems to consolidate all customers into a unified rate structure, or use single-tariff pricing, on a regional or statewide basis. Utilities regularly improve water systems to increase efficiencies in water use and to ensure that the system meets regulatory standards. Such upgrades are capital-intensive and, depending on the number of customers in a given water system, can be onerous to individual ratepayers. In an effort to defray the needed capital costs for system upgrades, utilities can institute single tariff pricing in order to spread the costs of system upgrades across all their systems. This allows utilities to take advantage of economies of scale to spread capital costs over an enlarged customer pool while increasing its overall operating efficiency, thereby minimizing the need for rate increases while allowing the utility to make system improvements as needed for the benefit of customers.

Currently, utilities cannot institute single tariff pricing for their systems unless the systems are "substantially similar" in their cost, infrastructure, and quality of service. This subjective standard has led to costly and

prolonged rate cases, ultimately leading to increased rates for utility customers. CSSB 1846 would address this issue and allow utilities eventually to upgrade facilities for all their customers at a lower cost. Under the bill, TCEQ still would have rate jurisdiction to hear customer protests on the grounds of cost.

Rates of depreciation. CSSB 1846 would allow a utility to account for the cost of salvaging assets in book value if there was a loss on the salvage rather than a gain.

CSSB 1846 would allow water and sewer utilities to be able to recover, as a cost of service, any remaining depreciation on retired assets and would bring Texas into parity with all 49 other states, and water and sewer utilities into parity with gas and electric utilities in Texas. Although this bill could allow assets to be left in a depreciable account where a utility still could make a return, the TCEQ could prevent this from happening through rulemaking.

OPPONENTS
SAY:

Interim rates. Allowing the executive director of the TCEQ to set interim rates would simplify the process, but there would need to be a definite timeframe for an interim rate to stay in effect so that it would not be able to drag on for an undefined period of time. Otherwise, there should be opportunity for a utility to comment to the commission before an interim rate was established. CSSB 1846 would allow for a strictly administrative decision. The executive director would be required to consider a utility's application, but would not allow the utility any real opportunity to comment if the executive director did not agree with the information provided in the application. This would allow the executive director to make a decision unilaterally on rates, limiting the opportunity for input not only from the utility, but from the ratepayer as well.

Utility facilities construction and improvement charge. CSSB 1846 would circumvent existing consumer protections meant to safeguard ratepayers who receive water or wastewater services from an investor-owned utility. Existing processes require such a utility to file a rate change case and potentially go through a hearing process if the change is met with complaints. As part of the hearing process, the utility has to demonstrate the need for the rate increase and justify the increase to a regulating body — a municipality, if the utility is in municipal jurisdiction, or TCEQ otherwise. The existing rate change review process was specifically

established to protect against unjustified rate increases on critical public necessities — water and wastewater services.

The bill could result in major increases to utility rates for customers that have no alternative service providers. Since the bill would remove existing provisions subjecting utility rate increases to review and would not allow the charge increase to be contested through other state proceedings, the bill in effect would authorize automatic rate increases with no recourse. The fact that the increase would show up on a bill as an improvement charge as opposed to a rate increase would not make any difference to consumers.

Provisions in the bill would be inadequate to protect consumers from compounding, runaway rate increases. TCEQ would be given no additional resources to perform an audit of charges, which would require considerable staff time. Further, the “true-up” provision in the bill would not be effective in protecting consumers, since there would be no requirement that this evaluation process take effect in a particular timeframe. A few years could elapse before the true-up process could modify charges, and with an annual surcharge, there may not even be any need for a rate charge review.

Single tariff. CSSB 1846 would remove current consumer protections for ratepayers to dispute proposed rate increases for system improvements that do not benefit them. The bill effectively would create winners and losers by allowing ratepayers who had paid for their system upgrades unfairly to subsidize those whose systems needed improvements. For individuals with fixed or modest incomes, this would represent a particularly onerous burden. Also, while customers still could protest rate increases, removing the “substantially similar” requirement for consolidation could make rate increases for any system upgrades a legitimate cost for a utility assessing a regional or statewide rate. As such, the bill effectively would remove any grounds on which customers could protest a rate increase.

NOTES:

The House committee substitute differs from the Senate-passed version by:

- adding a provision regarding the treatment and testing of well water;
- providing the TCEQ enforcement authority to assess penalties or order corrective measures to ensure compliance;

- adding a provision regarding rates of depreciation;
- providing for the use of a single tariff;
- adding a provision regarding interim rates; and
- adding a provision allowing utility facilities to assess construction and improvement charges.