

Briefing Paper

The Texas Model of Regulation of Water and Wastewater Utilities

The National Regulatory Research Institute

March 2006

Melissa J. Stanford
Senior Research Specialist

EXECUTIVE SUMMARY

State public utility commissions are impacted when demands on water and wastewater utilities increase and come to the fore. Currently new environmental regulations and the need to attend to and in some cases replace neglected, aging infrastructure combine to place upward pressure on rates. State economic regulators in many states are finding it useful and necessary to work more closely with state environmental authorities. Sometimes such cooperation is informal. In other states, a memorandum of understanding sets forth provisions for information exchange and cooperative efforts. In Texas, it's the Commission on Environmental Quality that has responsibility for both environmental and economic regulation of water and wastewater utilities among many other environmental and public health protection duties. This paper describes the Lone Star state's holistic approach, a model others may find instructive as they regulate water and wastewater utilities facing complex environmental mandates and the need for significant levels of capital investment in critical infrastructure.

Contents

Introduction	2	Benefits of Combined Approach to Regulating Water and Wastewater Utilities	8
Texas Commission on Environmental Quality (CEQ)	3	Conclusion	9
Water Supply Division Functions	3		

The author wishes to acknowledge Douglas Holcomb and Anthony Bennett of the Texas Commission on Environmental Quality for answering numerous questions and sharing their insights. The author would also like to thank Vivian Witkind Davis and Carmell Brown for careful editing and production. Mistakes in the paper, if any, are the author's alone.

INTRODUCTION

Although the National Association of Regulatory Utility Commissioners (NARUC) member states regulate many things, overall and ordinarily their major responsibilities are oversight of the electricity, natural gas, telecommunications, water, and wastewater industries. Forty-nine state utility commissions and the District of Columbia regulate electricity; all natural gas; all telecommunications; and 44 water supply; and 31 state commissions and the Texas CEQ regulate wastewater.¹ Cable companies, railroad safety, barges, and taxicabs are among the numerous other objects of regulation in some states. When an industry is not rate-regulated by the public utility commission in a state, it might not be regulated at all in that state or another agency may have that responsibility. The Texas Commission on Environmental Quality (CEQ) is a case in point. Like NARUC commissions, the CEQ has multiple commissioners. Unlike them, it has broad responsibilities for public health and environmental protection. Economic regulation of water and wastewater is an important but relatively small part of the agency's functions. The Texas legislature established the all-inclusive agency to provide one-stop shopping for compliance with Texas environmental requirements and access to environmental programs.

Many commissions have strong continuing cooperation and communication with the agencies in their states charged with health and environmental regulation of water utilities. Some

work together via memoranda of understanding, interagency workgroups and train each other in their respective roles. Those states and others may be interested in the CEQ model and how it attempts to assure that utilities provide good customer service at fair rates with a fair rate of return to investors. During a visit to CEQ's Austin headquarters during the NARUC Summer Meetings of 2005, NARUC Staff Subcommittee on Water members and others heard presentations by CEQ staff and CEQ Chairman Kathleen Hartnett White. Questions about CEQ's approach to rate regulation for water and wastewater utilities were many and varied reflecting a high level of interest among those present.

Thus, this briefing paper reviews the organization resources and processes of the CEQ. Benefits of one-stop shopping include cost savings from combining agencies with similar missions, the ability of the commissioners to have multiple perspectives on environmental as well as regulatory needs, and the broad-based knowledge in an array of programs. On the other hand, multiple areas of regulation under an umbrella agency may provide utilities more venues in which to pursue their agendas potentially making it more difficult to put a problem to rest and call a case closed.

The Texas legislature established the all-inclusive agency to provide one-stop shopping for compliance with Texas environmental requirements.

An umbrella agency may provide utilities more venues to pursue their agendas.

