

## HOUSE OF REPRESENTATIVES STAFF ANALYSIS

**BILL #:** PCS for HB 223 Water and Wastewater Utilities

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

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

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
Orig. Comm.: Energy & Utilities Subcommittee		Helpling	Collins

### SUMMARY ANALYSIS

Chapter 367, F.S., establishes the authority of the Public Service Commission (PSC) over the rates and service of regulated water and wastewater utilities. A regulated water or wastewater utility may only impose and collect rates and charges approved by the PSC.

The costs of utility infrastructure improvements, together with a return on investment, are recovered from utility customers through rates and charges set by the PSC in "general rate case proceedings." These costs may also be recovered through rates and charges set by the PSC in "limited proceedings", provided that the utility's rate of return is not adjusted in the proceeding.

PCS for HB 223 creates a new mechanism for regulated water and wastewater utilities to fund certain types of capital projects. Specifically, the bill creates s. 367.0819, F.S., to allow a utility to recover, through a surcharge, capital costs related to projects to enhance water quality, fire protection reliability, and long-term system viability. The PSC would determine the prudence of these projects and their costs at the time of the utility's next general rate case. The bill's stated intent is to promote utility investment in system improvement projects.

The surcharge provides a mechanism for utilities to recover the costs (depreciation and return on investment) for each eligible project completed and placed into service between general rate case proceedings. The bill caps the surcharge by limiting it to no more than 8 percent of the utility's total annual revenues for the preceding calendar year. On an annual basis, revenues from the surcharge would be reconciled with costs approved for recovery through the surcharge, with any difference either refunded to customers with interest or recovered from customers over a 12-month period. The bill requires individual notice to affected customers and published notice in the affected areas at the time of the utility's initial filing to request approval of a surcharge.

The bill's impact on state government revenues and expenditures is indeterminate. The PSC estimates it would require 2 FTEs to implement the bill. According to the PSC, there are more than 160 private utility water and wastewater companies in 34 of the 67 Florida counties. The impact on the PSC depends on how many private utilities decide to use the surcharge mechanism. The bill should have no impact on local government revenues or expenditures. The bill may encourage investment by water and wastewater utilities in infrastructure projects. Customers of utilities who opt to use this new mechanism may see more frequent, smaller rate increases between general rate cases.

The effective date of the bill is July 1, 2011.

## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. EFFECT OF PROPOSED CHANGES:

##### Present Situation:

Chapter 367, F.S., establishes the authority of the Public Service Commission (PSC) over the rates and service of regulated water and wastewater utilities.<sup>1</sup> A regulated water or wastewater utility may only impose and collect rates and charges approved by the PSC.<sup>2</sup>

Pursuant to s. 367.081, F.S., the PSC must set rates that are “just, reasonable, compensatory, and not unfairly discriminatory.”<sup>3</sup> In setting rates, the PSC must consider “the value and quality of the service and the cost of providing the service, which shall include, but not be 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.”<sup>4</sup> In determining whether property is to be “used and useful in the public service,” the PSC must consider whether the property is needed to serve current customers, whether the property is needed to serve customers up to five years after the end of the test year used to set rates,<sup>5</sup> or whether the utility has presented clear and convincing evidence to justify consideration of property needed to serve customers more than five full years from the end of the test year used to set rates.<sup>6</sup> The PSC may include such property in the utility’s base rates even if it is acquired or constructed up to 24 months or longer beyond the test year used to set rates.<sup>7</sup>

The PSC may also conduct limited proceedings to address any matter within its jurisdiction, including rate adjustments. However, the PSC may not use a limited proceeding to adjust rates if the effect of the adjustment would be to change a utility’s last authorized rate of return.<sup>8</sup>

Currently, a utility’s infrastructure improvements would be incorporated in rates adopted under either s. 367.081, F.S., or s. 367.0822, F.S.

