

# **CSWR-Florida's Post Workshop Comments to Workshop to Examine Regulatory Policies and Practices in the Water and Wastewater Industry**

## **Introductory Comments**

CSWR-Florida appreciates the opportunity to provide these post-workshop comments. The Workshop provided helpful information regarding the Florida Public Service Commission (FPSC) Staff's thoughts on various policy and practices and potential changes in those policies and practices.

In providing these comments CSWR-Florida has been guided by the comments made by FPSC Commissioners at the October 4, 2022 Agenda Conference which were the impetus for the Workshop. Those comments were focused on providing appropriate incentives to encourage the consolidation of smaller systems into larger entities with the goal of improving service to utility customers:

Commissioner La Rosa: "How do we get smaller companies that can no longer sustain be absorbed by other companies that have flexibility, have economies of scales, may be able today to provide customers in that territory better reliability, better cost controls.... I would encourage us, outside of this item, to discuss, maybe at a later point, workshop or whatever the appropriate time is, is that how do we encourage the investment?" (Transcript, p. 23)<sup>1</sup>

Commissioner Clark: "We have so many small – and they keep coming back in and we are looking at them on a regular basis – so may small water systems that are just under capitalized, and the system size will not allow enough economy of scale to put a rate in place that's going to allow that owner to be able to make changes or modifications to the system that the customers deserve, and so that's my concern... and if you - you look at a company's – you look at a company's motivation to go do an acquisition and basically bail out a failing system and there is none." (Transcript pp. 22-23)

Commissioner Clark: "And I think that dangling the carrot of a positive acquisition adjustment out there might be the incentive they need to help us

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<sup>1</sup> "Transcript" refers to the transcript of Item No. 8 on the October 4, 2022 Agenda Conference for Docket No. 20220019-WU

to resolve some of our water quality and water issues that we have in the state.” (Transcript, p. 23)

Commissioner Passidomo: “I agree with the sentiments of both Commissioner La Rosa and Commissioner Clark. I also think it’s important we encourage, you know, well equipped financially stable companies to help out for those small failing systems.” (Transcript p. 19)

CSWR-Florida agrees with the Commissioners that it is time to look at existing policies and practices with an eye toward encouraging system consolidation through encouraging the acquisition of small, non-viable systems by larger viable systems.

Consolidation of smaller systems into larger entities has been found to be a positive step in improving service to customers across the country. CSWR-Florida believes that the methodology its affiliates have used in various other jurisdictions can work to help both improve the services provided to customers and ensure that environmental health and safety standards are met. Encouraging consolidation will have direct and tangible benefits to small utility customers by allowing these customers to have access to a utility with adequate capital and the expertise not usually available from small water and wastewater companies. A larger, consolidated entity also can utilize rate-consolidation to combat rate impacts.

In addition to encouraging consolidation through positive acquisition adjustments, other incentives should be explored as well. This Commission has a long history of using incentives to encourage investments and operating efficiencies in other regulated industries, which incentives have provided significant benefits to customers.<sup>2</sup> The water and wastewater industry and its customers could likewise benefit from the same sort of creativeness to drive appropriate investment and efficiencies.

Certainty regarding cost recovery for investments is a necessary element of incenting needed investment. To that end, specific rather than general, non-specific standards for cost recovery are needed, such as specific improvement criteria a utility must satisfy to merit an acquisition adjustment. The current “extraordinary

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<sup>2</sup> For example: the Generating Performance Incentive Factor (GPIF); revenue sharing mechanisms; the Broker System’s share-the savings mechanism; and the Oil Backout Rule.

circumstances” standard is too general and too subjective to be of use to either the Commission or a company considering an acquisition in Florida.

Finally, steps to improve and streamline the regulatory process will reduce regulatory costs, which ultimately benefits customers.

### **Specific Responses**

CSWR-Florida’s initial comments address the topics of Acquisition Adjustments, Allowed Return on Equity, Used and Useful Adjustments, and System Consolidation.