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY (CEQ)

The CEQ is a large, complex agency with responsibility for a vast array of public health and environmental protection functions for the state. The commission's stated mission is to protect Texas human and natural resources in a manner consistent with economic development. Focal areas include regulations pertaining to clean air, clean water and safe management of waste.²

Commission Organization

Three full-time commissioners serving six-year terms oversee the second largest environmental regulatory agency in the world. The CEQ employs nearly 3,000 people in a central office and 16 regional offices and manages a budget in the range of \$510 million for the 2006 fiscal year, which comes primarily from state and federal funds.³ Responsibility for setting rates for water and wastewater utilities was moved from the Texas Public Utilities Commission (PUC) as part of a PUC reorganization in the 1980s. Those duties were assigned to the CEQ in 1986. For the last seven years, the CEQ has been functionally organized; previously duties were organized around the media being regulated.⁴ (See Figure 1 for the CEQ organizational chart.)

Objectives

Objectives of CEQ oversight of water and wastewater utilities are to assure that they have the financial, technical

and managerial capabilities to reliably serve customers, comply with state and federal environmental mandates, and where warranted, become part of a regional approach to water supply assurance and protection. The Water Supply Division is responsible for programs that ensure the efficient administration of surface water use, the delivery of safe and adequate drinking water, and the provision of dependable utility service at fair levels of compensation.

Three full-time commissioners serving six-year terms oversee the second largest environmental regulatory agency in the world.

WATER SUPPLY DIVISION FUNCTIONS

The Water Supply Division, where regulation of water and wastewater utilities is housed, performs the following functions:

- Oversees [public drinking water](#) protection by implementation of the Safe Drinking Water Act
- Provides [source water assessment](#) and [source water protection](#) for drinking water
- Provides technical assistance on design and operation of [public water systems](#)
- Reviews applications for rate changes, certificates of convenience and necessity, utility sales, district creation, and district bond issues
- [Reviews engineering plans](#) for new or significantly modified public water systems
- Assesses the financial, managerial and technical capabilities of public water systems

The Water Supply Division is one of five divisions within the CEQ's Office of Permitting, Remediation, and Registration.

