

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 Regulated Industries

BILL: SB 194

INTRODUCER: Senator Hooper

SUBJECT: Utility System Rate Base Values

DATE: March 20, 2023

REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Schrader	Imhof	RI	Pre-meeting
2.			AEG	
3.			FP	

I. Summary:

HB 194 creates s. 367.0811, F.S., to authorize public water and wastewater utilities to utilize an alternative fair market valuation methodology to establish the rate base for an acquired utility using the lesser of either:

- The purchase price paid for the acquired utility; or
- The average of three appraisals of the value of the acquired utility (appraised by three licensed appraisers chosen from a list established by the Florida Public Service Commission).

II. Present Situation:

Challenges for Small Water Utilities

The water and wastewater industry is one of the most capital intensive industries in the United States.¹ As of 2018, the United States Environmental Protection Agency (EPA) estimated that \$473 billion was needed to maintain and improve water infrastructure over the next 20 years and that thousands of treatment plants, storage tanks, and other key infrastructure need to be improved or replaced.² According to the American Society of Engineers (ASE) there is a water main break in the United States every two minutes and 6 million gallons of treated water is lost, on average, each day to such breaks.³ ASE also states that funding for water infrastructure has

¹ National Regulatory Research Institute, *A Review of State Fair Market Value Acquisitions Policies for Water and Wastewater Systems*, Sep. 2021 (available at: <https://pubs.naruc.org/pub/ED8E5710-1866-DAAC-99FB-B70190F3D64A>).

² Environmental Protection Agency, *Infographic: EPA's 6th Drinking Water Infrastructure Needs Survey and Assessment*, Aug. 2018, https://www.epa.gov/sites/default/files/2018-08/documents/dwinsa_infographic_august_2018_final.pdf.

³ American Society of Engineers, *2021 Report Card for America's Future*, <https://infrastructurereportcard.org/> (last visited Mar. 18, 2023).

not kept up with the needs to address aging systems and, in many places, water infrastructure is aging and deteriorating.⁴

Small water systems can especially struggle to make these needed investments. This happens for a number of reasons:

- Lack of expertise, these systems may simply lack the staff or managerial expertise necessary to identify systems in need of maintenance, repair, or replacement.
- Lack of capital, or at least the inability to access to lower-cost capital, to invest in system infrastructure.
- Lack of economies of scale inherent in larger systems.
- System abandonment due to disinterest of owners or management in running a system, death of the owner or operator of the system with no clear plan of succession, or frustration with an inability to meet water standards and other regulatory requirements.⁵

These challenges show up in system violations. Of the 38,853 Safe Drinking Water Act (SDWA)⁶ violations in the United States in 2021, 30,153 (77 percent) were in very small systems. For Florida, of the 1,382 SDWA violations, 1,017 (73 percent) were in very small systems.

Fair Market Value Statutes in General

Given the potential issues with small water systems, states have looked into ways to encourage system consolidation. One tool that has been used in other states is a concept called fair market valuation. Fair market valuation (FMV) is a regulatory tool that seeks to incentivize larger water utilities that may be better positioned to make investments in the system and may have better access to economies of scale, lower cost capital, and water and wastewater system expertise.⁷ To date, 14 states have passed some sort of FMV legislation: California, Illinois, Indiana, Iowa, Kentucky, Maryland, Missouri, New Jersey, North Carolina, Ohio, Pennsylvania, Texas, West Virginia, and Virginia.⁸

Valuation of a Water Utility

The traditional basis for determining the rate base of a utility is the original cost minus depreciation (also known as net book value).⁹ This type of valuation is typically called “original cost valuation.”¹⁰ Two other types of valuation are fair value—which attempts to value at a rate

⁴ American Society of Engineers, *The Economic Benefits of Investing in Water Infrastructure*, pg. 9-12, 2020 https://www.uswateralliance.org/sites/uswateralliance.org/files/publications/VOW%20Economic%20Paper_0.pdf

⁵ National Regulatory Research Institute, *supra* note 1, at 8-11.

⁶ The Safe Drinking Water Act, Pub. L. 93-523, is intended to ensure the quality drinking water by regulating public water systems in the United States. Under this Act, the EPA sets standards for drinking water quality and oversees the states, federally-recognized tribes, and territories that implement the United States’ drinking water program.

⁷ National Regulatory Research Institute, *supra* note 1, at 1-11, and United States Government Accountability Office, *Private Water Utilities: Actions Needed to Enhance Ownership Data*, pgs 38-39, Mar. 2021 (available at: <https://www.gao.gov/assets/gao-21-291.pdf>).