#### **Acquisition Adjustments (Rule 25-30.0371, Florida Administrative Code)**

**1. Should criteria other than extraordinary circumstances be considered for allowing positive acquisition adjustments? If so, what criteria should be considered?**

***Response:***

Yes. CSWR-Florida believes that specific criteria rather than the very general and subjective standard of “extraordinary circumstances” should be considered as the basis for allowing positive acquisition adjustments. The goal of the criteria should be to encourage and incent viable utilities to acquire small utilities that are non-viable currently or likely will become non-viable in the future. Viable utilities are those that have the managerial, technical and financial capabilities to safely and adequately operate the acquired the system on a short-term and long-term basis. Non-viable utilities do not possess those characteristics. Broadly speaking, indications of a non-viable utility would include things like:

- Inability to acquire and maintain the managerial technical and/or financial capabilities to assure an adequate, safe, and permanent water supply or treatment capacity over the short and long-term. The current system operator does not:
  - Maintain and improve essential equipment
  - Properly address population growth in excess of current capabilities
  - Properly address any needs for significant capital improvements associated with aging infrastructure
  - Properly address prevention of contaminants

- Regularly perform required testing
- Failure to meet requisite regulatory requirements
- Difficulty in remaining in compliance with PSC, DEP or health rules and regulations
- Significant capital improvements are necessary or mandated and the current operator is unable to meet those needs or mandates
- Setting of adequate rates to address needed operational and staffing issues or to address needed capital improvements would be unduly burdensome to existing customer base
- Inability to ensure adequate supply or treatment capabilities
- Lack of adequate staffing or certified operators
- Outstanding regulatory or health violations, a history of violations, and/or the inability or unwillingness to correct those violations
- Ongoing billing issues
- Appointment of an interim manager or operator
- Bankruptcy

More specifically, outstanding violations, a history of violations and/or the inability to correct violations can all be utilized as another indicator of non-viability. A history of any non-compliance is important because consistently failing to meet and maintain compliance with environmental regulations designed to protect the health and safety of customers means customers could be exposed to drinking water contaminants on a regular basis. The common goal of the water industry and regulators alike is to avoid this situation and prevent threats to human health and safety through proper water monitoring efforts, followed by preventative maintenance to ensure the quality of drinking water being provided to customers. A history of any non-compliance also indicates a utility's management lacks the expertise and capabilities necessary to operate a utility system. CSWR-Florida believes that a history of non-compliance is alone sufficient for a utility to qualify as non-viable. While a utility may be in compliance at one moment in time, the evaluation and analysis does not end there. Neither Staff nor the Commission can ignore a history of non-compliance with rules and regulations, as this would prevent consideration of all the relevant circumstances surrounding the issue of non-viability.

Evidence that a utility will not be able to meet other requisite regulatory agency requirements on a short or long-term basis can also be viewed as an indicator of non-viability. The very fact that an entity is a small utility makes it particularly susceptible to being non-viable. These utilities have fewer customers and consequently lower revenues than their larger counterparts, yet they generally must meet all the same financial, managerial and technical requirements as the larger companies. As a result, Class C, D and E utilities may be particularly susceptible to being non-viable for either the short or long term.

One further example is that smaller utilities often have difficulty addressing new national standards, such as those regarding PFAS contamination, which is microplastics that the United States Environmental Protection Agency (EPA) and medical community have recently declared as an acute human health issue. Additionally, without consistent investment to upgrade monitoring and/or filtrations systems, it will become increasingly difficult for small utilities to meet more stringent standards for existing and/or new contaminants directly impacting their ability to meet Secondary Drinking Water Standards.

Factors that show a lack of managerial capabilities often have a direct impact on the ability to provide safe, reliable, and environmentally sustainable services as well. Factors such as a declining net book value, the inability or unwillingness to file regular rate cases, and the lack of a succession plan are all indicators of non-viability. A declining net book value demonstrates a lack of consistent re-investment into the utility system infrastructure and highlights an inability or unwillingness to make the necessary investments to run a fully functioning system. Similarly, a lack of rate cases oftentimes leads to a Company's inability to raise the necessary capital to do prudent investment. Finally, a lack of a succession plan leaves customer vulnerable to the risk of an abandoned system or their system falling into the possession of an individual that cannot provide safe and reliable services.