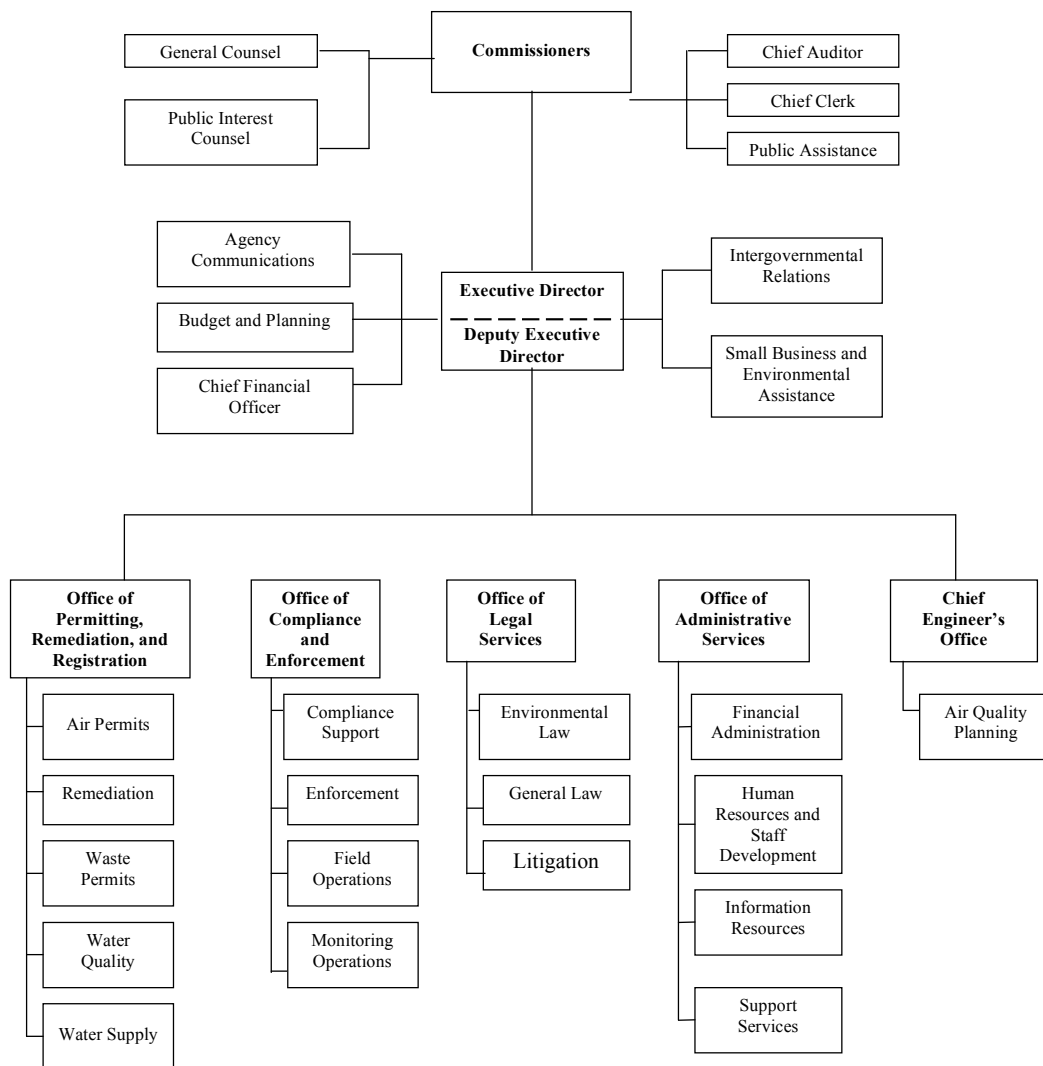


Fig. 1. TCEQ organizational chart as of Jan. 9, 2006.

- Reviews applications for surface water use, water rights ownership changes, and use of river beds and banks
- Provides support to interstate water compacts
- Maintains Water Availability Models for the river basins of Texas
- Serves as state coordinator for the National Flood Insurance Program
- Evaluates [water conservation](#) plans and drought contingency plans
- Administers the [Water-Saving Plumbing Fixtures Program](#)
- Manages the [Water Utility Database](#) and the Water Availability Modeling Database

- Performs groundwater quality planning and assessments
- Provides support for the inter-agency [Texas Groundwater Protection Committee](#) and the Texas Groundwater Protection Strategy
- Manages the state's plan for preventing groundwater pollution from pesticides and the state's program for the identification of priority groundwater management areas⁵

Setting Rates

There are 600-700 investor-owned water utilities over which the CEQ has original jurisdiction. However, the method of setting rates departs from the rate case process typically employed by other state commissions. A rate/tariff change request properly submitted to and approved by the CEQ and noticed to customers will *not* become the subject of a contested hearing unless a threshold number of customer complaints are received by the CEQ. In other words, rates go into effect without a hearing unless customers in sufficient numbers formally complain. (See selected excerpts from the Texas Administrative Code in the box on page 6.)

CEQ's rate authority varies according to the type of utility. For example, CEQ does not have original jurisdiction over municipalities with the exception of unincorporated areas. However, water or sewer customers may appeal a rate change decision made by a board of directors, city council or county commissioners to the CEQ.⁶

Legal Resources

CEQ attorneys handle any type of legal matter involving water or wastewater utilities including those concerned with economic regulation. However, if a rate request is contested, an Administrative Law Judge (ALJ) is appointed from the Office of Administrative Hearings, to handle the case. The ALJ's recommendation or decision then goes before the CEQ commissioners for a final decision and order.⁷

Capacity Development

The CEQ manages the Texas comprehensive Capacity Development Process comprised of the following components:

New System Screening to Prevent New, Non-Viable Systems

- Plans and specification review
- Certificate of convenience and necessity service review (certain systems)
- Business plan review
- Financial assurances
- Creation and bond review (certain systems)

Assess Existing System Capacity Using

- System compliance factor
- System condition factor
- Managerial and financial capacity factor
- Benchmarking
- Systems prioritized for detailed, on-site assessment

A rate/tariff change request submitted and approved by the CEQ will not become the subject of a contested hearing unless a threshold number of complaints are received.