⁸ National Association of Water Companies: Truth from the Tap, *The Many Benefits of Utility Valuation Reform*, <https://truthfromthetap.com/the-many-benefits-of-utility-valuation-reform/> (last visited: Mar. 18, 2023).

⁹ Florida Public Service Commission, *Bill Analysis for SB 194* (Feb. 10, 2023) (on file with the Senate Regulated Industries Committee).

¹⁰ Walter J. Primeaux, Jr., Edward L. Bubnys, and Robert H. Rasche, *Fair Value Versus Original Cost Rate Base Valuation*

more closely reflecting actual market value—and reproduction cost—which attempts to value at a rate that would permit the reproduction of the property in question.¹¹ The theory behind original cost valuation is that by applying a required rate of return (i.e. a return on investment) of the depreciated original cost of the investment in utility property devoted to public service, and then accounting for utility operating costs and taxes, the investors in the utility are given reasonable return on their capital put at risk in operating the utility.¹²

Stemming from this original cost methodology, the traditional method for valuing a utility is to use the original rate base value of the utility and deduct any depreciation. The presumption with this methodology is that the value of the system is based on the value of the presumed life left in the system, based off of the original investment.¹³ Proponents of FMV state that this methodology can sometimes undervalue a system and make it difficult to acquire as sellers can feel as though they are not getting a fair value for their system.¹⁴ Thus, what FMV statutes attempt to do, is set a rate that attempts to match the “market rate” for the system. This is typically done by requiring multiple appraisals of the system to be acquired and comparing that with the price paid for the system.¹⁵

Potential Issues with Fair Market Valuation

Generally, the purpose of FMV statutes is to encourage larger utilities (that generally have improved economies of scale and better access to capital) to acquire smaller or distressed systems, with the intent of improving water and wastewater system infrastructure for the acquired utility. However, FMV statutes can present some risks to ratepayers:

- It can encourage utilities to simply swap assets and increase ratepayer costs without any guarantee of improvement of quality of service or increased cost efficiencies.¹⁶
- Buyers and sellers both have an incentive to raise the purchase price of the acquired utility as high as possible. Typical market forces controlling acquisition prices (i.e. buyer and seller pressuring the acquisition price in opposing directions) do not work the same for monopoly businesses. Buyers can benefit when a premium is reflected in rate base that they can pass along to customers, plus the additional opportunity to service new customers. Sellers can stand to reap a financial windfall from proceeds from the sale, and these proceeds significantly exceed their investment.¹⁷
- Monopoly assets can be difficult to value because there are not as many comparable available. There may also be a shortage of experts who can do these types of valuations.¹⁸

During Inflation, The Energy Journal, Vol. 5, No. 2 (Apr. 1984) (available at: <https://ipu.msu.edu/wp-content/uploads/2018/12/41321682.pdf>).

¹¹ *Id.*

¹² Florida Public Service Commission, *Bill Analysis for SB 194*, *supra* note 9.

¹³ National Regulatory Research Institute, *supra* note 1, at 1.

¹⁴ *Id.* and National Association of Water Companies: Truth from the Tap, *Municipalities and Taxpayers Deserve a Fair Deal for Utility Assets*, <https://truthfromthetap.com/wp-content/uploads/2022/01/FMV-Factsheet.pdf> (last visited Mar. 18, 2023).

¹⁵ National Regulatory Research Institute, *supra* note 1, at 1.

¹⁶ Florida Public Service Commission, *Bill Analysis for SB 194*, *supra* note 9.

¹⁷ Janice Beecher, *Water utility consolidation: is fair market value fair?*, Michigan State University Institute of Public Utilities, June 25, 2019 (available at: <https://ipu.msu.edu/wp-content/uploads/2019/06/Beecher-Fair-Market-Value-Water-June-2019.pdf>), Scott Hempling, *Water Mergers: are they making economic sense?*, Jun. 2019 (available at: <https://energiahoy.com/2019/06/02/water-mergers-are-they-making-economic-sense/>), and United States Government Accountability Office, *supra* note 7, at 39-40.

¹⁸ National Regulatory Research Institute, *supra* note 1, at 17.