In its Report No. 08-63, the Office of Program Policy Analysis & Government Accountability (OPPAGA) addressed the “unique financial challenges” of small water and wastewater utilities regulated by the

---

<sup>1</sup> For purposes of chapter 367, F.S., “a utility” is defined in s. 367.021(12), F.S., as “a water or wastewater utility and, except as provided in s. 367.022, includes every person, lessee, trustee, or receiver owning, operating, managing, or controlling a system, or proposing construction of a system, who is providing, or proposes to provide, water or wastewater service to the public for compensation.” Section 367.022, F.S., specifies certain types of entities and activities that are exempt from regulation by the PSC as a utility. These exemptions include, among other things, “[s]ystems owned, operated, managed, or controlled by governmental authorities, including water or wastewater facilities operated by private firms under water or wastewater facility privatization contracts as defined in s. 153.91, and nonprofit corporations formed for the purpose of acting on behalf of a political subdivision with respect to a water or wastewater facility,” “[s]ystems with the capacity or proposed capacity to serve 100 or fewer persons,” and “[n]onprofit corporations, associations, or cooperatives providing service solely to members who own and control such nonprofit corporations, associations, or cooperatives.”

<sup>2</sup> Section 367.081(1), F.S.

<sup>3</sup> Section 367.081(2)(a)1., F.S.

<sup>4</sup> *Id.*

<sup>5</sup> Pursuant to Rule 25-30.430, Florida Administrative Code, prior to the filing of an application for a general rate increase, a utility must submit to the PSC a written request for approval of a test year, supported by a statement of reasons and justifications showing that the requested test year is representative of utility operations. Expenses and investment in the test year are used to establish a utility’s annual revenue requirement, which is used as the basis for setting rates.

<sup>6</sup> Section 367.081(2)(a)2., F.S.

<sup>7</sup> *Id.*

<sup>8</sup> Section 367.0822, F.S.

PSC.<sup>9</sup> The OPPAGA report notes that these small utility systems, because of a lack of economies of scale, frequently face financial challenges in maintaining system reliability, operating in a cost-effective manner, retaining an adequate labor pool, sustaining a stable financial position, and complying with regulatory requirements. The report also notes that these small utility systems may be reluctant to file for rate increases due to the time and expense involved in rate proceedings and the desire to keep rates low in light of the fact that, in contrast to some larger utilities, they have fewer customers over which to spread costs. The report suggests that the long-term financial viability and adequate investment in infrastructure may suffer as a result.

The OPPAGA report identifies some existing regulatory tools used to address these issues, including staff-assisted rate cases for small water and wastewater utilities, a price index that all water and wastewater utilities may apply to major categories of operating costs without a hearing, and pass-through rate adjustments that all water and wastewater utilities may employ for specific types of costs without a hearing. Still, the report suggests that the PSC should monitor small water and wastewater utilities to ensure adequate investment in infrastructure and, if deemed necessary, should consider adopting additional regulatory tools. As an example of such a tool, the report discusses a capital improvement surcharge mechanism by which a temporary surcharge would be added to rates to enable expeditious recovery of costs for qualifying investments and expenditures.

### **Effect of Proposed Changes:**

The bill creates a new mechanism for regulated water and wastewater utilities to fund certain types of capital projects. Specifically, the bill creates s. 367.0819, F.S. to allow a utility to recover, through a surcharge, prudently incurred capital costs related to projects to enhance water quality, fire protection, reliability and long-term system viability. The PSC would determine the prudence of these projects and their costs at the time of the utility's next general rate case. The bill's stated intent is to promote utility investment in system improvement projects.

#### *Eligible Projects*

For a project to qualify for cost recovery through this new surcharge mechanism it must be a "non-revenue producing project." The bill defines "non-revenue producing project" as "a project that is not constructed or installed for the purpose of serving a new customer." New infrastructure projects and projects to improve existing infrastructure that are designed to serve new customers are not eligible for cost recovery through this surcharge.

The bill provides that costs of a project are eligible to be recovered through the surcharge if the project is used for the production, treatment, transmission, storage, distribution, or provision of potable or recycled water to the public or for the collection, transportation, or disposal of wastewater for the public.

The bill lists examples of eligible projects, which include but are not limited to: water quality improvement projects designed to achieve primary or secondary water standards as determined by the Department of Environmental Protection, the United States Environmental Protection Agency, or any other governmental entity having similar regulatory jurisdiction; wastewater quality improvement projects; main, service line, and valve replacement projects; main relining and rehabilitation projects; fire and flushing hydrant installation and replacement projects; main extension to the eliminate dead ends; interconnection projects; water, wastewater, and reuse meter installation and replacement projects; wastewater collection, replacement, relining and rehabilitation projects; and manhole replacement and rehabilitation projects. The bill provides that onsite manufacturing of liquid chlorine or bleach does not constitute a water or wastewater treatment project eligible for recovery through the surcharge.