If a rate request is contested, an ALJ is appointed from the state Office of Administrative Hearings, to handle the case.

The commission may reclassify a portion of a utility's proposed rates as a capital improvement surcharge.

Texas CEQ Administrative Rule

The commission may conduct a public hearing on any application.

- (1) If, before the 91st day after the effective date of the rate change or the 61st day for a utility serving in 24 counties on Jan. 21, 2003, the commission receives a complaint from any affected municipality, or from the lesser of 1,000 or 10 percent of the ratepayers of the utility over whose rates the commission has original jurisdiction, or on its own motion, the commission shall set the matter for hearing...
- (3) If the commission does not receive sufficient customer complaints or if the executive director does not request a hearing within 120 days after the effective date, the utility's proposed tariff will be reviewed for compliance with the Texas Water Code and the provisions of this chapter. If the proposed tariff complies with the Texas Water Code and the provisions of this chapter, it shall be stamped approved by the executive director or his designated representative and a copy returned to the utility. The executive director may require the utility to notify its customers that sufficient complaints were not received to schedule a hearing and the proposed rates were approved without hearing.
- (5) If the commission sets a rate different from that proposed by the utility in its notice of intent, the utility shall include in its first billing at the new rate a notice to the customers of the rate set by the commission including the following statement: "The Texas Commission on Environmental Quality, after public hearing, has established the following rates for utility service."
- (6) If the commission conducts a hearing, it may establish rates different from those currently being charged or proposed to be charged by the utility, but the total annual revenue increase resulting from the commission's rates may not exceed the greater of the annual revenue increase provided in the customer notice or revenue increase that would have been produced by the proposed rates except for the inclusion of reasonable rate case expenses. The commission may reclassify a portion of a utility's proposed rates as a capital improvement surcharge if the revenues are to be used for capital improvements or are to service debt on capital items.

Source: Texas Administrative Code, Title 20, Part 1, Chapter 291, Subchapter B, Rule Section 291.28.

CEQ's Water Supply Division contracts with Rural Water to provide regular assistance and consultation to utilities.

Improve Capability of Existing Systems

- Technical assistance
- Corrective action Plans
- Operator certification
- Educational workshops
- Staff visits and contacts
- Regulatory guidance

Managerial Assistance

- Corrective action plans
- Consolidation assessments
- Staff contacts and field visits

- Small towns environment program (STEP)
- Educational workshops
- Regulatory guidance

Financial Assistance

- Drinking Water State Revolving Loan Fund Texas Water Development board (TWDB)
- Other TWDB Loans/Grants
- Rural development
- Community loan fund
- Co-Bank

- Community development block grants
- Private lenders and Small Business Association
- STEP3⁸

CEQ's Water Supply Division contracts with Rural Water to provide regular assistance and consultation to utilities in need or to conduct field assessments. However, internal staff may also carry out these functions particularly in cases where a utility's problems are pervasive and persistent and enforcement actions or the appointment of a receiver may be necessary.⁹

Regionalization Objectives and Practices

Pursuant to CEQ policy guidance,¹⁰ persons seeking to build and operate a water or wastewater system in the Lone Star state are urged, among other requirements, to:

- Request service from all existing providers within two miles of the proposed facility
- Consider the feasibility of regionalization versus a stand-alone system
- Evaluate the affordability of rates for service provided through a regional approach as compared to a stand-alone operation

Texas policy encourages proposed systems to presume that regionalization is feasible or to demonstrate that a stand-alone approach is warranted due to the lack of nearby and willing providers, affordability and other financial considerations show a stand-

alone system to be the most economic option or that the existing system or existing system's technical and managerial capabilities are inadequate. The aim of the CEQ's policy is two-fold:

