

## **BILL ANALYSIS**

C.S.H.B. 2741  
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Natural Resources  
Committee Report (Substituted)

### **BACKGROUND AND PURPOSE**

Utilities are among the most capital intensive industries, with water utilities more capital intensive than natural gas, electric, and telephone utilities. Water and wastewater utilities face a significant financial challenge to replace aging infrastructure and upgrade treatment as required by increasingly stringent requirements.

A system infrastructure improvement charge allows drinking water and wastewater utilities to replace infrastructure to improve reliability, to comply with environmental requirements, and to create solutions to regional water supply problems in a timely, cost-effective manner. Such a surcharge was adopted in Pennsylvania in 1996 and has since been implemented in at least seven other states.

Such a charge is a rate-case reform that allows adjustments to customer charges for one component of a utility's cost of providing public service without requiring a broad, costly, and time-consuming rate case. The surcharge has the potential to reduce rate-case expenses by extending the time between future base rate filings.

The surcharge allows a utility to accelerate investment in needed infrastructure projects that improve health, safety, and reliability, which are typically not the primary concern in a base rate case. These are non-revenue-producing, non-expense-reducing projects. The costs of extending facilities to serve new customers are not included.

Eligible projects might include wells, treatment works, services, meters, hydrants, mains, and valves installed as in-kind replacements; main extensions installed to eliminate dead ends and to address regional water supply problems; main cleaning and relining; and costs to relocate facilities, wastewater collection, and treatment.

The surcharge is adjusted at most on a quarterly basis to reflect eligible infrastructure additions after they are completed and placed in service and is required to be reviewed by the Texas Commission on Environmental Quality (TCEQ) annually.

The system infrastructure improvement charge is not intended to bypass the traditional ratemaking process. Costs recovered are subject to an annual audit by TCEQ and the amount of the surcharge is capped to prevent any long-term evasion of a base rate review of plant costs.

C.S.H.B. 2741 authorizes a water and sewer utility to charge a system construction and improvement charge to recover the depreciation and return on investment of a project that is completed and placed into service between two consecutive statements of intent to change the utility's rates or tariff and serves the utility's certificated service area. The bill requires TCEQ to adopt standards relating to such a charge.

### **RULEMAKING AUTHORITY**

It is the committee's opinion that rulemaking authority is expressly granted to the Texas Commission on Environmental Quality in SECTIONS 1 and 3 of this bill.

## **ANALYSIS**

C.S.H.B. 2741 amends the Water Code to authorize a water and sewer utility to assess a utility facilities construction and improvement charge to recover the depreciation and return on investment of a utility facilities construction and improvement project that is completed and placed into service between two consecutive statements of intent to change the utility's rates or tariff filed under provisions related to a statement of intent to change rates and serves the utility's certificated service area, including a facility used for the production, transmission, storage, distribution, or provision of potable or recycled water to the public or the collection, transportation, treatment, or disposal of sewage.

C.S.H.B. 2741 requires the Texas Commission on Environmental Quality (TCEQ) by rule to require a utility that proposes to assess such a charge to file a tariff establishing a just and reasonable manner for calculating the charge and to receive the executive director's approval of the tariff.

C.S.H.B. 2741 requires TCEQ, in adopting rules, to ensure that:

- not later than the 60th day before a utility's proposed inclusion of a charge or proposed increase of a charge in a tariff, the utility submits to the executive director for review of a project's eligibility a written notice containing the amount and proposed implementation date of the proposed charge or increase of a charge, a list of completed, eligible capital projects, and related depreciation and return on investment for which the utility seeks reimbursement through the charge or increase, and a calculation of the projected total annual increase in revenue due to the charge or increase;
- the total amount the utility is authorized to recover annually through a charge and the amount the utility actually recovers are subject to annual audit by the executive director;
- the amount of the charge the utility requests authorization to assess is based on the amount necessary to ensure that the surcharge yields a rate of return on invested capital that is equal to the rate of return approved for the utility in the utility's most recent approved base rate or tariff change application or the rate of return proposed by the utility if the rates in the utility's most recent base rate or tariff change application were approved by settlement;
- the cumulative annual amount the utility proposes to recover from the charge does not exceed an amount equal to 10 percent of the utility's annual revenue;
- the utility does not implement an increase under the bill's provisions more often than twice every calendar year;
- the charge is applied to each customer included in the tariff;
- the utility provides to each customer written notice of the charge on the initial tariff filing that proposes to implement the charge; and
- the charge is subject to a true-up or reconciliation at the utility's next rate case.

The bill provides that the implementation of a charge or an increase in a charge is not subject to a contested case hearing and specifies that these provisions do not apply to a utility that has in place a negotiated stay-out agreement on September 1, 2009.

C.S.H.B. 2741 requires TCEQ to adopt rules consistent with the bill's provisions not later than December 1, 2009.

## **EFFECTIVE DATE**

September 1, 2009.

## **COMPARISON OF ORIGINAL AND SUBSTITUTE**

C.S.H.B. 2741 authorizes a utility to assess a utility facilities construction and improvement charge, rather than a system construction and improvement surcharge as in the original, to recover the depreciation and return on investment of a utility facilities construction and improvement project that meets certain conditions, rather than the depreciation and pre-tax return costs of a project that meets other certain conditions as in the original, and makes conforming changes.

C.S.H.B. 2741 removes provisions in the original requiring the Texas Commission on Environmental Quality (TCEQ) by rule to adopt standards regarding the types of projects for which a utility is authorized to assess a surcharge and requiring a utility that proposes to assess a surcharge to file a tariff establishing the manner in which the utility intends to assess the charge. The substitute adds provisions not in the original requiring TCEQ by rule to require a utility that proposes to assess a charge to file a tariff establishing a just and reasonable manner for calculating the charge and to receive the executive director's approval of the tariff.

C.S.H.B. 2741 removes provisions in the original that require TCEQ, in adopting rules, to ensure that the utility submits a proposed capital budget to the executive director for review and approval specifying the projects and related depreciation and pre-tax return costs in relation to which the utility wants to impose the surcharge, and adds a provision not in the original requiring a utility to submit within a specified period a written notice to the executive director for review of the project's eligibility that contains the amount and proposed implementation date of the proposed charge or increase of a charge, a list of completed, eligible capital projects, and related depreciation and return on investment for which the utility seeks reimbursement through the charge or increase, and a calculation of the projected total annual increase in revenue due to the charge or increase.

C.S.H.B. 2741 adds a provision not in the original requiring TCEQ, in adopting rules, to ensure that, alternately, the amount of the charge is based on an amount equal to the approved rate of return for the utility in the most recent tariff change application or the rate of return proposed by the utility if the rates in the utility's most recent base rate or tariff change application were approved by settlement. The substitute differs from the original by requiring TCEQ, in adopting rules, to ensure that the utility does not implement a charge increase more often than twice every calendar year, whereas the original prohibits such an increase more often than once each calendar quarter. The substitute adds a provision not in the original requiring TCEQ rules to ensure that the charge is subject to a true-up or reconciliation at the utility's next filed rate case.

C.S.H.B. 2741 removes a provision in the original specifying that the implementation of a surcharge or an increase in a surcharge is not a rate change requiring the delivery of a statement of intent to change rates or a subsequent hearing. The substitute adds provisions establishing that the implementation of a charge or an increase in a charge is not subject to a contested case hearing and specifying that these provisions do not apply to a utility that has in place a negotiated stay-out agreement on September 1, 2009.