

**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.)

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Prepared By: The Professional Staff of the Committee on Innovation, Industry, and Technology

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BILL: SB 658

INTRODUCER: Senator Albritton

SUBJECT: Acquisition of Water and Wastewater Systems

DATE: February 14, 2020

REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Wiehle	Imhof	IT	<b>Pre-meeting</b>
2.			AEG	
3.			AP	

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**I. Summary:**

SB 658 creates a process by which a utility acquiring an existing utility system may seek to establish a rate base value (the value upon which rates are set) for the acquired utility system based on the fair market value of the utility system instead of the system's original cost at the time it was placed into service.

The process is available only to acquiring utilities that provide water and wastewater services to more than 10,000 customers and are engaged in a voluntary and mutually agreeable acquisition of a water and wastewater system.

To enable the process, the Public Service Commission (PSC or commission) is required to establish a list of licensed appraisers, and the prospective buyer and prospective seller each select from that list (and individually pay) an appraiser to represent their interests. The prospective buyer and prospective seller jointly retain a licensed engineer to conduct an assessment of the tangible assets of the utility system to be used by the two appraisers in determining the fair market value of the system. Each appraiser determines the fair market value using the Uniform Standards of Professional Appraisal Practice, employing cost, market, and income approaches in assessing the value. For ratemaking purposes, the fair market value is the average of the two appraisals.

The acquiring utility's application to the commission for approval of the rate base value of the utility system to be acquired must contain specified information.

The acquiring utility may include in the cost of the acquired utility system reasonable fees paid to the appraisers, if approved by the commission, and reasonable transaction and closing costs incurred by the acquiring utility. The rate base value of the acquired utility system is equal to the lesser of the purchase price negotiated between the parties to the sale or the fair market value, plus the authorized fees and costs.

If the application complies with these requirements, the commission must issue a final order approving or denying the application within eight months after the date on which the application was filed.

Notwithstanding any of these provisions, the commission retains its authority to set rates for the acquired utility system in future rate cases and may classify the acquired utility system as a separate entity for ratemaking purposes, consistent with the public interest.

The commission is required to adopt rules to implement the bill.

The bill takes effect July 1, 2020.

## II. Present Situation:

The Florida Public Service Commission has exclusive jurisdiction over each water and wastewater utility with respect to its service and rates.<sup>1</sup> However, the statutes also provide exclusions from commission jurisdiction. The two most significant exclusions relate to government utilities and to counties that have opted out of commission jurisdiction. The statutes expressly exempt utility systems owned, operated, managed, or controlled by governmental authorities, including water or wastewater facilities operated by private firms under privatization contracts, and nonprofit corporations formed for the purpose of acting on behalf of a political subdivision with respect to a water or wastewater facility.<sup>2</sup> The statutes also authorize a county to exclude itself from commission regulation, by resolution or ordinance, thereby reserving to itself the regulation of water and wastewater utilities that are completely within the county's boundaries;<sup>3</sup> the commission retains exclusive jurisdiction over all utility systems whose service crosses county boundaries, except for utility systems that are subject to interlocal utility agreements.<sup>4</sup> As of December 2018, the commission had jurisdiction over 150 investor-owned water and/or wastewater utilities in 38 counties.<sup>5</sup>

The commission sets rates for all water and wastewater utilities within its jurisdiction. The rates must be "just, reasonable, compensatory, and not unfairly discriminatory." As to the "compensatory" aspect of the rates, the commission is required, in each rate-setting proceeding, to consider "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>6</sup>

No utility may sell, assign, or transfer its certificate of authorization, facilities or any portion thereof, or majority organizational control without the approval of the commission after a

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<sup>1</sup> Section 367.011(2), F.S.

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

<sup>3</sup> Section 367.171, F.S.

<sup>4</sup> Section 367.171(7), F.S.

<sup>5</sup> Florida Public Service Commission, *Facts and Figures of the Florida Utility Industry*, p. 31 (Jun. 2019), available at <http://www.psc.state.fl.us/Files/PDF/Publications/Reports/General/Factsandfigures/June%202019.pdf>.

