

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** CS/CS/HB 491 Water and Wastewater

**SPONSOR(S):** Energy & Utilities Subcommittee; Smith

**TIED BILLS:** **IDEN./SIM. BILLS:** SB 534

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Energy & Utilities Subcommittee	12 Y, 1 N, As CS	Keating	Keating
2) Finance & Tax Committee	10 Y, 1 N, As CS	Aldridge	Langston
3) Regulatory Affairs Committee			

### SUMMARY ANALYSIS

Chapter 2012-187, Laws of Florida, created the Study Committee on Investor-Owned Water and Wastewater Utility Systems (Study Committee) to “identify issues of concern of investor-owned water and wastewater utility systems, particularly small systems, and their customers” and to research possible solutions. Consistent with the law, the Study Committee submitted a report containing its recommendations to the Speaker of the House, the President of the Senate, and the Governor, on February 15, 2013. This bill adopts several of the Study Committee’s recommendations for legislative action. In particular, the bill:

- Directs the Division of Bond Finance to review the allocation of private activity bonds in Florida with respect to water and wastewater projects.
- Creates an exemption from PSC regulation for persons who resell water service to individually-metered residents at a price that does not exceed the purchase price of water plus the actual cost of meter reading and billing, not to exceed 9 percent of the actual cost of service.
- Requires the PSC, upon an IOU’s request in a rate case, to create a reserve fund for the IOU to be used for certain infrastructure repair and replacement projects, with disbursement subject to PSC approval.
- Identifies specific types of expenses eligible for “pass-through” treatment in IOU rates and authorizes the PSC, by rule, to identify additional types of expenses eligible for such treatment, provided the expenses are beyond the utility’s control.
- Prohibits the recovery of an IOU’s rate case expense where the rate case expense is incurred to prepare or file a staff-assisted rate case in which no party intervenes.
- Authorizes the PSC, on its own motion or based on customer complaints, to review water quality issues involving secondary drinking water standards (e.g., standards related to odor, taste, and corrosiveness) and wastewater service issues involving odor, noise, aerosol drift, or lighting.
- Expands the availability of low-interest loans through the State Revolving Fund to all for-profit water utilities.

The Revenue Estimating Conference has not estimated the revenue impacts of the bill as amended. However, staff estimates that the bill will have no revenue impact on state or local government. The bill appears to have an insignificant impact on state government expenditures and no impact on local government expenditures.

The bill has an effective date of July 1, 2016.

# FULL ANALYSIS

## I. SUBSTANTIVE ANALYSIS

### A. EFFECT OF PROPOSED CHANGES:

#### Background

##### *Water and Wastewater Industry Overview*

In various areas throughout Florida, water and wastewater services are provided through privately-owned and operated water and/or wastewater companies. These privately-owned companies are referred to as “investor-owned utilities,” or “IOUs.” IOUs can range in size from very small systems, owned by individuals as sole proprietorships and serving only a few dozen customers in a small neighborhood, to systems owned by large interstate corporations which serve tens of thousands of customers in multiple Florida counties.

For IOUs operating within a single Florida county, the county has the option to regulate rates and service or allow the Public Service Commission (PSC or Commission) to regulate those utilities.<sup>1</sup> Regardless of whether the county has opted to regulate IOUs, the PSC has jurisdiction over all water and wastewater utility systems whose service transverses county boundaries, except for systems owned and regulated by intergovernmental authorities.<sup>2</sup> Currently, the PSC has jurisdiction over 146 water and/or wastewater IOUs in 37 of 67 counties in Florida.<sup>3</sup> The remaining water and wastewater customers in the state are served either by IOUs in non-jurisdictional counties, by statutorily exempt utilities (such as municipal utilities, cooperatives, and non-profits), by wells and septic tanks, or by systems owned, operated, managed, or controlled by governmental authorities.<sup>4</sup>

For regulatory purposes, the PSC classifies a water or wastewater IOU into one of three categories based on annual operating revenues.<sup>5</sup>

Class A – Operating revenues of \$1,000,000 or more

Class B – Operating revenues of \$200,000 or more but less than \$1,000,000

Class C – Operating revenues less than \$200,000

Currently, there are 13 Class A utilities, 37 Class B utilities, and 96 Class C utilities under the PSC’s jurisdiction.

##### *Study Committee on Investor-Owned Water and Wastewater Utility Systems*

Chapter 2012-187, Laws of Florida, created the Study Committee on Investor-Owned Water and Wastewater Utility Systems (Study Committee)<sup>6</sup> to “identify issues of concern of investor-owned water

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<sup>1</sup> s. 367.171, F.S. If a county chooses to allow regulation by the PSC, it may rescind this election only after 10 continuous years of PSC regulation.

