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FLORIDA PUBLIC SERVICE COMMISSION WORKSHOP

SUNSHINE WATER SERVICES POST-WORKSHOP COMMENTS

REGULATORY POLICIES IN THE WATER & WASTEWATER INDUSTRIES

I. Introduction

It is encouraging that there is sentiment at the Florida Public Service Commission ("Commission" or "PSC") to update its Rules, practices, and procedures to meet the changing dynamics of the water and wastewater industry, to encourage investment in aging infrastructure, and to create operational and administrative efficiencies. Sunshine Water Services ("SWS" or "Company") looks forward to working with the Commission and other interested parties in addressing those goals.

II. Acquisition Adjustments (Rule 25-30.0371, Florida Administrative Code)

A. Should criteria other than extraordinary circumstances be considered for allowing positive acquisition adjustments? If so, what criteria should be considered; how can the Commission ensure customers benefit from a positive acquisition adjustment if allowed; and how are customers protected from utilities "swapping assets"?

i. The Commission has not granted a positive acquisition adjustment utilizing the "extraordinary circumstances" standard since 1995 and has only granted positive acquisition adjustments four times ever. The perception from the water and wastewater industry is that it is impossible for a utility to meet this steep standard since, in spite of several other criteria, the single controlling criteria appears to be based upon the principle that, if rates are increased, there is no customer benefit, and rates may increase in a future rate case as the result of an acquisition adjustments. The other criteria - "anticipated improvements in quality of service, anticipated improvements in compliance with regulatory mandates, anticipate rate ...stability over a long period, anticipated cost efficiencies, and whether the purchase was made in an arms-length transaction" have been largely ignored or overridden. In evaluating and weighing these "anticipated" benefits, the Commission has placed the burden so high as to render these valuable customer and system benefits meaningless.

ii. The reference to "extraordinary circumstances" should be removed - instead, the PSC should identify the demonstrations that can be made by the acquirer, some of which are already listed. Considerations should also include the technical, managerial, or financial capabilities of an acquiring utility.

iii. The Commission should be incentivizing acquisitions before "extraordinary circumstances" come to pass – struggling systems that lack long-term viability should have an incentive to divest to a utility with more competent management, operations, and finances. The Commission's policies and Rules should reflect this and incentivize – for buyer and seller - acquisitions of non-viable systems. In Arizona, the Corporation Commission policy addresses both viable and non-viable small system acquisitions, providing standards for acquisition adjustment consideration and incentives for acquiring and consolidating small systems.[1]

iv. It is important to note that many potential sellers have poor recordkeeping for both asset management and financial records, and thus it may be difficult to interpret or implement the existing rules that rely on book value. An alternative or proxy methodology, as is used in certain other states such as New York[2], are helpful in this context.

v. Customers are protected from swapping assets by requiring a demonstration that the acquisition was an arm's length transaction. The Commission has the final determination that the acquisition is in the public interest and is therefore authorized.

B. Should acquisition adjustments be addressed only at the time of transfer, at the utility's next rate case, or at a limited time after the transfer of assets? What are the appropriate criteria and timing for addressing acquisition adjustments after the time of transfer? 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?

i. The determination of the appropriate rate base to record at closing, including an acquisition adjustment, in the transfer proceeding is necessary in certain contexts. The granting of an acquisition adjustment may be a condition to closing the transaction at the negotiated purchase price. In this case, the acquisition adjustment should be recognized and begin amortization at the effective date of the transfer to avoid potentially large out of period bookkeeping adjustments or skewed earnings test results which may cause a conflict with adherence to Rule 25-30.110(5)(d), F.A.C.

ii. There may be circumstances where benefits of the acquisition are not able to be shown at the time of purchase/transfer, and flexibility should be allowed at the discretion of the acquiring utility to make that showing in a subsequent proceeding, such as a limited proceeding or full rate case.