For a project to qualify for cost recovery through the new surcharge it must be completed and placed into service after the test year that was used by the PSC to establish a utility's current base rates. Also,

---

<sup>9</sup> *The PSC and Legislature Could Consider Several Options to Enhance Services and Consumer Protection*, Office of Program Policy Analysis & Government Accountability, Report No. 08-63, released November 2008.

any project that was approved for cost recovery through a previous rate case is not eligible for cost recovery through the new surcharge.

#### *Notice and Information to Customers*

The bill requires that a utility seeking to use the surcharge mechanism must provide notice by mail to each customer in the affected service areas of the initial surcharge tariff filing. The utility also must publish notice of the surcharge filing in a newspaper of general circulation in the affected service areas.

A new surcharge shall appear as a separate line item on each customer's bill and be billed in accordance with the current billing cycle used by the utility. If there is any change in a surcharge, it must be reflected in the first bill to the customer following the change.

Upon the approval of a surcharge, the bill requires a utility to maintain and make available for public inspection a detailed schedule for each completed project, including the plant account number and title, the category of the project, the project name and description, the cost of the project in the month of closing, and the month and year of closing. This information is to be made available during normal business hours at each utility location or on the utility's website.

#### *Surcharge Mechanism*

The bill provides that a utility seeking to use the surcharge mechanism must submit, for PSC approval, tariffs establishing a formula for calculation of rates reflecting the surcharge. The bill states that these rates must include cost recovery for depreciation and return on investment for each eligible project. The rate of return on investment for each eligible project must be based on the pre-tax rate of return last authorized by the PSC for the utility. The surcharge established by the proposed formula must be calculated, applied, and recovered in accordance with the utility's last authorized rate structure approved by the PSC. The bill provides that a surcharge tariff shall be approved as a matter of right without hearing within 60 days of filing the surcharge tariff with the commission.

Once an eligible project is complete, the utility, before including the project cost in the surcharge, must file a sworn affirmation as to the accuracy of the figures and calculations upon which the surcharged is based, stating that the change in rates will not exceed the utility's last authorized rate of return on equity. Any person that provides a false statement in the affirmation is guilty of a felony of the third degree, punishable as provided in s. 775.082, s. 775.083, or s. 775.084, F.S.

Pursuant to 367.121, a utility is required to file an annual report. If within 15 months after the filing, it is determined the utility exceeded the range of its last authorized rate of return on equity after the implementation of the surcharge for the year the report is filed, the commission may order the utility to refund, with interest, the difference to the rate payers and adjust the rates accordingly.

The bill provides that the surcharge will be revaluated, as needed, on a quarterly basis by the utility to include the costs of completed eligible projects that have been placed into service. The utility must file supporting data for an increase or decrease in the surcharge and must file a sworn affirmation as detailed above. The affirmation and the data supporting the adjustments must be delivered to the Office of Public Counsel. The adjusted surcharge will take effect, without hearing, 45 days after the supporting data and affirmation are filed with the commission and delivered to the Office of Public Counsel.

The bill provides that the initial tariff establishing the surcharge mechanism, as well as the adjustment to the surcharge, are not subject to s. 367.091 F.S., which outlines procedures currently in place for a utility's request with the PSC to adjust rates.

The revenues collected through the surcharge are subject to an annual reconciliation period of 12 months, from the date the surcharge tariff was approved. Within 30 days of the end of the 12 month reconciliation period, the utility must file with the commission and deliver to the Office of Public Counsel, a reconciliation report and affirmation, as detailed above. The reconciliation report shall compare the revenues collected through the surcharge with the actual eligible costs incurred by the

utility during the reconciliation period. The commission shall have 45 days to administratively approve, without hearing, the reconciliation report. The difference between revenue and costs shall be recovered or refunded as appropriate by the utility, without hearing, as an automatic adjustment to the subsequent surcharge calculation. Revenues that are in excess of system-improvement shall be refunded with interest to customers pursuant to commission rule for water and wastewater utilities.

