

BILL ANALYSIS

Senate Research Center

H.B. 3542
By: Phelan (Lucio)
Water & Rural Affairs
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Engrossed

AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

Current statutes in Texas can restrict private or privately-regulated water utilities' ability to recover an investment from the acquisition of a public or private water or wastewater system to its original cost. Due to current statute, some public systems are often deprived from receiving full market value for their assets and regulated water utilities are prevented from recouping their entire investment. H.B. 3542 removes these barriers by creating an optional and voluntary valuation appraisal process to determine the asset value while providing clarity to the valuation and rate-making process when a private or publicly-regulated utility acquires the water or wastewater assets of a public or private system.

H.B. 3542 amends current law relating to the provision of water and sewer services by certain retail public utilities.

RULEMAKING AUTHORITY

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Subchapter E, Chapter 13, Water Code, by adding Section 13.150, as follows:

Sec. 13.150. REPORTS REQUIRED FOR WATER AND SEWER UTILITIES. (a) Provides that this section applies only to a utility that provides retail water or sewer utility service through fewer than 10,000 taps or connections.

(b) Requires a utility, except as provided by Subsection (c), to deliver to the Public Utility Commission of Texas (PUC) a report of the utility's financial, managerial, and technical capacity to provide continuous and adequate service to its customers not later than the third anniversary of the date that the utility violates a final order of the Texas Commission on Environmental Quality (TCEQ) by failing to:

- (1) provide system capacity that is greater than the required raw water or groundwater production rate or the anticipated daily demand of the system;
- (2) provide a minimum pressure of 35 pounds per square inch throughout the distribution system under normal operating conditions; or
- (3) maintain accurate or properly calibrated testing equipment or other means of monitoring the effectiveness of a chemical treatment or pathogen inactivation or removal process.

(c) Provides that a utility that has an existing obligation to deliver a report under Subsection (b) is not required to deliver another report as a result of the occurrence of an event described by Subsection (b) if the event occurs before the date that the utility delivers the report required by Subsection (b).

(d) Requires TCEQ, on receiving notice that a utility has violated an order described by Subsection (b), to provide written notice of the violation to the PUC.

(e) Requires the PUC to deliver a copy of a report received under Subsection (b) to:

(1) each state senator representing a district that contains a portion of the service area of the utility that submitted the report; and

(2) each state representative representing a district that contains a portion of the service area of the utility that submitted the report.

(f) Requires the PUC, if a utility fails to deliver a report in accordance with Subsection (b), to report the failure to:

(1) TCEQ;

(2) each state senator representing a district that contains a portion of the utility's service area; and

(3) each state representative representing a district that contains a portion of the utility's service area.

SECTION 2. Amends Subchapter H, Chapter 13, Water Code, by adding Section 13.305, as follows:

Sec. 13.305. VOLUNTARY VALUATION OF ACQUIRED UTILITY OR FACILITIES. (a) Defines "acquiring utility," "ratemaking rate base," and "selling utility."

(b) Requires the PUC to maintain a list of experts qualified to conduct economic valuations of utilities for the purposes of this section.

(c) Authorizes an acquiring utility and a selling utility to agree to determine by the following process the fair market value of the selling utility or the facilities to be sold, as applicable:

(1) the acquiring utility and the selling utility are required to notify the PUC of their intent to determine the fair market value under this section;

(2) not later than the 30th day after the date the PUC receives notice under Subdivision (1), the PUC is required to select three utility valuation experts from the list maintained under Subsection (b);

(3) each utility valuation expert is required to perform an appraisal in compliance with Uniform Standards of Professional Appraisal Practice, employing the cost, market, and income approaches, to determine the fair market value; and

(4) the three utility valuation experts selected under Subdivision (2) jointly are required to retain a licensed engineer to conduct an assessment of the tangible assets of the selling utility, or the facilities to be sold, as applicable, and each utility valuation expert is required to:

(A) incorporate the assessment into the appraisal under the cost approach required under Subdivision (3); and

(B) provide the completed appraisal to the acquiring utility and the selling utility in a reasonable and timely manner.

(d) Prohibits a utility valuation expert described by Subsection (b) from:

(1) deriving any material financial benefit from the sale other than fees for services rendered; or

(2) being or having been within the year preceding the date the service contract is executed an immediate family member of a director, officer, or employee of the acquiring utility or the selling utility.

