

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 Committee on Appropriations

BILL: CS/CS/CS/SB 272

INTRODUCER: Appropriations Committee; Communications, Energy, and Public Utilities Committee; Community Affairs Committee; and Senator Simpson

SUBJECT: Water and Wastewater Utilities

DATE: March 17, 2014

REVISED: _____

| | ANALYST | STAFF DIRECTOR | REFERENCE | ACTION |
|----|----------|----------------|-----------|--------|
| 1. | Caldwell | Caldwell | CU | Fav/CS |
| 2. | White | Yeatman | CA | Fav/CS |
| 3. | Davis | Kynoch | AP | Fav/CS |

Please see Section IX. for Additional Information:

COMMITTEE SUBSTITUTE - Substantial Changes

I. Summary:

CS/CS/CS/SB 272 creates a process for customers to petition the Florida Public Service Commission (PSC, FPSC, or commission) to require compliance with secondary water quality standards. If a utility fails to comply with commission orders, the process could result in revocation of the utility's certificate of authority. The bill provides petition criteria and factors the commission must consider in its review of the petition and the action it may take to dispose of the petition.

The bill adds secondary water quality standards to the criteria that the PSC must consider when setting rates for water service. The bill provides guidelines for the secondary water quality standards. The bill authorizes the commission to deny all or part of a rate increase for a utility's system or part of a system if it determines that the quality of water service is less than satisfactory. The bill requires a utility to provide an estimate of the costs and benefits of plausible solutions for each concern that the commission finds, meet with the customers to discuss the costs and solutions, and periodically report on the progress of implementation. The commission may require the utility to resolve certain problems and require benchmarks and periodic progress reporting. The bill authorizes the commission to adopt rules to assess and enforce compliance with the secondary water standards and prescribe penalties for a utility's failure to adequately address each concern.

The bill appropriates \$212,521 in recurring funds and \$12,012 in nonrecurring funds from the General Revenue Fund to the PSC and authorizes three full-time equivalent positions for the 2014-2015 fiscal year to implement the provisions in this act.

II. Present Situation:

Regulatory Compact

Utilities subject to economic regulation have what is called a “regulatory compact” with their customers and the regulators, which is a method of balancing rights and obligations of a utility and its ratepayers. The regulatory compact has been described as follows:

The utility business represents a compact of sorts; a monopoly on service in a particular geographic area (coupled with state-conferred rights of eminent domain or condemnation) is granted the utility in exchange for a regime of intensive regulation, including price regulation, quite alien to the free market. . . . Each party to the compact gets something in the bargain. As a general rule, utility investors are provided a level of stability in earnings and value less likely to be attained in the unregulated or moderately regulated sector; in turn, ratepayers are afforded universal, non-discriminatory service and protection from monopoly profits through political control over an economic enterprise.¹

Public Service Commission Jurisdiction Over Water and Wastewater Utilities

Chapter 367, F.S., is the Water and Wastewater System Regulatory law. Section 367.011, F.S., grants the commission exclusive jurisdiction over each utility with respect to its authority, service, and rates. It also declares the regulation of utilities to be in the public interest, and the chapter to be an exercise of the police power of the state for the protection of the public health, safety, and welfare.

Despite this broad grant of authority, the PSC does not have the authority over all water and wastewater utilities. Section 367.022(2), F.S., exempts from the PSC regulation or application of chapter 367, F.S., to those water or wastewater systems owned, operated, managed, or controlled by governmental authorities,² including water or wastewater facilities operated by private firms pursuant to water or wastewater facility privatization contracts.

Section 367.171, F.S., provides that, after ten continuous years under the jurisdiction of the commission, a county can opt-out of commission jurisdiction by resolution or ordinance. In such a case, the county regulates the rates of all utilities in that county. However, the commission has exclusive jurisdiction over all utility systems whose services transverse county boundaries, whether the counties involved are jurisdictional or nonjurisdictional. The commission does not have jurisdiction over utility systems that are subject to, and remain subject to, interlocal utility

¹ Tomain and Cudahy, *Energy Law*, 121-122 (quoting *Jersey Cent. Power and Light Co. v. F.E.R.C.*, 810 F.2d 1168 (D.C. Cir. 1987)).

² In this context, the term “governmental authority” means a political subdivision, a regional water supply authority, or a nonprofit corporation formed for the purpose of acting on behalf of a political subdivision with respect to a water or wastewater facility. See Section 367.021(7), F.S.

agreements in effect as of January 1, 1991, that create a single governmental authority to regulate the utility systems whose service transverses county boundaries. According to the PSC webpage, the commission has jurisdiction over 143 investor-owned utilities in 37 counties that serve 120,567 water and 74,317 wastewater customers³ and counties have jurisdiction in 30 counties, as listed in the following table.⁴

| Jurisdictional Counties (37) | Non-Jurisdictional Counties (30) |
|------------------------------|----------------------------------|
| Alachua | Baker |
| Bradford | Bay |
| Brevard | Calhoun |
| Broward | Citrus |
| Charlotte | Collier |
| Clay | Columbia |
| Duval | Dade |
| Escambia | Desoto |
| Franklin | Dixie |
| Gadsden | Flagler |
| Gulf | Gilchrist |
| Hardee | Glades |
| Highlands | Hamilton |
| Jackson | Hendry |
| Lake | Hernando |
| Lee | Hillsborough |
| Levy | Holmes |
| Manatee | Indian River |
| Marion | Jefferson |
| Martin | Lafayette |
| Monroe | Leon |
| Nassau | Liberty |
| Okaloosa | Madison |
| Okeechobee | Santa Rosa |
| Orange | Santa Rosa |
| Osceola | Suwanee |
| Palm Beach | Taylor |
| Pasco | Union |
| Pinellas | Wakulla |
| Polk | Walton |
| Putnam | |
| Seminole | |
| St. Johns | |
| St. Lucie | |

³ Florida Public Service Commission, *Facts and Figures of the Florida Utility Industry* (April 2013), at 29-33, <http://www.psc.state.fl.us/publications/pdf/general/factsandfigures2013.pdf> (last visited Jan. 31, 2014).

⁴FPSC, *Jurisdictional and Non-Jurisdictional Counties*, <http://www.psc.state.fl.us/utilities/waterwastewater/wawtextchart.pdf> (last visited Jan. 31, 2014).

| Jurisdictional Counties (37) | Non-Jurisdictional Counties (30) |
|------------------------------|----------------------------------|
| Sumter | |
| Volusia | |
| Washington | |

Public Service Commission Rate-Making and Water Quality

Pursuant to s. 367.081, F.S., the PSC establishes rates which are just, reasonable, compensatory, and not unfairly discriminatory. In doing so, the commission 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.

According to the PSC staff:

The FPSC establishes rates for investor-owned water and wastewater utilities on an individualized, prospective basis. In the rate-setting process, a utility submits investments it believes are appropriate for inclusion into its rate base, and expenses that it considers appropriate for recovery in rates. The role of the PSC is to determine the extent to which such investments and expenses submitted are reasonable and prudent. Once the PSC determines which items are allowable for the purpose of recovery, rates are established that allow the utility an opportunity to earn a fair rate of return on its investment and to recover all prudently incurred expenses associated with the provision of utility service. The PSC does not set rates for government-owned utilities.

The commission establishes rates for investor-owned water and wastewater utilities pursuant to Chapter 367, F.S., in those counties that have elected to place utilities under the PSC jurisdiction. The objective of regulation under the statute is to provide safe potable water and wastewater services at fair and reasonable rates. The PSC sets rates through an evidentiary administrative proceeding, or through a process known as a Staff Assisted Rate Case (SARC). The commission holds customer service hearings in the investor-owned utility’s service area to accept customer testimony as part of the record of the proceeding. The FPSC reviews the utility’s costs to determine if they are prudently incurred. The FPSC also reviews the utility’s earnings to determine a fair rate of return on investment.

When setting rates, the PSC takes into account customer concerns and issues with water and wastewater utilities, including the value and the quality of the service. The commission has the flexibility to adjust rates based on the evidence on record in a rate case. However, current law does not give the PSC specific authority to consider secondary drinking water standards or wastewater standards.⁵

⁵ FPSC, *Senate Bill 272 Agency Analysis* (Nov. 13, 2013).

Although the statute requires the commission to consider quality of service in setting rates, the focus is on the quality of the service provided; that is, the focus is primarily on how well the utility provides water, not the quality of the water itself. The quality of the water and compliance with secondary water quality standards are recurrent issues at both the PSC and the Legislature.⁶ In 2012, the Legislature created the Study Committee on Investor-Owned Water & Wastewater Utility Systems (study committee) and directed it to review a list of issues, including water quality.⁷ The study committee recommended amending s. 367.081, F.S., to establish a mechanism within a rate case proceeding to require the PSC to consider the extent to which a utility meets secondary water and wastewater standards.⁸

Penalties

Section 367.161, F.S., provides penalties. If a utility knowingly refuses to comply with or willfully violates any provision of Chapter 367, F.S., or any commission rule or order, the utility is subject to a penalty for each such offense of not more than \$5,000 to be fixed, imposed, and collected by the commission. Each day that the refusal or violation continues constitutes a separate offense. Each penalty is a lien upon the real and personal property of the utility, enforceable by the commission as a statutory lien under Chapter 85, F.S. The proceeds from the enforcement of a lien are deposited into the General Revenue Fund.

Standards for Secondary Water Quality Characteristics

Secondary water quality characteristics refer to those characteristics of drinking water that typically have no adverse health effects, but instead are generally associated with aesthetic concerns.⁹ The Department of Environmental Protection (DEP) has established maximum allowed levels for 14 criteria of secondary water quality characteristics. Based on the U.S. Environmental Protection Agency (EPA) mandated standards, the DEP's list of secondary water quality characteristics includes: aluminum, chlorine, copper, fluoride, iron, manganese, silver, sulfate, zinc, color, odor, pH, total dissolved solids, and foaming agents.¹⁰

Water quality monitoring of secondary water quality characteristics by the DEP consists of a three-year schedule of sampling of all water systems in the state serving more than 25 people per

⁶ Water quality of service problems, for which customers have provided testimony at PSC hearings, include black water, pressure, odor, and customer service. See PSC, Final Order No. PSC-97-0280-FOF-WS (Mar. 12, 1997).

⁷ The Study Committee was created by Chapter 2012-187, s. 2, Laws of Fla. (CS/HB 1389).

⁸ For the text of the recommended statutory change, see Study Committee on Investor-Owned Water & Wastewater Utility Systems, Study Committee Report (Feb. 15, 2013), Attachment IV.9-D, at 115 of 386, *available at* <http://www.psc.state.fl.us/utilities/waterwastewater/Water-Wastewater%20Sub%20Committee%20Report.pdf> (last visited Jan. 31, 2014).

⁹ Secondary drinking water contaminants, if found at considerably high concentrations, may result in health implications in addition to just aesthetic degradation.

¹⁰ DEP, *Secondary Drinking Water Standards*, http://www.dep.state.fl.us/water/drinkingwater/sec_con.htm (last visited Jan. 31, 2014).

day.¹¹ Every three years a single sample¹² is taken from a plant or from the connected distribution system, but not from homes.¹³ Violations of DEP's secondary water quality characteristics found by the three year test result in quarterly sampling in accordance with a corrective action plan.¹⁴

III. Effect of Proposed Changes:

Section 1 creates s. 367.072, F.S., to allow customers to petition the commission for relief when water quality standards are not met by a utility. The bill requires customers to first file a notice of intent with the commission, wait up to ten days for instructions from the commission, and then collect signatures within 90 days of receiving instructions. The bill requires that the petition must be signed by at least 65 percent of the utility's customers of the service area covered under the certificate of authorization, and must state with specificity the problem that the utility's customers have with the utility's quality of water service. Customers who sign the petition must be customers currently receiving service from the utility. If customers are served by a master meter, 65 percent of the customers, tenants, or unit owners served must support the petition. Customers are given 30 days to cure an insufficient petition.¹⁵ The bill prohibits a utility from filing a rate case until the petition is acted upon by the commission.

The commission must review the petition to determine if it complies with the requirements set forth in the section and the issues identified support a reasonable likelihood that the utility is failing to provide quality of water service. A docket is opened if these standards are met. The utility must respond to each problem identified in the petition and explain if the utility meets federal and state primary standards or secondary standards established in s. 367.0812, F.S. The utility must also give an explanation of its relationship with its customers, including each complaint received, length of time each customer has been complaining, the resolution of each complaint, and the time taken to address each complaint.

The commission must evaluate the petition by considering the issues identified, the utility's response, and any other factors the commission deems relevant. Based upon its evaluation, the commission may dismiss the petition, require the utility to take the necessary steps to correct the quality of water service issues identified in the petition, within a time certain and with certain reporting benchmarks, or revoke the utility's certificate, in which case a receiver will be appointed. The commission must adopt rules relating to the requirements for the petition and may adopt other rules to implement the section.

Section 2 creates s. 367.0812, F.S., to provide that when the PSC is setting rates for a water utility, it must consider the extent to which the utility has met secondary water quality standards

¹¹ The schedule of sampling is based on system size. Systems serving large communities are being tested this year, and small communities will be tested next year. Telephone interview with Van Hoofnagle, DEP Division of Water Resource Management (Jan.23, 2014).

¹² A confirmation sample is allowed. *Id.*

¹³ See Rule 62-550.520, F.A.C.

¹⁴ Senate Communications, Energy, & Public Utilities telephone interview with Van Hoofnagle, DEP Division of Water Resource Management (Jan.23, 2014).

¹⁵ If the petition is dismissed for insufficiency, customers would not be allowed to file a subsequent petition for one year.

established by the DEP. In determining whether a utility has met these standards, the PSC must consider:

- Testimony and evidence provided by customers and the utility;
- The results of past tests required by the DEP or a county health department which measure the utility's compliance with the applicable secondary water quality standards;
- Complaints filed by customers with the relevant regulatory authority regarding the applicable secondary water quality standards, or wastewater standards, during the past five years; and
- Results of any updated tests deemed necessary by the commission.

The commission shall consider a finding by the DEP as to whether the utility has failed to meet the DEP's secondary water quality standards.

The utility is required to meet with its customers within a time prescribed by the commission to discuss estimated costs and benefits to implement plausible solutions and report to the commission if the customers and the utility agree on a solution for each quality of service issue identified or if the customers and the utility prefer a different solutions to at least one of the quality of service issues identified. The commission may require the utility to implement solutions that are in the best interest of the customers for each issue and establish benchmarks and interim reporting on the progress of implementation. The commission may allow companies to recover its costs for solutions required by the commission.

During a rate case proceeding under new s. 367.0812, F.S., customers may not file a petition to revoke a certificate.

The commission may prescribe penalties for a utility's failure to adequately resolve each quality of water service concern, which may include fines provided in s. 367.161, F.S., a reduction of return on equity of up to 100 basis points (one percent), denial of all or part of a rate increase until the quality of service is found to be satisfactory, or revocation of the certificate of authorization. The commission is required to adopt rules to assess and enforce a utility's compliance with this section.

Section 3 appropriates \$212,521 in recurring funds and \$12,012 in nonrecurring funds from the General Revenue Fund to the PSC and authorizes three full-time equivalent positions for the 2014-2015 fiscal year to implement the provisions in this act related to the regulation of the quality of water service.

Section 4 provides an effective date of July 1, 2014.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

D. Other Constitutional Issues:

While the concept of reducing a utility's rate of return on equity (ROE) based on mismanagement is "by no means new to Florida or other jurisdictions,"¹⁶ the PSC staff notes that the denial of all of a rate increase, pursuant to Section 2 of the bill, could be interpreted as confiscatory ratemaking and, therefore, unconstitutional.¹⁷ Utilities are entitled to a reasonable rate of return on equity, which may be offset by the commission based on a utility's "overall quality of service and the performance of the management."¹⁸

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Under CS/CS/CS/SB 272, private water utilities that do not satisfactorily address customer complaints regarding secondary water standards might lose their certificate of authority to provide service. Customers may realize an increase in the cost of water services if certain services are improved; however, the customer will be fully informed of the costs and benefits and may participate in the decision to incur those costs before increases are incurred.

C. Government Sector Impact:

Section 2 of the bill will require water rate cases heard by the Commission, to consider additional testimony and evidence. The PSC staff estimates the implementation of this bill will require three full-time equivalent positions and \$224,533 for Fiscal Year 2014-2015, based on incremental staffing needs, travel to facilitate meetings between customers and utilities, and other expenses associated with the water initiatives.¹⁹ Due to declining revenue, the estimated Fiscal Year 2014-2015 adjusted unreserved Regulatory Trust Fund (RTF) balance is projected to be \$557,724 (includes \$1,137,474 five percent state trust fund reserve) as of 6-30-15. According to the PSC, a \$4.4 million cash balance is needed in the trust fund for cash flow. The minimum cash flow requirement is based on an estimated need of two months operating and non-operating costs, and because Regulatory Assessment fees are received semi-annually. The commission plans to initiate rulemaking to increase revenue in October 2014.²⁰

¹⁶ *Gulf v. Wilson*, 597 So. 2d 270 at 273-274 (Fla. 1992).

¹⁷ FPSC, *supra* note 5.

¹⁸ See Order No. PSC-01-1988-PAA-WU, *In re: Application for staff-assisted rate case in Columbia County by Consolidated Water Works, Inc.*, Docket No. 001682-WU (Oct. 8, 2001).

¹⁹ FPSC, *Estimated Fiscal Impact of CS for SB272* (Feb. 3, 2014).

²⁰ Discussion during meeting with FPSC staff on February 27, 2014.

Based on the current expenditure and revenue projections in the RTF, the bill appropriates \$212,521 in recurring funds and \$12,012 in nonrecurring funds from the General Revenue Fund to the PSC and authorizes three full-time equivalent positions for the 2014-2015 fiscal year to implement the provisions in this act.

VI. Technical Deficiencies:

None.

VII. Related Issues:

CS/CS/SB 272 inadvertently changed the effective date of the bill to July 1, 2014. The effective date should be October 1, 2014, to accommodate rulemaking provisions in the bill.

VIII. Statutes Affected:

This bill creates sections 367.072 and 367.0812 of the Florida Statutes.

IX. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS/CS/CS by Appropriations on March 13, 2014:

- Removes all reference to wastewater service and applies only to quality of water service;
- Clarifies and revises the process for filing a petition by customers and the process the commission follows in reviewing the petition;
- Removes reference to placing a certificate of authority on probationary status;
- Removes the requirement that the DEP set secondary wastewater service standards;
- Clarifies that customers may not petition the commission to revoke a certificate if there is an open ratemaking docket for that utility;
- Makes conforming changes to use the term “quality of water service”;
- Replaces the term “system” with “customer of the service area covered under the certificate of authorization”; and
- Provides an appropriation to the PSC for implementing the provisions of the bill.

CS/CS by Community Affairs on February 4, 2014:

The bill refines and clarifies the petition process for revocation. After receiving notice of intent to file a petition from customers, the PSC would:

- Notify appropriate parties while maintaining privacy of customer records;
- Receive and verify supporting documentation during a 90 day petition signature timeframe;
- Allow petitioners one opportunity to cure an insufficient petition;
- Ensure compliance with federal and state secondary water and wastewater criteria; removing references to local or water management districts;
- Dismiss the petition when supported by clear and convincing evidence;

- Determine whether to place the utility's certificate on probationary status in conjunction with corrective action, or revoke the certificate; and
- Disallow petitioners from filing another petition for one year subsequent a dismissal.

Additionally, the bill provides further direction to the PSC on water and wastewater rate cases, by:

- Requiring the DEP to set, by rule, acceptable secondary water quality and wastewater service standards;
- Allowing companies to recover costs for solutions required by the commission;
- Providing penalties, including denial of all or part of a rate increase;
- Disallowing a utility from filing a rate case while a revocation docket is open; and
- Disallowing customers from filing a petition to revoke the certificate of a utility during rate case proceedings.

CS by Communications, Energy, and Public Utilities on January 14, 2014:

The CS removes the provisions that:

- Limit the rates that may be charged by a private water and wastewater utility; and
- Require adjustment of rates to that of government-owned water and wastewater utilities and that requires that any amount collected the previous 12 months that is greater than the adjusted rate must be refunded.

The bill creates a process whereby customers may petition the commission to require compliance with secondary water quality standards and, if the utility fails to comply with the commission orders, the utility's certificate of authority may be revoked. The bill provides criteria the petition must meet to be considered by the commission. The bill provides criteria the commission must consider in its review of the petition and the action it may take to dispose of the petition.

The bill authorizes the commission to deny all or part of a rate increase for a utility's system or part of a system if it determines that the quality of water or wastewater service is less than satisfactory.

The bill revises the ratemaking process the commission must follow when considering secondary water quality and wastewater service standards to include that the utility inform the commission of the issues and solutions on which the utility and the customers agree and disagree. The commission may require the utility to implement solutions that are in the best interest of the customer and establish benchmarks and require periodic reporting.

B. Amendments:

None.