The surcharge will reset to zero on the effective date that new base rates are approved by the PSC which include the previously recovered costs collected by the utility through use of the surcharge.

The total cumulative amount recovered by a utility utilizing the surcharge shall not exceed 8 percent of the utility's total annual retail water service revenues, and where applicable, 8 percent of the utility's total annual wastewater service revenues for the preceding calendar year. Thus, each year the 8 percent cap will fluctuate with the total amount of water and wastewater service revenues a utility collects.

The commission may review the prudence of all projects subject to the surcharge at the utility's next base rate proceeding following the commission's initial approval of the surcharge. If the commission determines that the costs of a project were not prudently incurred, or that the project was not used and useful to the customers, all revenue collected through the surcharge shall be refunded pursuant to PSC rules.

#### *Impact to Rate Payers*

The impact on rate payers is capped at 8 percent of the utility's "total annual retail water service revenues, and where applicable, 8 percent of the utility's total annual wastewater service revenues, for the preceding year." Including the revenues collected through the surcharge in the total annual retail service revenues, could result in a significant increase in rate payer's bills over a short amount of time as the 8 percent cap increases year to year with the collection of surcharge revenues. However, staff has been informed that this is not the sponsor's intent, therefore an amendment has been prepared to clarify that revenues collected through the surcharge cannot be included in a utility's total service revenues.

If surcharge revenues are not included in the total annual retail service revenues, customers will see a more gradual, smaller increase over time in their average bill between rate cases. The cap will fluctuate year to year as a utility's total annual retail service revenue fluctuates based on sales and adjustments to rates currently allowed by the PSC.

#### B. SECTION DIRECTORY:

**Section 1.** Creates s. 367.0819, F.S., providing a new mechanism for regulated water and wastewater utilities to fund specified types of projects.

**Section 2.** Provides an effective date of July 1, 2011.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

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

##### 1. Revenues:

The bill's impact on state government revenues is indeterminate. Use of the new surcharge mechanism created in the bill may reduce the frequency of general rate case filings by utilities. According to the PSC, it averages 21 general rate cases per year, with filing fees ranging from \$200 to \$4,500, depending on the type of case and the size of the utility. Twelve of the 21 cases are staff-assisted rate cases for very small utilities, and the associated filing fees range from \$200 to

\$1,000. No filing fee is currently applicable to the surcharge mechanism. It is not clear if the PSC's existing rulemaking authority would allow it to adopt a filing fee for the surcharge mechanism.

2. Expenditures:

While there may be a reduction in general rate cases, the PSC notes that processing the initial and subsequent quarterly surcharge tariff filings will increase staff time to process. Also, the PSC notes it will be required to true-up revenues recovered through the surcharge on an annual basis. The PSC estimates it would need 2 FTEs to implement the bill. According to the PSC, as of December 2008, there are more than 160 investor owned water and wastewater utility companies in 34 of the 67 Florida counties. The total impact to the PSC will depend on how many of these utilities choose to use the surcharge mechanism.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None. Utility systems owned, operated, managed, or controlled by governmental authorities are exempt from regulation by the PSC, pursuant to s. 367.022, F.S., thus this bill would not apply to local government water and wastewater utilities.

2. Expenditures:

None. See comment above.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

The bill may encourage investment by water and wastewater utilities in infrastructure projects that enhance water quality, fire protection reliability, and long-term system viability by establishing a surcharge mechanism that allows utilities to avoid filing a general rate case to recover the costs of eligible projects and earn a return on their investment. Customers of utilities who opt to use this new mechanism could see more frequent, but smaller, rate increases associated with the addition of eligible projects.

D. FISCAL COMMENTS:

None.

### III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

This bill does not appear to require counties or municipalities to take an action requiring the expenditure of funds, reduce the authority that counties or municipalities have to raise revenue in the aggregate, nor reduce the percentage of state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None provided.

C. DRAFTING ISSUES OR OTHER COMMENTS:

An amendment is being offered by the bill sponsor to clarify that revenues collected through the surcharge cannot be included in a utility's total service revenues.

**IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES**