

HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 207 Acquisition of Water and Wastewater Systems

SPONSOR(S): Commerce Committee; McClain

TIED BILLS: **IDEN./SIM. BILLS:** CS/SB 658

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Energy & Utilities Subcommittee	15 Y, 0 N	Keating	Keating
2) Government Operations & Technology Appropriations Subcommittee	11 Y, 0 N	Helpling	Topp
3) Commerce Committee	23 Y, 1 N, As CS	Keating	Hamon

SUMMARY ANALYSIS

When a water or wastewater utility regulated by the Public Service Commission (PSC) acquires an existing water or wastewater utility system, the PSC establishes a rate base value for the acquired utility system. The rate base established by the PSC is the amount upon which the acquiring utility may earn a rate of return. This value is determined using the acquired utility's net book value, i.e., the original cost of the utility's assets when first dedicated to public service, less depreciation. This valuation method is called the "original cost" method.

If the purchase price of a utility system is greater than its net book value, no part of the difference is included in rate base absent a showing of extraordinary circumstances, which may include anticipated cost efficiencies and improvements in service quality and regulatory compliance, among other things. If the PSC determines that extraordinary circumstances exist, it will allow the acquiring utility to include all or part of the difference in its rate base as a "positive acquisition adjustment." This adjustment will be reflected in the utility's rates that are set during the utility's next general rate case.

As an alternative to the current process, the bill allows certain PSC-regulated water and wastewater utilities (those with over 10,000 customers) who acquire an existing system to petition the PSC to establish rate base for the acquired system based on the lesser of: (1) the purchase price negotiated by the two utilities; or (2) the average of two appraisals of the system conducted by licensed appraisers chosen from a list established by the PSC. Appraisal fees and transaction costs may also be included. One appraiser is chosen and paid by the acquiring utility, and the other is chosen and paid by the utility to be acquired. An engineering assessment must be conducted and used by the appraisers. To support its request to use this approach, the utility must provide the PSC certain information specified in the bill. Within 8 months of receiving a complete petition, the PSC must issue a final order granting the petition, in whole or in part, or denying the petition, consistent with the public interest.

Current law allows for the creation of intergovernmental utility authorities (IGUAs), which are not regulated by the PSC. The law prohibits an IGUA from acquiring a water or wastewater utility system that was previously acquired through eminent domain by a local government. The bill creates an exception to the law by allowing an IGUA to acquire a utility system that was acquired through eminent domain at least 10 years prior.

The bill is not expected to have a fiscal impact on state or local governments. The bill may encourage transactions involving the purchase of smaller utility systems by eligible utility systems and will allow an IGUA to acquire certain previously condemned systems. These transactions may lead to needed infrastructure improvements, cost efficiencies, and improvements in service quality and regulatory compliance. For acquisitions by PSC-regulated utilities that petition to use the alternative valuation process created in the bill, the PSC may consider potential rate impacts and proposed improvement plans in its consideration of each petition.

The bill provides an effective date of July 1, 2020.

FULL ANALYSIS

This document does not reflect the intent or official position of the bill sponsor or House of Representatives.

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I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Present Situation

Regulated Water and Wastewater Utilities

In various areas throughout Florida, water and wastewater services are provided through privately-owned and operated utilities. These privately-owned utilities, sometimes referred to as investor-owned utilities, 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 privately-owned utilities operating within a single Florida county, the county has the option to regulate rates and service or allow the Public Service Commission (PSC) to regulate those utilities.¹ Regardless of whether the county has opted to regulate those utilities, the PSC has jurisdiction over all water or wastewater utility systems whose service transverses county boundaries, except for systems owned and regulated by intergovernmental authorities.² As of December 2018, the PSC had jurisdiction over 150 utilities in 38 counties.³ Still, the vast majority of water and wastewater customers in the state are served by water and wastewater utilities not regulated by the PSC, primarily by systems owned, operated, managed, or controlled by governmental authorities.