(e) Authorizes a fee paid to a utility valuation expert to be included in the transaction and closing costs associated with the acquisition by the acquiring utility. Prohibits a fee from exceeding the lesser of:

(1) five percent of the fair market value; or

(2) a fee amount approved by the PUC.

(f) Provides that, for the purposes of the acquisition, the fair market value is the average of the three utility valuation expert appraisals conducted under Subsection (c).

(g) Provides that for an acquisition of a selling utility, the ratemaking rate base of the selling utility is the lesser of the purchase price negotiated by the acquiring utility and the selling utility or the fair market value. Requires that the ratemaking rate base of the selling utility be incorporated into the rate base of the acquiring utility during the utility's next rate base case under Subchapter F.

(h) Requires the acquiring utility, if the acquiring utility and the selling utility use the process for establishing fair market value in Subsection (c), to submit as attachments to an application required under Section 13.301:

(1) copies of the three appraisals performed by the utility valuation experts under Subsection (c);

(2) the purchase price agreed to by the acquiring utility and the selling utility;

(3) if applicable, the ratemaking rate base determined under Subsection (g);

(4) if applicable, the transaction and closing costs incurred by the acquiring utility that will be included in the utility's rate base; and

(5) if applicable, a tariff containing a rate equal to the existing rates of the selling utility at the time of the acquisition.

(i) Requires the PUC, if the PUC approves the application for acquisition under Section 13.301 (Report of Sale, Merger, ETC; Investigation; Disallowance of Transaction), to issue an order that includes:

(1) the ratemaking rate base of the selling utility as determined under Subsection (g); and

(2) any additional conditions for the acquisition the PUC requires.

(j) Requires a tariff submitted under Subsection (h)(5) to remain in effect until the PUC approves new rates as part of a rate base case proceeding.

(k) Provides that the original sources of funding for any part of the water or sewer assets of the selling utility are not relevant to determine the value of the selling utility's assets. Requires the selling utility's cost of service to be

incorporated into the revenue requirement of the acquiring utility's next rate base case proceeding.

(l) Defines "allowance of funds used during construction" for purposes of this subsection. Requires an acquiring utility's postacquisition improvements to accrue an allowance of funds used during construction after the date the cost was incurred until the earlier of:

(1) the fourth anniversary of the date the asset entered into service; or

(2) the inclusion of the asset in the acquiring utility's next rate base case.

(m) Requires depreciation on an acquiring utility's postacquisition improvements to be deferred for book and ratemaking purposes.

SECTION 3. Amends Section 13.4132(a), Water Code, as follows:

(a) Authorizes the PUC or TCEQ, after providing to the utility notice and an opportunity to be heard by the commissioners at a PUC or TCEQ meeting, to authorize a willing person to temporarily manage and operate a utility if the utility:

(1)–(2) makes nonsubstantive changes to these subdivisions; or

(3) provides retail water or sewer utility service through fewer than 10,000 taps or connections and violates a final order of TCEQ by failing to:

(A) provide system capacity that is greater than the required raw water or groundwater production rate or the anticipated daily demand of the system;

(B) provide a minimum pressure of 35 pounds per square inch throughout the distribution system under normal operating conditions; or

(C) maintain accurate or properly calibrated testing equipment or other means of monitoring the effectiveness of a chemical treatment or pathogen inactivation or removal process.

SECTION 4. (a) Requires a utility that provides retail water or sewer utility service through fewer than 10,000 taps or connections and that, not more than three years before the effective date of this Act, violated an order described by Section 13.150(b), Water Code, as added by this Act, except as provided by Subsection (b) of this section, to submit a report described by Section 13.150(b), Water Code, as added by this Act, not later than the fifth anniversary of the event.

(b) Provides that a utility that provides retail water or sewer utility service through fewer than 10,000 taps or connections and that has an existing obligation to deliver a report under Subsection (a) of this section is not required to deliver another report as a result of the occurrence of an event described by Section 13.150(b), Water Code, as added by this Act, if the event occurs before the date that the utility delivers the report required by Subsection (a) of this section.

SECTION 5. Effective date: September 1, 2019.