## **2. How can the Commission ensure customers benefit from a positive acquisition adjustment if allowed?**

### ***Response:***

The acquisition of non-viable utilities by larger viable utilities aligns with ensuring the indicators listed above are remedied. Customers benefit from a positive

acquisition adjustment by encouraging the acquisition of these small, rural utilities by capable, well capitalized companies that can ensure customers receive safe and reliable service that complies with applicable health, safety, and environmental laws.

Prior to the adoption of the acquisition adjustment rule, Commission orders listed criteria for a positive acquisition adjustment that focused on benefits that could be expected with the consolidation of a small, struggling utility into a larger viable utility: Increased quality of service; lower operating costs; increased ability to attract capital for improvements; and lower overall cost of capital.<sup>3</sup> In considering modifications to that rule, the Commission should refocus on these and similar benefits to customers.

In gas acquisition cases the Commission has consistently used the same benefits-based criteria for a positive acquisition adjustment, while adding the criteria of “more professional and experienced managerial, financial, technical and operational resources.” A similar approach is warranted for water and wastewater utilities.

### **3. How can customers be protected from utilities “swapping assets”?**

#### ***Response:***

The criteria outlined in the Response to Question 1 would ensure that well-operated companies cannot just “swap assets” as two well capitalized, viable entities would not satisfy the criteria. Evidence of such behavior should be easy to identify and can be dealt with when and if facts warrant. But it would be a mistake – and also bad regulatory policy – to assume incentives would encourage such behavior. Based on the experience of CSWR affiliated companies outside Florida, asset swapping happens infrequently if at all.

### **4. Should acquisition adjustments be addressed only at the time of transfer, at the utilities next rate case, or at a limited time after the transfer of assets?**

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<sup>3</sup> See for example, Application for Staff Assisted Rate Case in Columbia County by Consolidated Water Works, Inc. Order No. PSC-01-1988-PAA-WU, issued October 8 2001, Docket No. 20001682-WU.

***Response:***

CSWR-Florida believes acquisition adjustments should be addressed at a time after the transfer, such as the utility's first rate case.

Water and wastewater utilities, like gas companies, should have the opportunity to operate a system for a period after closing to identify needed improvements and efficiencies. This would enable the utility to present a more complete picture regarding the benefits customers have or will receive from an acquisition.

Customers are not harmed if an adjustment is not addressed at the time of transfer if the current service rates are not changed at the time of transfer. They will still have the ability to object to any adjustment when the utility files a request for an acquisition adjustment.<sup>4</sup>

**5. What are the appropriate criteria and timing for addressing acquisition adjustments after the time of transfer?**

***Response:***

Criteria for adjustment should be the same regardless of the timing of the decision on an adjustment.

The order approving a transfer could specify the timing for consideration of an acquisition adjustment.

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<sup>4</sup> Customers' objections to a proposed transfer is not a basis for denying a transfer, which Public Counsel seems to imply is a basis for denying a transfer by their statement that customers have a right to have it considered at the time of transfer. Neither the statute nor settled case law in Florida provide that right. The statute does not require a decision on an acquisition adjustment at the time of transfer and under case law customers have no organic right to choose their utility service provider. Denying a transfer which is otherwise in the public interest on the basis of customers' objections is, in effect, recognizing a customer's right to choose their service provider.

**6. What conditions, if any, should be placed upon the approval of an acquisition adjustment that would be subject to review in a future rate proceeding?**

***Response:***

Acquisition adjustments should be conditioned on the demonstration of customer benefits resulting from the acquisition, which could be made subject to verification in a subsequent rate case. If required upgrades and improvements are not made or if projected savings do not materialize, the amount of the allowed adjustment could be adjusted accordingly.

**7. Should the Commission's existing policy regarding negative acquisition adjustments be modified or eliminated?**

***Response:***

Yes. Consistent with the Commission staff's statement at the Workshop, CSWR-Florida is not aware of any other state that imposes a negative acquisition adjustment. And as the staff also pointed out, there is a lack of parity in the treatment of rate base in a transfer situation; the rate base of the existing utility carries over to the acquiring utility unless you pay less than the existing rate base.

The goal of an acquisition adjustment policy should be to encourage beneficial acquisitions, A negative acquisition adjustment does not align with that goal.