- Acquisitions can result in significant “rate shock” for ratepayers, especially in systems that have been historically underinvested in.¹⁹
- FMV statutes can encourage “bad behavior” in utility owners considering selling their systems as these owners may calculate that they do not need to invest in/properly maintain their system in order to sell it for a profit.²⁰
- The hope with most FMV statutes is that struggling and distressed utilities will be acquired by larger, better run utilities. However, what can happen with FMV statutes is that the most lucrative systems to acquire are the ones that are acquired first (or at all), and, potentially, the ones most in need of investment are not.²¹
- Increases in the underlying value of the land upon which the acquired utility is situated can result in significant rate increases solely based on real estate prices.²²
- Inflated purchase costs can run counter to two of the typical reasons for FMV statutes: lower costs for the consumer and improved performance.²³

Given these risks, most states that have enacted FMV statutes have placed restrictions on which, and under what circumstances, a water or wastewater utility may be acquired under an FMV statute. These may include:

- Requiring that the acquiring utility be of sufficient size.
- Requiring that the acquired utility be municipal, small, or disadvantaged or distressed.
- Requiring that acquisition benefit from economies of scale.
- Providing an initial moratorium or a limit on rate increases (i.e. “rate shock protection”). This could be through a rate stabilization plan submitted by the acquiring utility or required by the utility regulator.
- Requiring disclosure of anticipated rate impacts in an FMV application.²⁴

Other proposed ideas for ratepayer protections include limiting or linking rate increases to cost savings or service improvements, or creating competition amongst potential acquirers and the acquirer with the most value offered to the ratepayer “wins” (this would essentially be an auction of the utility once it puts itself up for sale).²⁵

Florida Public Service Commission

The Florida Public Service Commission (PSC) is an arm of the legislative branch of government.²⁶ The role of the PSC is to ensure Florida’s consumers receive utility services, including electric, natural gas, telephone, water, and wastewater, in a safe, affordable, and reliable manner.²⁷ In order to do so, the PSC exercises authority over public utilities in one or

¹⁹ *Id.*

²⁰ *Id.* at 18.

²¹ *Id.* at 18-19.

²² Florida Public Service Commission, *Bill Analysis for SB 194*, *supra* note 9.

²³ Scott Hempling, *supra* note 17.

²⁴ National Regulatory Research Institute, *supra* note 1, at 19-31.

²⁵ Scott Hempling, *supra* note 17.

²⁶ Section 350.001, F.S.

²⁷ See Florida Public Service Commission, *Florida Public Service Commission Homepage*, <http://www.psc.state.fl.us> (last visited Mar 3, 2023).

more of the following areas: rate base or economic regulation; competitive market oversight; and monitoring of safety, reliability, and service issues.²⁸

Florida Public Service Commission Regulation of Water and Wastewater Utilities

Florida’s Water and Wastewater System Regulatory Law, ch. 367, F.S., regulates water and wastewater systems in the state. Section 367.011, F.S., states that the PSC has exclusive jurisdiction over each utility with respect to its authority, service, and rates. For the chapter, a “utility” is defined as “a water or wastewater utility and, except as provided in s. 367.022, F.S., 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., exempts certain types of water and wastewater operations from PSC jurisdiction and the provisions of ch. 367, F.S. (except as expressly provided). Such exempt operations include: municipal water and wastewater systems, public lodging systems that only provide service to their guests, systems with a 100-person or less capacity, landlords that include service to their tenants without specific compensation for such service, and mobile home parks operating both as a mobile home park and a mobile home subdivision that provide “service within the park and subdivision to a combination of both tenants and lot owners, provided that the service to tenants is without specific compensation.”²⁹ The PSC also does not regulate utilities that have exempted themselves from regulation pursuant to s. 367.171, F.S.

Currently, the PSC has over 149 water, wastewater, and water and wastewater utilities that are under its regulatory authority.³⁰ This is in comparison to four investor-owned electric utilities and eight investor-owned gas utilities in the state.³¹ Florida’s investor-owned water and wastewater utilities are much less consolidated than the state’s investor-owned electric and gas utilities. Many of these systems are quite small—currently the United States Environmental Protection Agency (EPA) classifies 83.2 percent of Florida’s water systems as very small (meaning that the system serves 500 people or less).³² PSC data also shows that the vast majority of water and wastewater systems are quite small, with 83 water systems and 58 wastewater in Florida having gross annual revenues of \$300,000 or less. This means these utilities qualify (due to their small size) to have PSC staff assistance in their rate cases.³³

²⁸ Florida Public Service Commission, *About the PSC*, <https://www.psc.state.fl.us/about> (last visited Mar 16, 2023).

²⁹ Section 367.022(2), F.S.

³⁰ Email from Mark Futrell, Deputy Executive Director—Technical, Florida Public Service Commission, to Senate Regulated Industries Staff (Mar 19, 2023)(on file with the Senate Regulated Industries Committee).

³¹ Florida Public Service Commission, *2022 Facts and Figures of the Florida Utility Industry*, pg. 5, Apr. 2022 (available at: <https://www.floridapsc.com/pscfiles/website-files/PDF/Publications/Reports/General/FactsAndFigures/April%202022.pdf>)

³² Environmental Protection Agency, *Enforcement Compliance History Online*, <https://echo.epa.gov/trends/comparative-maps-dashboards/drinking-water-dashboard> (last visited Mar. 18, 2023).