<sup>2</sup> *Id.*

<sup>3</sup> *Facts and Figures of the Florida Utility Industry*, Florida Public Service Commission, March 2015, available at <http://www.psc.state.fl.us/publications/reports.aspx>.

<sup>4</sup> s. 367.022(2), F.S.

<sup>5</sup> Rules 25-30.110(4) and 25-30.115, F.A.C. As noted in these rules, this classification system is used by the National Association of Regulatory Utility Commissioners for publishing its system of accounts.

<sup>6</sup> As required by the law, the Study Committee was comprised of 18 members, including three non-voting members and 15 voting members. The three non-voting members included Commissioner Julie I. Brown (representing the PSC as the Study Committee Chair), a representative of the Florida Department of Environmental Protection, and the Public Counsel. The 15 voting members included State Senator Alan Hays (appointed by the President of the Senate), State Representative Ray Pilon (appointed by the Speaker of the House), and representatives of the following entities or groups, as appointed by the Governor: a county commission that regulates investor-owned water/wastewater utilities; a governmental authority created under ch. 163, F.S.; a water management district; a county health department; two Class A utilities; a Class B utility; a Class C utility; a utility owned or operated by a municipal or county government; customers of a Class A utility; customers of a Class B or C utility; the Florida Section of the American Water Works Association; and the Florida Rural Water Association.

and wastewater utility systems, particularly small systems, and their customers” and to research possible solutions.<sup>7</sup> Specifically, the Study Committee was required to consider:

- The ability of a small IOU to achieve economies of scale when purchasing equipment, commodities, or services;
- The availability of low interest loans to a small, privately owned water or wastewater utility;
- Any tax incentives or exemptions, temporary or permanent, which are available to a small water or wastewater utility;
- The impact on customer rates if a utility purchases an existing water or wastewater utility system;
- The impact on customer rates of a utility providing service through the use of a reseller; and
- Other issues that the Study Committee identifies during its investigation.<sup>8</sup>

The Study Committee conducted 12 public meetings at which it heard public comment on these issues, identified additional issues for consideration and research (and heard public comment on the additional issues), and discussed and debated solutions to the issues.<sup>9</sup> Consistent with the law, the Study Committee submitted a report containing its recommendations to the Speaker of the House, the President of the Senate, and the Governor, on February 15, 2013.

The Study Committee’s report included recommendations for legislative action, agency rulemaking, and other agency action. Based on the issues that it was required to consider, the Study Committee recommended legislative action to do the following:

- Increase the availability of low-interest loans to small, privately owned water and wastewater utilities by:
  - Expanding availability of low-interest loans through the State Revolving Fund (SRF) to all for-profit water utilities;
  - Allowing IOUs to apply “pass-through” treatment for loan service fees or loan origination fees for eligible projects as identified by the PSC; and
  - Directing the Division of Bond Finance to review the allocation of private activity bonds (PABs) in Florida with respect to water and wastewater projects.
- Provide a sales tax exemption for sales or leases to an IOU owned or operated by a Florida corporation.
- Create an exemption from PSC regulation for persons who resell service to individually-metered end-users at a price that does not exceed the actual purchase price of water plus actual costs of meter reading and billing not to exceed 9%.

Based on additional issues that it identified and considered, the Study Committee recommended legislative action to do the following:

- Authorize the PSC, during a rate case, to create individual utility reserve funds to be used for projects identified in an IOU’s capital improvement plan, with disbursement subject to approval by the PSC, as a means of reducing borrowing costs and making funds more readily available.
- Identify specific types of expenses eligible for “pass-through” treatment in utility rates, and/or authorize the PSC to adopt rules identifying such expenses, provided the expenses are beyond the utility’s control, to help minimize the need for costly rate case proceedings.
- Reduce the impact of rate case expense on customer rates by prohibiting the recovery of rate case expense in certain circumstances.
- Provide a mechanism for the resolution of issues involving secondary water standards (e.g., odor, taste, corrosiveness, etc.) and wastewater operational requirements.

### *Private Activity Bonds*

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<sup>7</sup> s. 2, Ch. 2012-187, Laws of Fla.

<sup>8</sup> *Id.*

<sup>9</sup> See Sections II and III, *Report of the Study Committee on Investor-Owned Water and Wastewater Utility Systems*, February 15, 2013 (*Study Committee Report*), available at <http://www.psc.state.fl.us/utilities/waterwastewater/>.