- To reduce per customer costs by spreading them over a larger number of customers
- To minimize the number of unsustainable utilities¹¹

In practice, there is an understandable tension between the goal of preventing proliferation of stand-alone systems and the profit motive and economic development benefits associated with large, high-density housing developments. As well, adjacent municipal systems may not have the desire or ready capacity to take on a large number of new customers. And larger decentralized systems do have a certain amount of economies of scale to sustain operations—at least in the short run. Over time, however, connecting to a neighboring system may be revealed to have been the better choice and may ultimately take place as a municipality grows and is physically closer to the stand-alone system's service territory. Another potential problem with decentralized systems is when the houses are built and a system created and the new houses simply don't sell.

Public Involvement and Stakeholder Communication

CEQ has an extensive public involvement and advisory program that operates alongside public notices, meetings and opportunities for affected

Texas policy encourages proposed systems to presume that regionalization is feasible or to demonstrate that a stand-alone approach is warranted.

CEQ has an extensive public involvement and advisory program.

ratepayers to make comments before CEQ Commissioners concerning rate decisions. Among the drinking water groups are:

CEQ's combined knowledge and authority increases the agency's efficacy to solve problems and pursue agency-wide goals.

- **Advisory Committee for Water Utility Operator Licensing:** Advisory committee that advises the CEQ on matters related to training and licensing of water and wastewater utility operators
- **Certificate of Convenience and Necessity Stakeholder Meeting:** An open-participation stakeholder group that offers input to CEQ staff regarding rules for establishing public water or sewer utility service areas
- **Drinking Water Advisory Work Group:** An open-participation group, which meets quarterly to discuss compliance with state and federal drinking-water regulations and improving customer service

Some smaller programs, such as utility rate setting, take proportionately more time and resources.

CEQ also has numerous publications available on its website including some that are directed at customers of water and wastewater utilities and written in lay terms, for example, among others:

- “Utility Funding and Rate Design: A Guide for Customers of Private or Investor-Owned Utilities” which describes the ways water and wastewater utilities fund their capital improvements and daily operations in order to provide services to their customers
- “Protesting a Rate Change Made by a Private or Investor-Owned Utility: A Customer Guide to the Public Hearing Process”¹²

Rates matter. Customers can be very vocal when rates are going up.

BENEFITS OF COMBINED APPROACH TO REGULATING WATER AND WASTEWATER UTILITIES

The Texas legislature established the all-inclusive CEQ in order to provide for one-stop shopping for all Texas environmental programs and concerns including those associated with water and wastewater utilities. Benefits of a one-stop shop are obvious and include cost savings associated with combining agencies with similar missions both physically and in terms of staffing. In addition, commissioners who govern all of CEQ's myriad programs have a broad, comprehensive view of Texas environmental needs and opportunities. Commissioners are able to view issues through multiple perspectives and may readily tap into a broad-based knowledge bank populated by CEQ staff working in an array of programs.

At the staff level, knowledge on the environmental side and knowledge on the economic, utility, and regulatory side are mutually available and respective staffs can readily work together in a holistic and comprehensive manner to address problems. An example would be in the case of a utility struggling financially, managerially, and technically and thereby adversely affecting its' customers and other stakeholders. CEQ's combined knowledge and authority increases the agency's efficacy to solve specific problems and pursue agency-wide goals and objectives.

Not all CEQ programs are of equal size nor of equal importance at a given point

in time and some relatively smaller programs, such as utility rate setting, tend to take proportionately more time, resources, public communication, and public involvement. Although the significance of a rate hike may pale when compared to a major environmental infraction, such as a toxic spill, rates matter to customers and customers can be very vocal when rates are going up. In addition, while multiple areas of regulation combined under the umbrella of a single entity helps regulators do their jobs better, the arrangement may also give utilities and others more ways and venues in which to tenaciously pursue their agendas. This may make it more difficult to bring problems and cases to resolution. To reiterate an important point, most of CEQ's work is focused on environmental regulation. Economic regulatory functions are a relatively small part of the agency's duties.