For each utility within its jurisdiction, the PSC has exclusive authority to regulate the utility's rates and service.⁴ The PSC must establish rates that are just, reasonable, compensatory, and not unfairly discriminatory.⁵ In doing so, the PSC must consider the value and quality of the service and the cost of providing the service, which includes, but is not limited to: debt interest; the requirements of the utility for working capital; maintenance, depreciation, tax, and operating expenses incurred in the operation of all property used and useful in the public service; and a fair return on the investment of the utility in property used and useful in the public service.⁶ The PSC has consistently interpreted the "investment of the utility" to be the original cost of the utility's property when first dedicated to public service.⁷

Acquisition of Water and Wastewater Utility Systems by Regulated Utilities

Each water or wastewater utility subject to the PSC's jurisdiction must obtain a certificate of authorization to provide water or wastewater service.⁸ A PSC-regulated utility may not sell, assign, or transfer its certificate of authorization, facilities, or majority organizational control without approval by the PSC. Likewise, PSC approval is required for the transfer of a utility system exempt from PSC jurisdiction, such as a system owned or operated by a governmental authority, to a PSC-regulated utility. To grant approval, the PSC must determine that the sale, assignment, or transfer is in the public interest and that the acquiring utility will fulfill the commitments, obligations, and representations of the utility to be acquired.⁹ The PSC considers, among other things, the financial ability of the buyer to maintain and operate the acquired utility and the technical ability of the buyer to provide service.¹⁰

When the PSC approves a sale, assignment, or transfer of an existing utility system to a PSC-regulated utility, the PSC may establish the rate base for the utility being transferred.¹¹ The PSC establishes the

¹ 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.

² *Id.*

³ Florida Public Service Commission, *Facts and Figures of the Florida Utility Industry*, p. 31 (Jun. 2019).

⁴ S. 367.011, F.S.

⁵ S. 367.081, F.S.

⁶ *Id.*

⁷ Florida Public Service Commission (FPSC), *Agency Analysis of 2020 House Bill 207*, p. 1 (Jan, 6, 2020).

⁸ S. 367.031, F.S.

⁹ S. 367.071(1), F.S.

¹⁰ Rule 25-30.037 (2), F.A.C.

¹¹ S. 367.071(5), F.S.

value of an existing utility's rate base using "original cost." Using original cost, the value of a utility's rate base is determined using the depreciated original cost, or net book value, of the property devoted to the public service. This rate base is the amount upon which the utility may earn a fair return, as established by the PSC.¹²

A utility system may be acquired at a price higher or lower than the net book value of its assets. If the purchase price is greater than net book value, no part of the difference is included in a utility's rate base absent a showing by the utility of extraordinary circumstances.¹³ In determining whether a utility has demonstrated extraordinary circumstances, the PSC will consider evidence including:

- Anticipated improvements in quality of service;
- Anticipated improvements in compliance with regulatory mandates;
- Anticipated rate reductions or rate stability over a long-term period;
- Anticipated cost efficiencies; and
- Whether the purchase was made as part of an arms-length transaction.¹⁴

If the PSC determines that extraordinary circumstances exist, it will allow the acquiring utility to include all or part of the difference in its rate base as a "positive acquisition adjustment." This adjustment will be reflected in the utility's rates that are set during the utility's next general rate case.

A review of 78 water and wastewater utility transfers addressed by the PSC between August 15, 2002,¹⁵ and September 14, 2018, shows that the purchase price of a utility system exceeded its net book value in 39 cases. A positive acquisition adjustment was requested in two of those cases, but the requests were withdrawn prior to the PSC's decision in each case.

Intergovernmental Utility Authorities

The Florida Interlocal Cooperation Act of 1969 (Act) is intended to permit local governmental units to make the most efficient use of their powers by enabling them to cooperate with other localities on a basis of mutual advantage.¹⁶ The Act provides that local governmental entities may jointly exercise their powers by entering into a contract in the form of an interlocal agreement.¹⁷ Under such an agreement, the local governmental units may create a separate legal or administrative entity "to provide services and facilities in a manner and pursuant to forms of governmental organization that will accord best with geographic, economic, population, and other factors influencing the needs and development of local communities."¹⁸

The Act specifically addresses the establishment of such entities to provide water service or sewer service (hereinafter referred to as "intergovernmental utility authorities" or "IGUAs"). Section 163.01(7)(g), F.S., authorizes the creation of IGUAs to acquire, own, construct, improve, operate, and manage public facilities relating to a governmental function or purpose, including water and alternative water supply facilities, wastewater facilities, and water reuse facilities.¹⁹ The membership of an IGUA created under this provision is limited to two or more special districts, municipalities, or counties of the state. The IGUA's facilities may serve populations "within or outside of the members of the entity" but not within the service area of an existing utility system. IGUAs are not subject to regulation by the Public Service Commission.