Customers are not harmed by not imposing a negative acquisition adjustment because the rate base on which a new utility can earn is not changed and they receive the benefit of better quality of service through better management, economies of scale and efficiencies.

Allowing the acquiring utility to earn on the seller's actual rate base encourages the acquiring utility to negotiate for a price lower than the rate base. The additional earnings then provide a resource that could be used to reinvest in the acquired system.

**Allowed Return on Equity (ROE)**

**8. Should the Commission consider a time-limited ROE adder for infrastructure replacement investments?**

*Response:*

Yes. Appropriate incentives promote investment in infrastructure replacement and/or improvement to ensure safe and reliable service.

Missouri has a rule authorizing an acquiring utility to request a rate of return premium (in addition to an acquisition adjustment) as an incentive for the acquisition of a non-viable utility by a viable utility, with a final decision on the amount of any such premium deferred to the acquiring utility's first rate case. A copy of that rule is attached as Appendix A.

**9. Should the Commission consider an increase to the midpoint or an expansion of the traditional ROE range?**

*Response:*

Yes. Expanding the top of the traditional range could provide incentives for utilities to continue to seek efficiencies and cost saving methods by providing owners the opportunity to increase earnings.

The setting of rates above the mid-point to recognize the achievement of efficiencies and costs savings, or providing superior service (as has been done in the electric industry) should also be considered.

**Used and Useful Adjustments (Rules 25-30.431, 25.30.432, and 25-30.4325,  
Florida Administrative Code)**

**10. Should the Commission consider modifications to its Used and Useful Rules to provide incentives that encourage new investment and replacement of aging infrastructure?**

*Response:*

Yes. It was pointed out at the Workshop that the used and useful rules are out of date, no longer necessary, and act as a disincentive to replacing aging infrastructure. The used and useful rules were designed to address developers who built extensive systems in anticipation of the build out of the development, which build out did not materialize. As these developers are replaced by utilities whose business is the operation of water and wastewater system, system expansion and improvement are based on the needs of those systems, as dictated by sound engineering, rather than factors extrinsic to providing utility serve. Further, the FPSC should eliminate the “lot count method” of determining used and useful. This method is not used in the electric and gas industries and should not be used in water and wastewater.

The rules act as a disincentive to infrastructure replacement if applying the rules results in the utility earning on only a percentage of that replacement investment.

### **System Consolidation**

#### **11. How can economies of scale be maximized?**

***Response:***

Economies of scale can be maximized by promoting the consolidation of smaller, rural systems into well-capitalized entities. Access to technical/operational expertise, capital, and various technological advances allows larger entities to achieve economies of scale not generally available to smaller utilities.

#### **12. How can rate impacts be minimalized?**

**Response:**

Rate Impacts can be mitigated through consolidated tariff pricing. Although it is generally more costly to provide safe and reliable water/sewer service, CSWR-Florida has seen the benefits of consolidated tariff pricing in many of jurisdictions in which its affiliates operate. Because the expenditures necessary to bring many rural systems into compliance are greater than for larger systems, customer impact would be most significant if rates are set on a system-by-system basis. CSWR-Florida has seen that over time all systems will require the same or similar investments to the infrastructure over the lifespan of any system.

Rate impacts can also be minimized by the use of gradualism, i.e., a phasing in of rate increases needed to provide cost recovery for necessary improvements. Deferred revenues resulting from the phasing in of rates would be recorded as a regulatory asset.

**13. How can the Commission improve regulatory efficiency?**

***Response:***

The Commission can improve regulatory efficiency through the following methods:

- Focus on issues that have a material impact on rates
- Review the current MFR requirements to eliminate requiring information on non-material issues
- Eliminate paper copies for all filings
- Provide deadlines for processing limited proceedings cases
- Enforce discovery limitations
- Eliminate the requirement of a staff audit for setting rate base at the time of transfer using instead information provided in the utility's last rate case and subsequent annual reports.

**14. What regulatory processes are obstacles to consolidation of systems?**

***Response:***

The unrealistic standard for the award of a positive acquisition adjustment has rendered this a non-viable incentive for the consolidation of systems.