CONCLUSION

Public utility commissions in states with strong ongoing cooperation and communication among the agencies charged with health and environmental regulation of water utilities may be interested in the CEQ model. The regulatory structure in Texas, California's new water action plan¹³ and other newly established or revised approaches to water and wastewater regulation are beginning to reflect—from a state regulatory perspective—the American Water Works Association Research Foundation (and others) resounding admonition that today's water utilities must engage in a holistic approach to

their work.¹⁴ They call this approach Total Water Management, which is the management of water resources with a comprehensive approach balancing resources, demands, and environmental issues. Total Water Management considers water supply, water quality and treatment, storage, conveyance, potential use of alternative water supplies (such as water reuse or desalting of saline waters), conservation and demand-side management, effects of water users, and environmental needs and concerns.¹⁵

Regulatory agency restructuring, broad-based planning, and greater cooperation between environmental and economic regulators are signs of the times and harbingers of the future of water and wastewater provision and oversight.

Notes

¹ See <http://www.nrri.ohio-state.edu/bluepages/f/maps1.swf>.

² For governing rules, see Texas Administrative Code, Title 30: Environmental Quality, Chapter 30: Texas Commission on Environmental Quality.

³ See <http://www.tceq.state.tx.us/about/>.

⁴ Authors Notes, Doug Holcomb, Remarks, Austin, TX, July 2005.

⁵ See <http://www.tceq.state.tx.us/about/organization/oprr.html#6>.

⁶ Go to <http://www.tceq.state.tx.us> and click on Publications and forms to view document GI-024, Appealing a Rate Case Decision, September 2004.

⁷ Anthony E. Bennett, Telephone interview, November 2005.

⁸ Anthony E. Bennett, Presentation, Austin, TX, July 05.

⁹ Ibid 6.

Most of CEQ's work is focused on environmental regulation. Economic regulatory functions are a small part of the agency's duties.

¹⁰ The Feasibility of Regionalizing Water and Wastewater Utilities: A TCEQ Policy Statement, RG-357, Appendix B, January 2003. The policy implements portions of Senate Bill 1 (1997) and is intended to assist with implementation of regionalization requirements in Texas Administrative Code (30 TAC) Chapters 290 and 291. See 291.102: Criteria For Considering and Granting Certificates or Amendments. The policy statement (RG-357) does not change administrative requirements or procedures pertaining to Certificates of Convenience and Necessities and ratemaking.

¹¹ The Feasibility of Regionalizing Water and Wastewater Utilities: A TCEQ Policy Statement, RG-357, January 2003, pp. 3-4.

¹² These and more are available at http://www.tceq.state.tx.us/comm_exec/forms_pubs.

¹³ California PUC News Release, PUC Adopts Water Action Plan As Roadmap for Policies and Priorities, Dec. 15, 2005. Available at http://www.cpuc.ca.gov/word_pdf/NEWS_RELEASE/52086.pdf.

¹⁴ Robert Renner, Presentation before the NARUC Committee on Water, February 2006, Washington, D.C.

¹⁵ James M. Symons, Lee C. Bradley, Jr., and Theodore C. Cleveland, The Drinking Water Dictionary, AWWA, Denver, Colorado, p. 442.

The National Regulatory Research Institute
1080 Carmack Road
Columbus, Ohio 43210-1002
Phone: 614-292-9404
Fax: 614-292-7196
www.nrri.ohio-state.edu

This report was prepared by the National Regulatory Research Institute (NRRI) with funding provided by the member commissions of the National Association of Regulatory Utility Commissioners (NARUC). The views and opinions of the authors do not necessarily express or reflect the views, opinions or policies of the NRRI, NARUC, or NARUC member commissions.