<sup>6</sup> Section 367.081, F.S.

determination that the proposed sale, assignment, or transfer is in the public interest and that the buyer, assignee, or transferee will fulfill the commitments, obligations, and representations of the utility. Except for any sale, assignment, or transfer to a governmental authority, the commission may, by order entered during the approval proceeding, establish the rate base for a utility or its facilities or property.<sup>7</sup>

The commission has consistently interpreted the “investment of the utility” to be the original cost of the property when first dedicated to public service.<sup>8</sup> This original cost of acquiring an asset and placing it into service for first utility use includes the direct costs of acquiring the asset and the cost of labor, materials, and associated costs of installation to prepare the asset for first utility use. When an asset is acquired that is already in public service, the original cost of the asset is recorded as part of the in-service infrastructure, and the historic accumulated depreciation is charged to the accumulated depreciation account.<sup>9</sup> The depreciated original cost, or net book value, is the value of an existing utility’s rate base.<sup>10</sup> Additional capital expenditures through expansion of the system or new infrastructure for the initial system add to the investment of the utility and thus to the net book value.

If the purchase price is different from the net book value, the acquiring utility may petition for an acquisition adjustment. If the purchase price is higher than the net book value, the utility seeks a “positive acquisition adjustment” to increase the rate base. A positive acquisition adjustment may not be included in rate base, however, absent proof of extraordinary circumstances such as:

- Anticipated improvements in quality of service;
- Anticipated improvements in compliance with regulatory mandates;
- Anticipated rate reductions or rate stability over a long-term period; or
- Anticipated cost efficiencies.<sup>11</sup>

### **III. Effect of Proposed Changes:**

The bill creates a process by which a utility acquiring an existing utility system may seek to establish a rate base value (the value upon which rates are set) for the acquired utility system based on the fair market value of the utility system instead of the system’s original cost at the time it was placed into service.

The process is available only to acquiring utilities that provide water and wastewater services to more than 10,000 customers and are engaged in a voluntary and mutually agreeable acquisition of a water and wastewater system.

To enable the process, the commission is required to establish a list of licensed appraisers, and the prospective buyer and prospective seller each select from that list (and individually pay) an appraiser to represent their interests. The prospective buyer and prospective seller jointly retain a licensed engineer to conduct an assessment of the tangible assets of the utility system to be used

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<sup>7</sup> Section 367.071, F.S.

<sup>8</sup> Florida Public Service Commission, *Agency Analysis of 2020 House Bill 207*, p. 1 (Jan, 6, 2020) (on file with the Senate Committee on Innovation, Industry, and Technology).

<sup>9</sup> Rule 25-30.140 (1)(r), F.A.C.

<sup>10</sup> *Supra*, note 8.

<sup>11</sup> Rule 25-30.0371(2), F.A.C.

by the two appraisers in determining the fair market value of the system. Each appraiser determines the fair market value using the Uniform Standards of Professional Appraisal Practice, employing cost, market, and income approaches in assessing the value.<sup>12</sup> The original source of funding for the utility system being acquired is not relevant to an evaluation of fair market value. For ratemaking purposes, the fair market value is the average of the two appraisals.

The acquiring utility's application to the commission for approval of the rate base value of the utility system to be acquired must contain the following:

- The contract of sale;
- The licensed engineer's assessment of tangible assets;
- Each deficiency identified by the engineering assessment and a three-year plan for prudent and necessary infrastructure improvements;
- Copies of the appraisals performed by the appraisers;
- The average of the appraisals, which shall constitute the fair market value of the system;
- The estimated value of fees and transaction and closing costs to be incurred by the acquiring utility;
- The projected rate impact for the selling utility's customers for the next five years; and
- A tariff, including rates equal to the rates of the selling utility.

The acquiring utility may include in the cost of the acquired utility system:

- Reasonable fees paid to the appraisers, if approved by the commission; and
- Reasonable transaction and closing costs incurred by the acquiring utility.

The rate base value of the acquired utility system, which must be reflected in the acquiring utility's next general rate case for ratemaking purposes, is equal to the lesser of the purchase price negotiated between the parties to the sale or the fair market value, plus the authorized fees and costs.

If the application complies with these requirements, the commission shall issue a final order approving or denying the application within eight months after the date on which the application was filed. An order approving an application must determine the rate base value of the acquired utility system for ratemaking purposes in a manner consistent with these provisions.

Notwithstanding any of these provisions, the commission retains its authority to set rates for the acquired utility system in future rate cases and may classify the acquired utility system as a separate entity for ratemaking purposes, consistent with the public interest.

The commission is required to adopt rules to implement this section.

The bill takes effect July 1, 2020.

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<sup>12</sup> The cost approach considers the current cost of reproducing or replacing a building, minus an estimate for depreciation, plus the value of the land (and entrepreneurial incentive, if applicable). The market (sales comparison) approach considers the value indicated by recent sales of comparable properties on the market. The income approach considers the value that the property's net earning power will support. See The Appraisal Foundation, *Understanding the Appraisal*, [https://www.appraisalinstitute.org/assets/1/7/understand\\_appraisal\\_1109\\_\(1\).pdf](https://www.appraisalinstitute.org/assets/1/7/understand_appraisal_1109_(1).pdf) (last visited Jan. 21, 2020).