³³ Many small water and wastewater utilities struggle with the resources and expertise necessary to properly file for and complete a full rate case. Thus, Fla. Admin. Code R. 25-30.455, authorized pursuant to s. 367.0814, F.S., provides that “water and wastewater utilities whose total gross annual operating revenues are \$300,000 or less for water service or \$300,000 or less for wastewater service, or \$600,000 or less on a combined basis,” may apply with the PSC for staff assistance with rate applications. In staff-assisted rate cases (SARCs),

Water and Wastewater Ratemaking in Florida

Florida is an “original cost” state in terms of rate base value. The PSC sets rates for all water and wastewater utilities within its jurisdiction and the rates must be “just, reasonable, compensatory, and not unfairly discriminatory.”³⁴ Florida Administrative Code Rule 25-30.115, requires that water and wastewater utilities maintain their accounts and records in conformity with the 1996 National Association of Regulatory Utility Commissioners (NARUC) Uniform Systems of Accounts (USOA).³⁵ The NARUC USOA states that “‘original cost’, as applied to a utility plant, means the cost of such property to the person first devoting it to the public service.”³⁶

As to the “compensatory” aspect of rates, the PSC is required, in each rate-setting proceeding, to consider “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.”³⁷ However, the PSC is prohibited from allowing “the inclusion of contributions-in-aid-of-construction³⁸ in the rate base of any utility during a rate proceeding,” nor can the PSC, “impute prospective future contributions-in-aid-of-construction against the utility’s investment in property used and useful in the public service; and accumulated depreciation on such contributions-in-aid-of-construction shall not be used to reduce the rate base, nor shall depreciation on such contributed assets be considered a cost of providing utility service.”

As to the “a fair return on the investment of the utility in property used and useful in the public service” required under s. 367.081(2)(a)1., F.S., the PSC has consistently interpreted the “investment of the utility” to be the original cost of the property when first dedicated to public service. Florida Administrative Code Rule 25-30.140(1)(r), states that, “[i]n the event that an asset is acquired that is already in public service, the original historic cost of the asset should be recorded in plant in service.”

Water and Wastewater Utility Acquisitions in Florida

Section 367.031, F.S., requires that each water and wastewater utility under the PSC’s jurisdiction must obtain a certificate of authorization from the PSC. This certificate grants the utility the authorization to provide water or wastewater service within a defined geographic area. This certificate of authorization, or the corresponding utility’s facilities, may not be sold, assigned, or transferred without authorization from the PSC. Pursuant to s. 367.071(1), F.S., the PSC may approve a sale, assignment, or transfer if such is in the public interest. A sale, transfer, or assignment may occur prior to PSC approval, if the contract executing such transaction is made contingent to PSC approval. Section 367.071(5), F.S., provides that the PSC “may establish the rate base for a utility or its facilities or property when the commission approves a

³⁴ Section 367.081(2)(a)1., F.S.

³⁵ NARUC USOA is incorporated by reference into Florida Admin. Code Rule 25-30.115.

³⁶ Florida Public Service Commission, *Bill Analysis for SB 194*, *supra* note 9.

³⁷ Section 367.081(2)(a)1., F.S.

³⁸ Section 367.021(3), F.S., defines “Contribution-in-aid-of-construction” as “any amount or item of money, services, or property received by a utility, from any person or governmental authority, any portion of which is provided at no cost to the utility, which represents a donation or contribution to the capital of the utility, and which is used to offset the acquisition, improvement, or construction costs of the utility property, facilities, or equipment used to provide utility services.”

sale, assignment, or transfer thereof, except for any sale, assignment, or transfer to a governmental authority.”

III. Effect of Proposed Changes:

Section 1 of the bill creates s. 367.0811, F.S., to establish an alternative FMV process for establishing the rate base of a purchased water system to be used for ratemaking purposes in the acquiring utility’s next rate case. This method differs, and is an alternative, from the original cost method existing in current statute in s. 367.081, F.S.

The rate base established by the proposed procedure in the bill cannot exceed the lesser of the purchase price negotiated between the parties to the acquisition transaction or the average of three required appraisals. This amount “may not be adjusted for capital in aid of construction used and useful in serving the public.”³⁹ The rate base value established may also include reasonable transaction and closing costs incurred by the acquiring utility and reasonable fees paid to the appraisers. The appraisers used in valuing the utility to be acquired must be paid by the acquiring utility (acquirer), chosen from a list provided by the PSC, and the appraisal they provide must be consistent with the Uniform Standards of Professional Appraisal Practice.

