

The Florida Senate
BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Environmental Preservation and Conservation Committee

BILL: SB 950

INTRODUCER: Senator Bennett

SUBJECT: Water and Wastewater Utilities

DATE: March 21, 2011 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Wiggins	Yeatman	EP	Pre-meeting
2.	_____	_____	CU	_____
3.	_____	_____	BC	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

The bill creates a mechanism for regulated water and wastewater utilities to recover, through a surcharge, incurred capital costs for investment in non-revenue producing system improvements. The bill defines eligible projects and the manner in which companies may request cost recovery and how the surcharge should be implemented.

The bill creates section 367.0819 of the Florida Statutes.

II. Present Situation:

Chapter 367, F.S., establishes the authority of the Public service Commission (PSC) to establish 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 PSC¹. Section 367.081(2)(a), further specifies that the PSC, “on its own motion or upon request of the utility, may fix rates for the utility that are just, reasonable, compensatory, and not unfairly discriminatory”². The section further provides that the PSC consider: the value and quality of the service and the cost of providing the service; which includes, but 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.

¹ See s. 367.081, F.S.

² See s. 367.081(2)(a)1., F.S.

Section 367.0822, F.S., authorizes a utility, in a limited proceeding, to come before the PSC for any matter under its jurisdiction including a request to adjust its rates. Within the proceeding, the PSC must identify issues to be considered and can, upon its discretion, expand the scope of the proceeding to other related matters. A limited proceeding cannot be used to adjust rates if the effect of the adjustment would be to change the last authorized rate of return.

Currently, infrastructure improvements have to be incorporated in utility rates via a PSC proceeding under either s. 367.081(2), F.S., or s. 367.0822, F.S. Current law does not permit these infrastructure improvement surcharges without an evidentiary hearing. According to s. 367.081(2), F.S., the portion of unutilized capacity beyond the five-year period cannot be recovered from current customers.

Section 367.091(6), F.S., provides that an application through a tariff filing to establish, increase, or change a rate or charge other than through a rate proceeding pursuant to s. 367.081, F.S., or s. 367.101, F.S., must be accompanied by a cost justification. The statute further provides that the PSC may withhold consent to the operation of any or all portions of the new rate schedules, by a vote to that effect within 60 days, and must give a reason or statement of good cause for withholding its consent. The PSC must make its final decision on the application within eight months after the official date of filing.

The PSC typically approves or denies tariff filings, giving substantially affected persons a point of entry to file a petition and request a hearing to protest any points of contention with the decision. Substantially affected persons, including customers of the utility, may protest the Proposed Agency Action (PAA), potentially triggering a PSC evidentiary proceeding.

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 PSC. 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.³

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

³ *The PSC and Legislature Could Consider Several Options to Enhance Services and Consumer Protection*, Office of Program Analysis & Government Accountability, Report No. 08-63. released November 2008.

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.⁴

III. Effect of Proposed Changes:

Section 1 creates s. 367.0189(1), F.S., to promote utility investment in non-revenue producing system improvement projects and for the PSC to allow for recovery of incurred capital costs of projects to enhance water quality, fire protection reliability, and long-term system viability through a quarterly surcharge. The section creates s. 367.0189(6)(b), F.S., and defines the type of infrastructure improvement projects eligible for recovery through a surcharge as being capital improvement projects. A project is eligible for recovery if it is not included in the test year on which current rates are based. There are occasions when the PSC includes projects in rates set by a rate proceeding under s. 367.081(2), F.S., that fall outside the test year. However, the project items are not eligible for recovery if already included in established rates.

The section creates s. 367.0189(4)(b), F.S, which refers to the surcharge as a quarterly surcharge and references to quarterly updates. The utility files a tariff for PSC approval demonstrating the calculation of the surcharge, a notification to customers of the filing, and disclosure of the surcharge as a separate line item on a customer's bill. The language does not specify whether the surcharge will be billed monthly or quarterly.⁵

The language in s. 367.0189(6)(b) further states that a project is only eligible if it 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 sewage for the public. However, examples of eligible projects listed in the bill include such items as "main relining and rehabilitation," and "fire and flushing hydrant installation and replacement." In addition, the section provides the caveat that eligible projects "are not limited to" those described items. This language is broad and could result in filings that would not be generally considered capital infrastructure improvement projects.⁶

The language specifically designates projects that improve facilities to meet water quality standards set by the U. S. Environmental Protection Agency (EPA) to be eligible for recovery. Due to the implementation of new EPA rules on Numeric Nutrient Criteria Standards, it is reasonable to expect that there will be an increase in the number of infrastructure improvement projects undertaken by affected wastewater utilities. Numeric nutrient criteria compliance costs for affected utilities are expected to be substantial and the increase in costs will result in rate increases.

Section 367.0819(2), F.S., provides that in order for the utility to recover costs from its customers, it must submit tariffs establishing a formula for calculation of rates. The calculation should include recovery of depreciation and return on investment for each eligible project. The

⁴ *The PSC and Legislature Could Consider Several Options to Enhance Services and Consumer Protection*, Office of Program Analysis & Government Accountability, Report No. 08-63. released November 2008.

⁵ Florida Public Service Commission, *Senate Bill 950 Analysis* (February 22, 2011) (on file in the Senate Committee on Environmental Preservation and Conservation).

⁶ *Id.*

proposed language of the bill does not state how the appropriate rate of return on investment will be calculated. There are at least three possible options for rate of return calculation: (1) use the company's overall cost of capital using the currently authorized return on equity; or (2) the PSC established leverage formula for water and wastewater utilities; or (3) the incremental cost of capital for the included projects. There is no direction given regarding the appropriate return on equity to apply. There is nothing to prohibit a company that is over earning from receiving the increase. Also, the language does not distinguish whether pretax or post tax return on equity should be applied.⁷

The language provides that the company must provide notice to each customer in the affected service area and publish notice of the filing pursuant to PSC rules. The bill does not address the timing of the notice to a utility's customers. Traditionally, a customer should be given notice of a change in a rate before that rate is effective to allow enough time to alter usage patterns. It also does not allow for customer meetings in the utility's service area.

Section 367.0819(2), F.S.:

- implies that more than one project may be recoverable at any given time; however, the language sets no constraints on the number of projects;
- does not specify whether surcharges may be limited to a single system of a multisystem utility rather than recovered from all systems; and
- does not address used and useful adjustments pursuant to subsection 367.081(2), F.S.⁸

The language further states that the surcharge may not exceed eight percent of otherwise applicable rates and charges approved by the PSC. It is unclear whether the eight percent cap is intended as an annual cap. It is also unclear whether the eight percent cap applies to a single project surcharge or a total cap of eight percent for all eligible projects. It is not clear whether the cap is applied on a system-by-system basis or on a total utility basis.

Section 367.0189(3), F.S., allows the surcharge tariff to be approved automatically within 60 days of filing. According to PSC rules, a substantially affected person has 21 days to protest the approval of a tariff that would then trigger an evidentiary hearing. The potential time and cost savings for the PSC and the utility of the surcharge may be negated if the PSC must conduct hearings to address customer concerns relating to the surcharge.

Proposed section 367.0189(4), F.S., establishes criteria the utility must follow when applying the surcharge to a customer's bill. The surcharge shall be listed as a separate line charge on a customer's bill and is subject to a revenue true-up based on a period of 12 months ending December 31 of each year. The surcharge will be reset at zero as of the effective date of a new base rate that includes recovery of said costs. Once reset, the surcharge will only include new projects that had not been previously reflected in the base rate. The timing of the true-up review is pegged to the calendar year which creates the possibility of partial year true-ups at the beginning and end of the surcharge recovery. It is unclear whether partial calendar year recovery

⁷ Florida Public Service Commission, *Senate Bill 950 Analysis* (February 22, 2011) (on file in the Senate Committee on Environmental Preservation and Conservation).

⁸ Florida Public Service Commission, *Senate Bill 950 Analysis* (February 22, 2011) (on file in the Senate Committee on Environmental Preservation and Conservation). A used and useful adjustment is typically applied when the PSC determines that a portion of utility capacity is unlikely to be necessary during a five-year prospective period.

of capital costs (depreciation and return) is to be trued-up to twelve months of surcharge revenue, or revenue for a prorated portion of the year based on the number of months the surcharge was recovered. In addition, the subsection does not address the appropriate interest rate to be applied to refunds in the event that refunds are required nor does the language specify whether credits may be applied to a customer's bill in lieu of a cash refund.

Section 367.0189(4)(b), F.S., describes that a surcharge established in this section is to be reevaluated on a quarterly basis to reflect the costs of eligible projects placed into service. The language states that a utility must file supporting data to the PSC on a quarterly basis in order to "increase or reduce the surcharge." It also requires the data to be filed with the Office of Public Counsel "at least 10 days before the effective date of the modified surcharge." The surcharge as structured may cause a major increase in the workload of the PSC to process the quarterly evaluations. A ten-day notice to the Office of Public Counsel may not provide enough time for a thorough review. There is also no direction provided for a depreciation adjustment in the reevaluation.

Section 367.0189(9), F.S., gives the PSC authority to review the prudence of all of the projects funded by the surcharge during a utility's subsequent rate proceeding. The section also requires refunds in the event that a project is found to be imprudent if the project was not used and useful in the public service. The payment of interest on the monies paid towards an ineligible project is not addressed. This process may result in more infrequent rate proceedings and the prudence review may not occur in a timely manner. This may result in full recovery of a project before any review has taken place.

Section 2 provides that this act shall take effect July 1, 2011.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:**A. Tax/Fee Issues:****B. Private Sector Impact:**

The bill will encourage investment by water and wastewater utilities in infrastructure projects. Utilities who choose to undergo these capital improvements will incur costs for attorney's fees and consulting fees. If their request is protested, the companies will further incur costs associated with defending the request. The proposed changes might allow some companies to obtain quicker rate relief. These capital improvements may improve the job market for occupations related to executing those improvements. Customers of utilities who opt to use this new mechanism will incur quarterly surcharges associated with the water and wastewater improvement projects.

C. Government Sector Impact:

According to the PSC, there will be increased costs and up to two FTE's including the cost of two regulatory analysts

In general, the bill allows more expedient recovery of infrastructure improvement investments by investor owned water and wastewater utilities if no substantially affected person formally protests the PSC's decision. Florida law requires the PSC to give substantially affected persons a point of entry to contest tariff decisions. The likelihood for consumer intervention escalates as the costs of the projects increase, therefore creating an impact on the PSC's workload. It is not clear whether costly PSC proceedings can be avoided since the decision to approve a tariff may be protested, potentially triggering a PSC evidentiary proceeding. There will be staff time devoted to rulemaking, including, drafting forms as well as writing administrative procedures.

VI. Technical Deficiencies:

None.

VII. Related Issues:

According to the PSC, providing rulemaking authority to the PSC would permit the PSC and the industry to develop rule guidance on the appropriate return on equity and mechanisms for updating the procedures related to the collection of surcharges. Further, this could address some of the issues related to increased workload to the agency.

VIII. Additional Information:**A. Committee Substitute – Statement of Substantial Changes:**

(Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

B. Amendments:

None.

This Senate Bill Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.