**IV. Constitutional Issues:**

## A. Municipality/County Mandates Restrictions:

None.

## B. Public Records/Open Meetings Issues:

None.

## C. Trust Funds Restrictions:

None.

## D. State Tax or Fee Increases:

None.

## E. Other Constitutional Issues:

None.

**V. Fiscal Impact Statement:**

## A. Tax/Fee Issues:

None.

## B. Private Sector Impact:

The bill's full fiscal impact on ratepayers of an acquiring utility is uncertain, however, they likely will have higher rates due to the following factors:

- As identified in the commission's analysis of the bill:<sup>13</sup>
  - Small utilities that are acquired will likely have higher valuations, increasing the resulting purchase price; and
  - Each acquisition will also have the added costs for contracting two appraisers;<sup>14</sup> and
- In each acquisition, the acquiring utility may include all reasonable transaction and closing costs.

The commission analysis also identifies a potential cause for additional rate increases: "The bill could encourage larger utilities to acquire smaller systems, potentially resulting in better access to low cost capital and improved infrastructure."<sup>15</sup> If such improvements

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<sup>13</sup> Florida Public Service Commission, *Agency Analysis of 2020 House Bill 207*, p. 4 (Jan, 6, 2020) (on file with the Senate Committee on Innovation, Industry, and Technology).

<sup>14</sup> While there would also be additional costs for the licensed engineer's assessment of tangible assets of the utility system, the bill does not provide for recovery of these costs.

<sup>15</sup> *Supra*, note 13, at 2.

are made, the capital expenditures would increase rate base and, in turn, customers' rates, on top of any rate increase due to a higher acquisition price and cost.

C. Government Sector Impact:

None.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

**Appraisal and Real Property**

The bill requires that each appraiser determine the fair market value of the utility system being acquired "using the Uniform Standards of Professional Appraisal Practice, employing cost, market, and income approaches in assessing the value." An industry publication summarizes these approaches as follows:

The cost approach considers the current cost of reproducing or replacing a building, minus an estimate for depreciation, plus the value of the land (and entrepreneurial incentive, if applicable). The market (sales comparison) approach considers the value indicated by recent sales of comparable properties on the market. The income approach considers the value that the property's net earning power will support.<sup>16</sup>

Some of value considerations used in some of these approaches may not be appropriate for use in these circumstances. For example, the publication states the following:

Highest and best use is a critical step in the development of a market value opinion. In highest and best use analysis, the appraiser considers the use of the land as though it were vacant and the use of the property as it is improved. To qualify as the highest and best use, a use must satisfy four criteria: it must be legally permissible, physically possible, financially feasible and maximally productive. The highest and best use is selected from various alternative uses.<sup>17</sup>

An older utility may have deteriorated infrastructure but the real property on which it sits may have appreciated significantly. As it is being purchased for continued use as a utility, however, it appears that applying a real estate value based on use as a site for a theme park, condominium, or other such use is unlikely to result in rates that are "just, reasonable, compensatory, and not unfairly discriminatory."

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<sup>16</sup> See The Appraisal Foundation, *Understanding the Appraisal*, [https://www.appraisalinstitute.org/assets/1/7/understand\\_appraisal\\_1109\\_\(1\).pdf](https://www.appraisalinstitute.org/assets/1/7/understand_appraisal_1109_(1).pdf) (last visited Jan. 21, 2020).

<sup>17</sup> *Id.*

**Commission Comments**

The commission analysis on the bill raises the following points:<sup>18</sup>

The bill states that it applies exclusively to utilities that “regularly provide water and wastewater services to more than 10,000 customer connections.” At this time, only three Commission-regulated utilities are of sufficient size to qualify under the bill.

Unlike the Department of Business and Professional Regulation that regulates appraisers, the Commission has no expertise in property appraisal. An alternative may be to have a more appropriate agency prepare and maintain the list of appraisers required by paragraph (2)(a).

**VIII. Statutes Affected:**

This bill creates section 367.0712 of the Florida Statutes.

**IX. Additional Information:**

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

None.

B. **Amendments:**

None.

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

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<sup>18</sup> Florida Public Service Commission, Agency Analysis of 2020 House Bill 207, p. 4 (Jan, 6, 2020) (on file with the Senate Committee on Innovation, Industry, and Technology).