The acquiring utility and the utility system to be acquired (acquiree) must jointly retain a licensed engineer to assess the tangible assets of the acquiree. This assessment must be provided to the appraisers to assist in valuing the acquiree.

A petition filed pursuant to s. 367.0811, F.S., to establish an FMV rate base value must include:

- The requested rate base value for the acquiree.
- Copies of the required appraisals, including the average of the valuations produced by each appraisal.
- A copy of the required assessment of tangible assets.
- A 3-year plan to address each deficiency identified by the assessment of tangible assets. The plan must address impact on quality of service and any planned improvements to water quality.
- The 5-year projected rate impact on the customers of the acquiree, including, but not limited to, the rate impact of all of the following:
 - Any cost efficiencies expected to result from the acquisition transaction.
 - Use of this section, instead of the original cost method pursuant to s. 367.081, F.S., to establish the rate base value.
- The contract of sale.
- The estimated value of fees and transaction and closing costs to be incurred by the acquiring utility.
- A tariff, including rates equal to the rates of the utility system being acquired.

If a completed petition meets all of the filing requirements of the bill, the PSC will have eight months from the date of filing to issue a final order on the petition. In its order, the PSC may grant the petition, in whole or in part, or with modifications in the public interest, or may deny

³⁹ This portion should likely read “may not be adjusted for contributions in aid of construction or used and useful in serving the public,” as those terms are commonly used in Florida and other jurisdictions in regards to setting rate base. *See* Technical Deficiencies, *infra* Section VI, of this analysis.

the petition if it is in the public interest. However, the PSC may not approve a rate base value higher than that requested in the petition.

In future rate cases, the bill permits the PSC to, pursuant to ch. 367, F.S., 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 if it is deemed to be in the public interest.

The acquiring utility under s. 366.0811, F.S., must be engaged in an arms-length transaction with the acquiree and have 10,000 or more customers, or provide 3 million gallons per day of permitted drinking water.

The bill also directs the PSC to adopt rules to implement the section.

Section 2 of the bill provides an effective date of July 1, 2023.

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:

In its analysis of the bill the PSC stated that the alternative utility valuation authorized in the bill will likely cause significant new costs for the private sector. The PSC elaborated that under SB 194, “small utilities will likely see higher valuations, which will increase the purchase price of utilities; this could lead to higher rates for customers.” SB 194 may

encourage “larger utilities to acquire smaller systems, potentially resulting in better access to low cost capital and improved infrastructure.” However, as currently drafted, SB 194 does not require such benefits in order for the PSC to approve a petition. Customers may simply see rate increases due to purchase price valuation,⁴⁰ with no required improvement in service. Customers may also see a rate impact from transaction, closing, and appraiser costs allowed to be included in rate base value under the bill.

C. Government Sector Impact:

According to the PSC’s analysis, the impact of SB 194 on state agencies is not known at this time. It is unclear how the change to the PSC’s cost for transfer and rate proceedings will be affected.⁴¹

VI. Technical Deficiencies:

Lines 36 and 37 of the bill read, in part, “and may not be adjusted for capital in aid of construction used and useful in serving the public.” This portion should likely read “and may not be adjusted for contributions in aid of construction or used and useful in serving the public,” as the terms “contributions in aid of construction” and “used and useful in serving the public” are commonly used in Florida and other jurisdictions in regards to setting rate base.

Line 84-86 of the bill reads “the commission may grant the petition, in whole or in part, or with modifications in the public interest, or may deny the petition if it is in the public interest.” For clarity, the sponsor may wish to revise the sentence as follows, “the commission may, in the public interest, grant the petition, in whole or in part, or with modifications, or may deny the petition.”

VII. Related Issues:

In its analysis of the bill, the PSC stated that it does not have expertise in property appraisers and thus they may be ill-equipped to establish and maintain a list of approved appraisers. The PSC suggested an alternative to have another agency with expertise in the area, such as the Department of Business and Professional Regulation, which regulates appraisers, maintain this list.⁴²

SB 194 may generate litigation, as the PSC states that all FMV acquisitions may have to be processed exclusively as s. 120.57, F.S., hearings. In addition, the PSC believes there may be litigation from ratepayers and consumer advocates in regards to assessment of potentially excessive rates and evaluation costs. The PSC also anticipates that it may have litigation in regards to establishing and maintaining the list of appraisers.⁴³

VIII. Statutes Affected:

This bill creates section 367.0811 of the Florida Statutes.

⁴⁰ Florida Public Service Commission, *Bill Analysis for SB 194*, *supra* note 9.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

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.

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