Qualified private activity bonds are tax-exempt bonds issued by a state or local government, the proceeds of which are used for a defined qualified purpose by an entity other than the government issuing the bonds. For a private activity bond to be tax-exempt, 95% or more of the net bond proceeds must be used for one of the qualified purposes listed in ss. 142 through 145 and 1394 of the Internal Revenue Code (the Code). These qualified purposes include facilities used to furnish water or sewer services. The Code limits an issuing authority (such as a state) to a maximum amount of tax-exempt bonds that can be issued to finance a particular qualified purpose during a calendar year. Facilities used to furnish water or sewer services are subject to a volume cap.<sup>10</sup>

Private activity bonds are administered in Florida by the Division of Bond Finance of the State Board of Administration (the Division) under ss. 159.801-159.816, F.S. Each year, the Division determines the amount of private activity bonds permitted to be issued in Florida under the Code.<sup>11</sup> This amount is allocated on January 1 of each year as follows:<sup>12</sup>

- An initial amount is allocated to manufacturing facility projects.
- 50 percent of the amount remaining after the initial allocation is allocated to individual counties and groups of counties<sup>13</sup> on a per capita basis for any permitted purpose, which may include water and sewer projects.
- 25 percent of the amount remaining after the initial allocation is allocated to the Florida Housing Finance Corporation for use in connection with the issuance of housing bonds.
- 5 percent of the amount remaining after the initial allocation is allocated to the state allocation pool and applied to “priority projects,” which may include water and sewer projects.
- 20 percent of the amount remaining after the initial allocation is allocated to the Florida First Business allocation pool for projects certified by the Department of Economic Opportunity.

The Study Committee was unable to determine the amount of private activity bonds ultimately utilized for water and sewer projects in Florida.<sup>14</sup>

### *Resellers of Water Service*

As noted above, the PSC currently has jurisdiction to regulate the rates and service of water and wastewater utilities in 37 of 67 counties in Florida. For purposes of the PSC’s jurisdiction, “utility” is defined as every person owning, operating, managing, or controlling a system, who is providing water or wastewater service to the public for compensation.<sup>15</sup> However, certain entities that meet this definition are exempt from PSC regulation as utilities.<sup>16</sup> Included among these exemptions are persons who resell water or wastewater service at a rate or charge which does not exceed the actual purchase price of the water or wastewater.<sup>17</sup> If the reseller includes any additional costs in the rate or charge to the retail customer, the reseller is considered a utility subject to PSC regulation.

Reseller utilities that are regulated by the PSC generally have significant investment in distribution and collection lines and other utility equipment. Examples include mobile home parks and subdivisions. In a rate proceeding, the PSC determines the utility’s investment and expenses related to the facilities it owns and operates, then it sets rates accordingly. The cost of the water and/or wastewater service purchased from a wholesale provider, which is often a significant portion of the customers’ bills, is allowed to be passed through to the customers pursuant to s. 367.081(4)(b), F.S. Resellers that choose not to pass along costs beyond their cost to purchase water or wastewater (and therefore remain exempt from PSC regulation) generally have very little investment in equipment or lines needed

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<sup>10</sup> *Tax-Exempt Private Activity Bonds, Compliance Guide*, Internal Revenue Service Publication 4078, Version 09-2005.

<sup>11</sup> s. 159.804, F.S.

<sup>12</sup> *Id.*

<sup>13</sup> These individual counties and groups of counties are identified in s. 159.804(2)(b), F.S.

<sup>14</sup> *Study Committee Report*, p. 43.

<sup>15</sup> s. 367.021(12), F.S.

<sup>16</sup> *See* s. 367.022, F.S.

<sup>17</sup> s. 367.022(8), F.S.

to provide the service. Examples include apartment complexes, condominium buildings and small master-metered shopping centers.<sup>18</sup>

In its report, the Study Committee noted that a metered charge for water sends an appropriate price signal to end users and is a means of discouraging indiscriminate use of this resource. However, if a reseller wishes to install sub-meters for its users and bill those users for their actual water use, it will be unable to recover those metering and billing costs from its customers without becoming regulated and incurring the costs of regulation.<sup>19</sup>

### *Reserve Funds for Water and Wastewater Utilities*

As noted above, the Study Committee was required to consider, among other things, the availability of low interest loans to a small, privately owned water or wastewater utility. In its report, the Study Committee noted the following:

Affordable, accessible financing is an ongoing issue for the water and wastewater industry and is a particularly acute need for smaller systems. Smaller utilities ... have difficulty securing low-cost, long-term financing because the characteristics and track record of the industry make smaller systems more risky in the view of lending institutions. Timing is also an issue, particularly when critical system failures occur and small utilities do not have the cash reserves to address such short-term needs. In addition, regulatory policy frequently does not provide sufficient cash flow to fully service the debt over the term of the loan. The establishment of individual utility reserve funding and/or establishment of a broader statewide reserve fund could reduce borrowing costs and make funding more readily available.<sup>20</sup>

Section 367.081, F.S., establishes the rate-setting procedures for water and wastewater IOUs regulated by the PSC. None of these procedures provides explicit statutory authority for the PSC to establish reserve funds for water and wastewater IOUs during the rate-setting process.

### *Pass-Through Costs*

Outside of a rate case, PSC-regulated water and wastewater IOUs are entitled to “pass through” specific types of expenses without the requirement of a PSC hearing.<sup>21</sup> This mechanism provides quick rate relief to a utility when it experiences an increase in one of these types of costs and may help defer the need for a full rate case. Currently, the types of expenses eligible for pass-through treatment are limited by statute to the following:<sup>22</sup>

- Purchased water or wastewater service.
- Electric power.
- Ad valorem taxes.
- Regulatory Assessment Fees.
- DEP fees for the National Pollutant Discharge Elimination System Program.
- Water quality or wastewater quality testing required by DEP.

Prior to changing rates using this mechanism, the IOU must file, under oath, an affirmation as to the accuracy of the figures and calculations upon which the change in rates is based and a statement that the change will not cause the utility to exceed the rate of return on equity last approved by the PSC.<sup>23</sup>

### *Recovery of Rate Case Expense*

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<sup>18</sup> *Study Committee Report*, p. 61.

<sup>19</sup> *Id.*, pp. 61-62.

<sup>20</sup> *Id.*, p. 67.

<sup>21</sup> s. 367.081(4)(b), F.S.

<sup>22</sup> *Id.*

<sup>23</sup> s. 367.081(4)(c), F.S.

In a rate case conducted by the PSC, a water or wastewater IOU is entitled to recover its reasonable expenses incurred in preparing and proceeding with the rate case.<sup>24</sup> These expenses (referred to as “rate case expense”) typically include legal, engineering, and accounting expenses and are reviewed by the PSC as part of the rate case. Any rate case expense deemed unreasonable by the PSC may not be recovered by the IOU through its rates.<sup>25</sup> The amount of rate case expense deemed reasonable is apportioned for recovery through the IOU’s rates over a period of 4 years. At the end of this 4-year period, the IOU’s rates are reduced to remove the impact of the rate case expense.<sup>26</sup> According to the Study Committee, the impact of rate case expense on customer bills varies from case to case and is often negligible.<sup>27</sup> However, one analysis presented to the Study Committee noted 3 cases between 2006 and 2011 in which the annual rate impact attributed to rate case expense (over the 4-year recovery period) exceeded the annual revenue increase approved in the rate case, excluding rate case expense. In addition, this analysis noted 6 additional cases over the same period in which the annual rate impact attributed to rate case expense equaled more than 25 percent of the annual revenue increase approved in the rate case, excluding rate case expense.<sup>28</sup>

There is no legal limit on the frequency of rate cases. In some instances, an IOU may file for approval to change its rates less than 4 years after its previous rate case. In these cases, the IOU’s rates may, for a certain period of time, include rate case expense for more than one rate case, provided that the PSC has determined that there is a reasonable level of rate case expense to be recovered.

A water or wastewater IOU with gross annual revenues under \$275,000 is permitted by law to request and obtain assistance from the PSC staff in preparing the IOU’s rate case.<sup>29</sup> These rate cases are referred to as staff-assisted rate cases (SARCs). In these cases, the PSC staff reviews the IOU’s books and records, inspects the IOU’s premises, prepares a quality of service analysis, and presents recommended rates and charges to the PSC for consideration. In requesting staff assistance, the IOU agrees to accept the final rates and charges approved by the PSC unless these rates and charges produce less revenue than the existing rates and charges.<sup>30</sup> An IOU that uses the SARC process may still seek assistance from other professionals in preparing and proceeding with its case and may submit the associated expenses for recovery as rate case expense.<sup>31</sup> One analysis presented to the Study Committee showed an average rate case expense of \$4,563 for 23 SARCs conducted between 2007 and 2011 in which some level of rate case expense was approved.<sup>32</sup> The average drops to \$3,025 by removing one case.<sup>33</sup>

### *Quality of Service / Secondary Standards*

The Department of Environmental Protection (DEP) is the state agency with primary authority to implement and enforce federal and state drinking water and wastewater standards. The focus of DEP’s permitting, monitoring, and enforcement of water and wastewater systems is to ensure compliance with primary drinking water standards and wastewater operational requirements to protect the health and safety of the public and the environment.<sup>34</sup>

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<sup>24</sup> s. 367.081(7), F.S.

<sup>25</sup> *Id.*

<sup>26</sup> s. 367.0816, F.S.

<sup>27</sup> *Study Committee Report*, p. 83.

<sup>28</sup> *Study Committee Report*, p. 88.

<sup>29</sup> s. 367.0814, F.S.

<sup>30</sup> *Id.* However, a person other than the utility may protest or appeal the PSC’s order approving the rates and charges.

<sup>31</sup> *Study Committee Report*, pp. 84-91.

<sup>32</sup> *Study Committee Report*, p. 87.

<sup>33</sup> *Id.* Information provided by the PSC indicated that there were approximately 48 SARCs conducted during this time frame, thus the average rate case expense for all SARCs is likely to be lower than this amount.

<sup>34</sup> See ch. 403, F.S., and Chapters 62-550, 555, 602, and 699, F.A.C., for drinking water regulations, and Chapters 62-600, 604, 610, 620, 621, and 640, F.A.C., for wastewater regulations.

With respect to drinking water, DEP has also adopted secondary standards for contaminants related to color, corrosion, and odor.<sup>35</sup> Testing for these secondary standards is required on a regular basis, though DEP generally requires corrective action only if users (i.e., water customers) voice significant complaints or if a primary contaminant level has also been exceeded.

With respect to wastewater, DEP requires that new treatment plants and modifications to existing plants be designed and sited to minimize adverse effects on neighboring residential and commercial areas resulting from odors, noise, aerosol drift, and lighting.<sup>36</sup> Permittees must give reasonable assurance that such effects will not be potentially harmful to human health or welfare or unreasonably interfere with the enjoyment of life or property.<sup>37</sup> Likewise, if existing facilities fail to function as intended and create such adverse effects, the permittee must take corrective action, or DEP may require corrective action.<sup>38</sup> DEP generally requires corrective action only in response to significant complaints or if a primary contaminant level has also been exceeded.<sup>39</sup>

The PSC considers an IOU's quality of service in rate cases. In doing so, the PSC evaluates the quality of the product, the operating condition of the IOU's plant and facilities, and the IOU's efforts to address customer satisfaction.<sup>40</sup> Sanitary surveys, outstanding citations, violations and consent orders on file with DEP and county health departments are also considered. In addition, DEP and county health department officials' testimony and customer testimony concerning quality of service is considered.<sup>41</sup> In most cases, the emphasis of this evaluation is compliance with standards related to health and safety of the public and the environment.<sup>42</sup> If the PSC finds that an IOU has failed to provide its customers with water or wastewater service that meets the standards set by DEP or the water management districts, the PSC may reduce the IOU's return on equity until the standards are met.<sup>43</sup>

In 2014, the Legislature passed CS/CS/CS/SB 272,<sup>44</sup> which established a process by which the customers of an IOU may petition the PSC to investigate issues concerning the quality of the water service provided by the utility. Upon review of a petition signed by at least 65 percent of the IOU's customers, the utility's response, and other relevant factors, the PSC may:

- Dismiss the petition, if doing so is supported by clear and convincing evidence;
- Require the utility to take corrective actions to resolve the issues identified; or
- Revoke the utility's certificate of authorization and appoint a receiver until a sale of the utility is approved by the PSC.

The bill also required the PSC, when setting rates for a water utility, specifically to consider the extent to which the utility provides service that meets secondary drinking water standards established by DEP. If the PSC determines that the utility's water service does not meet these standards, the utility must create an estimate of the costs and benefits of a plausible solution to address each issue identified by the PSC, meet with its customers to discuss these estimates and the time necessary to implement the solution, and report the results of these meetings to the PSC. The PSC may require the utility to implement a solution for each issue that is in the best interests of the customers, and the utility may recover its costs to implement any solutions ordered by the PSC. The PSC may impose penalties for a utility's failure to adequately resolve each issue as required.

### *Drinking Water State Revolving Fund*

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<sup>35</sup> Rule 62-550.320, F.A.C.

<sup>36</sup> Rule 62-600.400(2)(a), F.A.C.

<sup>37</sup> *Id.*

<sup>38</sup> Rule 62-600.410, F.A.C.

<sup>39</sup> *Study Committee Report*, p. 105.

<sup>40</sup> Rule 25-30.433(1), F.A.C.

<sup>41</sup> *Id.*

<sup>42</sup> *Study Committee Report*, p. 106.

<sup>43</sup> s. 367.111(2), F.S.

<sup>44</sup> Ch. 2014-68, Laws of Florida, codified at ss. 367.072 and 367.0812, F.S.

Sections 403.8532 and 403.8533, F.S., establish the Drinking Water State Revolving Fund (SRF). The SRF, which is administered by DEP, provides low-interest loans to eligible entities for planning, designing, and constructing public water facilities. Eligible entities include, among others, investor-owned public water systems that are legally responsible for public water services and which serve no more than 1,500 connections.<sup>45</sup> Projects eligible for SRF loans include new construction and improvements of public water systems, inclusive of storage, transmission, treatment, disinfection, and distribution facilities.<sup>46</sup> Loan funding is based on a priority system which takes into account public health considerations, compliance, and affordability.<sup>47</sup>

Based on data gathered from IOU's 2011 annual reports filed with the PSC, the Study Committee determined that all Class C water IOUs and almost all (28 out of 33) Class B water IOUs serve no more than 1,500 connections and are therefore eligible for the SRF program.<sup>48</sup> The remaining PSC-regulated Class B and Class A water IOUs are, presumably, not eligible to use the SRF program.

## Effect of Proposed Changes

This bill adopts several of the Study Committee's recommendations for legislative action. In particular, the bill:

- Directs the Division of Bond Finance to review the allocation of private activity bonds (PABs) in Florida with respect to water and wastewater projects.
- Creates an exemption from PSC regulation for persons who resell water service to individually-metered residents at a price that does not exceed the purchase price of water plus the actual cost of meter reading and billing, not to exceed 9 percent of the actual cost of service.
- Requires the PSC, upon an IOU's request in a rate case, to create a reserve fund for the IOU to be used for certain infrastructure repair and replacement projects, with disbursement subject to PSC approval.
- Identifies specific types of expenses eligible for "pass-through" treatment in IOU rates and authorizes the PSC, by rule, to identify additional types of expenses eligible for such treatment, provided the expenses are beyond the utility's control.
- Prohibits the recovery of an IOU's rate case expense where the rate case expense is incurred to prepare or file a staff-assisted rate case in which no party intervenes.
- Authorizes the PSC, on its own motion or based on customer complaints, to review water quality issues involving secondary drinking water standards (e.g., standards related to odor, taste, and corrosiveness) and wastewater service issues involving odor, noise, aerosol drift, or lighting.
- Expands the availability of low-interest loans through the State Revolving Fund (SRF) to all for-profit water utilities.

### *Private Activity Bonds*

The bill directs the Division of Bond Finance of the State Board of Administration to review the allocation of private activity bonds (PABs) to determine the availability of additional allocation and reallocation of PABs for water and wastewater infrastructure projects.

### *Resellers of Water Service*

The bill creates an exemption from PSC regulation for a person who resells water service to his or her tenants or to individually metered residents for a fee that does not exceed the reseller's actual purchase

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<sup>45</sup> s. 403.8532(3), F.S. An investor-owned public water system that serves more than 1,500 connections may qualify for a loan only if the proposed project will result in the consolidation of two or more public water systems.

<sup>46</sup> Florida Department of Environmental Protection, *Drinking Water State Revolving Fund - Eligible Local Governments*, <http://www.dep.state.fl.us/water/wff/dwsrf/ellocgov.htm> (last accessed November 12, 2015).

<sup>47</sup> s. 403.8532(9)(a), F.S.

<sup>48</sup> *Study Committee Report*, pp. 36-37. The report notes that this data does not include water IOUs that are regulated by counties.

price of the water plus the actual cost of meter reading and billing, not to exceed 9 percent of the actual cost of service.

Absent this exemption, a water reseller who charges more than the actual purchase price of the water would be subject to PSC regulation and would incur the costs and obligations of such regulation. While the costs would be recoverable from the reseller's customers through PSC-approved rates, a reseller may not wish to incur the additional regulatory obligations.

This provision may encourage resellers to utilize individual metering more often for their tenants. Through individual metering, water users can be charged more accurately for the water they consume. Thus, customers of resellers who utilize individual metering may be more likely to use water more efficiently.

#### *Reserve Funds for Water and Wastewater IOUs*

The bill requires the PSC, upon request by a water or wastewater IOU in a rate case proceeding, to create a reserve fund to be used by the IOU for repair or replacement of its existing distribution and collection infrastructure if the infrastructure is either near the end of its useful life or detrimental to water quality or reliability of service. The reserve fund may be funded through a portion of the rates charged by the utility, by a secured escrow account, or through a letter of credit. The bill directs the PSC to adopt rules to govern the funding, implementation, management, and use of the fund. These rules must include, but are not limited to:

- Provisions related to the expenses for which the fund may be used.
- Segregation of the reserve fund accounts.
- Requirements for the IOU to maintain a capital improvement plan.
- Requirements for PSC authorization prior to disbursements from the fund.

The establishment of individual reserve funds may reduce borrowing costs and make funding more readily available for PSC-regulated water and wastewater IOUs. IOUs may be able to avoid the need to access capital markets to finance certain projects and repairs and/or avoid the need to request a rate increase to cover the costs of the projects and repairs.

#### *Pass-Through Costs*

The bill expands the types of expenses eligible for "pass-through" treatment in IOU rates by adding the following non-exclusive list of expense items:

- Fees charged for wastewater biosolids disposal.
- Costs incurred for a tank inspection required by DEP or a local governmental authority.
- Treatment plant operator and water distribution system license fees required by DEP or a local governmental authority.
- Water or wastewater operating permit fees charged by DEP or a local governmental authority.
- Consumptive or water use permit fees charged by a water management district.

The bill authorizes the PSC, by rule, to establish additional specific expense items eligible for pass-through treatment. To be eligible for such treatment, an additional expense item must be imposed by a local, state, or federal law, rule, order, or notice and must be outside the control of the utility. If the PSC uses this authority, it must review its rule at least once every 5 years to determine if each specific expense item should remain eligible for pass-through treatment or if any additional expense items should become eligible.

The bill continues the current requirement that an IOU wishing to change its rates to reflect a change in any of these costs must provide verified notice to the PSC 45 days before implementing a change in its rates. The bill provides that the new rates must reflect, on an amortized or annual basis, as appropriate, the cost or amount of change in the cost of the specified expense item. Further, the bill provides that the new rates may not reflect the costs of any specific expense item already included in

the IOU's rates. The bill also continues the current prohibition on use of the pass-through mechanism for increases or decreases in a specific expense item that occurred more than 12 months before the IOU's filing.

#### *Rate Case Expense*

The bill prohibits the PSC, where the IOU has requested a staff-assisted rate case, from approving rate case expense to cover fees for attorneys and other outside consultants who are engaged by an IOU for purposes of preparing or filing the case, unless another party has intervened in the case. The bill provides two exceptions. It authorizes the recovery of rate expense for such fees if the fees are incurred to provide consulting or legal services to the IOU after the initial PSC staff report is issued to customers and the utility. It also requires that the PSC allow recovery of rate case expense for such fees incurred after any protest or appeal of the PSC's decision by a party other than the IOU. The bill requires the PSC to adopt rules by December 31, 2016, to implement these provisions.

#### *Quality of Service / Secondary Standards*

The bill provides the PSC specific authority to review, on its own motion or based upon customer complaints, a water IOU's water quality in relation to secondary drinking water standards (e.g., standards related to odor, taste, and corrosiveness) established by DEP. The bill also authorizes the PSC, on its own motion or based upon customer complaints, to review a wastewater IOU's service in relation to odor, noise, aerosol drift, or lighting issues.

#### *Drinking Water State Revolving Fund*

The bill removes the current size restrictions on water IOUs eligible to utilize the Drinking Water State Revolving Fund (SRF). Water IOUs of any size will be eligible to seek low-interest loans through the SRF for planning, designing, and constructing public water facilities, including storage, transmission, treatment, disinfection, and distribution facilities. This may increase competition for available funds.

#### B. SECTION DIRECTORY:

**Section 1.** Creates s. 159.8105, F.S., requiring the Division of Bond Finance to review the allocation of private activity bonds.

**Section 2.** Amends s. 367.022, F.S., relating to exemptions to regulation by the Public Service Commission.

**Section 3.** Amends s. 367.081, F.S., relating to the procedure for fixing and changing rates.

**Section 4.** Amends s. 367.0814, F.S., relating to staff assistance in changing rates and charges.

**Section 5.** Amends s. 367.111, F.S., relating to service quality.

**Section 6.** Amends s. 403.8532, F.S., relating to use of the drinking water state revolving loan fund.

**Section 7.** Amends s. 367.171, F.S., to conform a cross-reference.

**Section 8.** Provides an effective date of July 1, 2016.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

#### A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

The Revenue Estimating Conference has not estimated the revenue impacts of the bill as amended. However, staff estimates that the bill will have no revenue impact on state local government.

2. Expenditures:

The bill appears to have an insignificant impact on state government expenditures.

The PSC has not identified an impact on agency expenditures; however, it may be required to expend resources to complete rulemaking as required by the bill. In its analysis of a similar bill filed in 2015, the Department of Revenue identified an insignificant impact on its expenditures.<sup>49</sup> DEP, in its analysis of the same bill filed in 2015, estimated additional expenditures of between \$10,000 and \$100,000 to employ additional expertise needed to evaluate the credit worthiness of large, complex water systems that become eligible under the bill to seek low-interest loans through the SRF; however, it indicated that these costs will be covered by service fees collected in the normal course of the SRF program.<sup>50</sup>

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

The Revenue Estimating Conference has not estimated the revenue impacts of the bill as amended. However, staff estimates that the bill will have no revenue impact on local government.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

*Private Activity Bonds*

To the extent that additional private activity bonds are made available for eligible projects, more water and wastewater IOUs may be encouraged to make investments in water and wastewater infrastructure in the state at a lower cost to ratepayers than would otherwise result from such expenditures.

*Resellers of Water Service*

The creation of a regulatory exemption for water resellers who add no more than the costs of meter reading and billing (capped at 9 percent) to their purchase price for water, will allow these resellers to avoid the costs and obligations of regulation and may encourage them to invest in individual metering apparatus.

*Reserve Funds for Water and Wastewater IOUs*

The establishment of individual reserve funds may reduce borrowing costs and make funding more readily available for PSC-regulated water and wastewater IOUs to make needed improvements and repairs. In some instances, the availability of these reserve funds may allow IOUs to avoid or defer the need for a rate case, the expense of which ultimately would be borne by ratepayers.

*Pass-Through Costs*

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<sup>49</sup> Department of Revenue, Agency Analysis of 2015 HB 1173, p. 3 (March 5, 2015).

<sup>50</sup> Department of Environmental Protection, Agency Analysis of 2015 HB 1173, pp. 2-4 (March 13, 2015).

The expanded availability of “pass-through” treatment for new expense items may, in some instances, allow IOUs to avoid or defer the need for a rate case, the expense of which ultimately would be borne by ratepayers.

#### *Rate Case Expense*

The limitation on the recovery of rate case expense may reduce the impact of rate case expense on ratepayers’ bills. However, these limitations may discourage an IOU from seeking a rate increase necessary to make system repairs and improvements or to assure it a reasonable rate of return on its investment.

#### *Quality of Service / Secondary Standards*

Depending on the PSC’s application of the mechanism established to identify and potentially resolve secondary water quality issues and wastewater operational issues, IOUs may be compelled to incur additional costs to resolve these issues. To the extent that an IOU is compelled to incur additional costs, these costs will likely be recovered from ratepayers.

#### *Drinking Water State Revolving Fund*

The expanded availability of low-interest financing through the State Revolving Fund to additional water IOUs may encourage more of these utilities to make investments in water infrastructure in the state at a lower cost to ratepayers than would otherwise result from such expenditures.

#### D. FISCAL COMMENTS:

None.

### **III. COMMENTS**

#### A. CONSTITUTIONAL ISSUES:

##### 1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to: require counties or municipalities to spend funds or take an action requiring the expenditure of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of a state tax shared with counties or municipalities.

##### 2. Other:

The PSC’s analysis indicates that the provisions of the bill that prohibit or limit recovery of rate case expense in certain circumstances may result in a regulatory taking without just compensation in violation of Amendment XIV of the U.S. Constitution.<sup>51</sup> This provision of the constitution establishes that no person shall be deprived of life, liberty or property without due process of law and that private property shall not be taken for public use without just compensation.

#### B. RULE-MAKING AUTHORITY:

The bill requires the PSC to adopt rules:

- To govern the operation of individual utility reserve funds created by the PSC.
- To administer the prohibition on recovery of rate case expense in specified circumstances in a staff-assisted rate case.

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<sup>51</sup> Public Service Commission, Analysis of 2016 HB 491 (November 12, 2015).

The bill authorizes the PSC to adopt rules establishing additional specific expense items eligible for pass-through treatment in IOU rates.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

**IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES**

On November 17, 2015, the Energy & Utilities Subcommittee adopted three amendments to the bill and reported the bill favorably as a committee substitute. The amendments:

- Make it mandatory, rather than permissive, that the PSC create a reserve fund if requested by a utility in a rate case proceeding.
- Make it mandatory, rather than permissive, that the PSC allow recovery of rate case expense (i.e., fees for attorneys and other outside consultants) incurred by a utility in a staff-assisted rate case after any protest or appeal of the PSC's decision by a party other than the utility.
- Remove a provision of the bill that limited a utility's recovery of rate case expense to 50 percent of the amount of rate case expense deemed reasonable by the PSC.

On January 21, 2017, the Finance and Tax Committee adopted two amendments to the bill and reported the bill favorably as a committee substitute. The amendments:

- Remove the provision that created an exemption from sales and use tax for sales or leases to a water or wastewater IOU.
- Remove the provision that required an IOU, when it begins recovery of approved rate case expense associated with a new rate case, to discontinue the recovery of any uncollected rate case expense approved in a prior rate case.

This analysis has been updated to reflect these changes.