Except as limited by the interlocal agreement under which the entity is created, all of the privileges, benefits, powers, and terms of the statutes relating to counties²⁰ and municipalities²¹ are fully applicable

¹² FPSC, *supra* note 7, at 1.

¹³ Rule 25-30.0371(2), F.A.C.

¹⁴ *Id.*

¹⁵ The PSC's rule on positive acquisition adjustments was adopted August 4, 2002.

¹⁶ S. 163.01(2), F.S.

¹⁷ S. 163.01(5), F.S.

¹⁸ S. 163.01(2), F.S.

¹⁹ S. 163.01(7)(g), F.S.

²⁰ S. 125.01, F.S.

²¹ S. 166.021, F.S.

to the IGUA. However, the IGUA may not exercise the power of eminent domain over the facilities or property of an existing water or wastewater utility system, and it may not acquire title to any water or wastewater utility facilities or property that were previously acquired by another governmental entity through the use of eminent domain.²²

The Florida Governmental Utility Authority (FGUA) was formed in 1999 pursuant to s. 163.01(7)(g), F.S. As noted on its website, FGUA is a separate legal entity created by interlocal agreement with the limited purpose of owning and operating a public utility system. FGUA currently owns and operates over 80 water and wastewater utility systems in 13 counties: Alachua, Citrus, Hardee, Hillsborough, Lake, Lee, Marion, Orange, Pasco, Polk, Putnam, Seminole, and Volusia.²³

Effect of Proposed Changes

Acquisition of Water and Wastewater Utility Systems by Regulated Utilities

The bill allows certain PSC-regulated water and wastewater utilities who acquire an existing water or wastewater utility system to petition the PSC to establish rate base for the utility system being acquired, without regard to the system's original cost. Using this alternative approach, the acquiring utility may petition the PSC to establish rate base for the system being acquired based on the lesser of: (1) the negotiated purchase price; or (2) the average of two appraisals of the system conducted by licensed appraisers chosen from a list established by the PSC. The rate base established for the system being acquired may also include reasonable transaction and closing costs incurred by the acquiring utility and reasonable fees paid to appraisers. If the rate base established through this approach exceeds the net book value of the system being acquired, the effect is the same as if the acquiring utility had received a positive acquisition adjustment that increases the value of the acquired system's rate base.

The bill provides that one appraiser will be chosen and paid by the acquiring utility and a second appraiser will be chosen and paid by the utility system being acquired. The bill requires each appraiser to provide an appraisal of the value of the utility system being acquired, in a manner consistent with the Uniform Standards of Professional Appraisal Practice.²⁴

Under the bill, the acquiring utility and the utility system being acquired must jointly retain a licensed engineer to assess the tangible assets of the system being acquired. The bill specifies that this assessment must be provided to the two chosen appraisers for use in determining the value of the system being acquired.

A utility that wishes to use this alternative approach must include the following in a petition to the PSC:

- The requested rate base value for the utility system being acquired;
- Copies of the two required appraisals performed by the chosen appraisers, including the average of the valuations produced by each appraisal;
- A copy of the required engineering assessment of tangible assets;
- A 3-year plan to address each deficiency identified in the engineering assessment, which must address impact on quality of service and address any planned improvements to water quality;
- The 5-year projected rate impact on the customers of the utility system being acquired, including, but not limited to, the rate impact of any expected cost efficiencies and the rate impact of using of the alternative valuation approach in lieu of the original cost method;
- The contract of sale;

²² S. 163.01(7)(g)8., F.S.

²³ FGUA, About Us, *FGUA Systems*, <https://www.fgua.com/systems/> (last visited Feb. 28, 2020).

²⁴ The Uniform Standards of Professional Appraisal Practice (USPAP) is the generally recognized ethical and performance standards for the appraisal profession in the United States. USPAP was adopted by Congress in 1989, and contains standards for all types of appraisal services, including real estate, personal property, business, and mass appraisal. See The Appraisal Foundation, *What is USPAP?*,

https://www.appraisalfoundation.org/imis/TAF/Standards/Appraisal_Standards/Uniform_Standards_of_Professional_Appraisal_Practice/TAF/USPAP.aspx?hkey=a6420a67-dbfa-41b3-9878-fac35923d2af (last visited Feb. 28, 2020).

- The estimated appraisal fees, and the estimated transaction and closing costs to be incurred by the acquiring utility; and
- A tariff, including rates equal to the rates of the utility system being acquired.

Within 8 months of receiving a complete petition to use this alternative approach, the PSC must issue a final order on the petition. The PSC may grant the petition, in whole or in part or with modifications in the public interest, or it may deny the petition if in the public interest. The PSC may not approve a rate base value higher than that requested in the petition.

The bill specifies that it applies only to acquiring utilities that provide water service, wastewater service, or both to more than 10,000 customers and are engaged in an arms-length acquisition of a water system, wastewater system, or both types of systems. Currently, it appears that there are three PSC-regulated utilities to which the bill may apply.²⁵ All other PSC-regulated utilities that acquire a water or wastewater system would continue to operate under the PSC's current rules that use the original cost approach to establish rate base and that allow a positive acquisition adjustment upon a demonstration of extraordinary circumstances.

If the alternative approach created by the bill is used to establish rate base for an acquired utility system, that rate base value must be used by the PSC to establish rates during the acquiring utility's next general rate case. The bill specifies that the PSC, in setting future rates for customers of the acquired system, may classify the system as a separate entity, consistent with the public interest.

Acquisition of Condemned Water and Wastewater Utility Systems by IGUAs

Currently, an IGUA may not acquire title to any water or wastewater utility facilities or property that were previously acquired by another governmental entity through the use of eminent domain. The bill creates an exception to this prohibition by allowing an IGUA to acquire a utility system that was previously acquired through eminent domain if at least 10 years have elapsed since the acquisition by eminent domain.

B. SECTION DIRECTORY:

Section 1. Amends s. 163.01, F.S., relating to the Florida Interlocal Cooperation Act of 1969.

Section 2. Creates s. 367.0712, F.S., providing an alternative process to establish rate base for an acquired water or wastewater utility system.

Section 3. Provides an effective date of July 1, 2020.

²⁵ FPSC, *supra* note 7, at 4. As noted in the *Drafting Issues or Other Comments* section of this analysis, this provision of the bill could be clarified as to its specific application.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill may encourage transactions involving the purchase of smaller utility systems by eligible utility systems and will allow an IGUA to acquire certain previously condemned systems. These transactions may lead to needed infrastructure improvements,²⁶ cost efficiencies, and improvements in service quality and regulatory compliance. For acquisitions by PSC-regulated utilities that petition to use the alternative valuation process created in the bill, the PSC may consider potential rate impacts and proposed improvement plans in its consideration of each petition.

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 action requiring the expenditures of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

The bill requires the PSC to adopt implementing rules.

C. DRAFTING ISSUES OR OTHER COMMENTS:

Appraisals

²⁶ *Id.* at 2. If any such improvements are made, the impact of those improvements on rates would be separate from any rate impact of the acquisition itself.

The PSC notes that it has no expertise in property appraisal and suggests that an agency with such expertise may be a more appropriate choice to establish the list of approved appraisers required by the bill.²⁷

The bill provides that one appraiser will be chosen and paid by the acquiring utility and the other appraiser will be chosen and paid by the utility system being acquired. Both parties may benefit from a higher valuation of the utility system to be acquired: the seller could use the valuation to seek a higher sales price, and the buyer could use the valuation to request a higher rate base upon which it will earn a return. This may create a perverse incentive for the appraisals to come in higher than they might otherwise.

Other Drafting Issues

Under the bill, the acquiring utility and the utility system being acquired must jointly retain a licensed engineer to assess the tangible assets of the system being acquired. The bill does not specify what type of information this assessment should include. This may be clarified through implementing rules.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On February 27, 2020, the Commerce Committee adopted a strike-all amendment to the bill and reported the bill favorably as a committee substitute. The amendment:

- Reorganized and streamlined existing provisions of the bill.
- Clarified ambiguous language concerning applicability of the bill.
- Specified the Public Service Commission's discretion to establish rate base consistent with the public interest.
- Required consideration of potential cost efficiencies when projecting the rate impacts associated with a utility acquisition.
- Extended the Commission's review period to 8 months.
- Clarified that the bill applies to arms-length acquisitions of both investor-owned utility systems and government owned or operated systems.
- Allowed an intergovernmental utility authority to acquire a water or wastewater system that was previously acquired through eminent domain if at least 10 years have passed since that system was acquired by eminent domain.

This analysis addresses the committee substitute as approved by the Commerce Committee.

²⁷ *Id.* at 4.