[1] Decision 75626, Arizona Corporation Commission Docket No. W-W-00000C-16-0151, *Investigation into Potential Improvements to its Water Policies*, July 25, 2016.

[2] "Statement of Policy on Acquisition Incentive Mechanisms for Small Water Companies", page 3, New York Public Service Commission Case 93-W-0962, *Proceeding on Motion of the Commission to Establish a Policy to Provide Incentives for the Acquisition and Merger of Small Water Utilities*, August 8, 1994.

Therefore, the timing for determination of the acquisition adjustment must be done on a case-by-case basis.

iii. The current Rule requires that the amortization of the acquisition adjustment begin on the date of issuance of the order approving the transfer. This Rule should be amended to provide for flexibility should the acquiring utility request a deferral of such determination, or the Commission were to only provisionally approve the acquisition adjustment at the time of acquisition approval. This amendment will avoid retroactively applying amortization, creating earnings aberrations. At no time should the utility begin amortization of an acquisition adjustment before the acquisition closes and ownership changes, as this would be inconsistent with the matching of amortization of the adjustment with the acquired system assets' depreciation.

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

i. This policy, which is not accepted in any other state, should be eliminated[3]. If an acquisition is at less than net book value, it is likely because the selling utility has technical, managerial and/or financial deficiencies. This would constitute a "troubled", "non-viable" utility and imposing a negative acquisition adjustment discourages such purchases at a negotiated purchase price, which is contrary to the policy of having such troubled utilities taken over by well-managed, operated and financed utilities.

III. Allowed Return on Equity (ROE)

At the outset, it should be reiterated that the leverage formula provides an inadequate ROE for water and wastewater utilities in light of the risk relative to natural gas and electric utilities. The Commission has recognized that there are many reasons why water and wastewater utilities have more risk than other utilities, which includes but is not limited to: (1) water and wastewater utilities are more capital intensive than electric or natural gas utilities; (2) water and wastewater utilities experience lower relative depreciation rates than other utilities, thereby providing less cash flow; (3) they experience consistently negative free cash flow, thereby increasing their financing requirements; (4) their credit metrics are inferior to those of electric and natural gas utilities; (5) the majority of water and wastewater utilities are substantially smaller than electric and natural gas utilities by virtually any measure including total revenues, total assets, and market capitalization; (6) their earnings are much more volatile (uncertain) than electric and natural gas utilities' earnings; and (7) water and wastewater utilities experience many more business failures than electric and natural gas utilities.

[3] The New York Public Service Commission policy referenced in footnote 2 above is an example.

Although the Company and other water and wastewater utilities have substantially greater risks when compared to natural gas and electric utilities, the Commission has consistently authorized lower ROEs when compared to their natural gas and electric counterparts. The most recent example is the FPU case, where the Commission approved an ROE of 10.25%, with a range of plus or minus 100 basis points, and a 55.1% equity ratio. In SWS's recent rate case, its expert testified to an ROE of 11.75% (which would be more in line with the FPU finding), but the Commission approved an ROE of 9.75% and only a 42.57% equity ratio, only slightly above the 9.70% utilizing the leverage formula.

The US Supreme Court in the Hope and Bluefield cases determined that a public utility was entitled to a return on its investments equal to that generally being made on investments in other businesses where there are corresponding risks. In other words, the greater the risks, the greater the ROE, and vice versa. However, the leverage formula tends to produce counter-intuitive results when comparing the allowed ROEs of water and wastewater utilities with those that have been allowed for natural gas and electric utilities.

If the Commission fails to approve an appropriate ROE for water and wastewater utilities, it creates difficulties in maintaining and supporting their credit and enable them to raise the money necessary for the proper discharge of their public duty to provide safe and reliable water and wastewater service.

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

i. Depending upon the utility's debt/equity ratio this would likely provide minimal cash flow to be of any substantial benefit. Adders are typically included to incentivize investments in particular areas. For water and sewer utilities, incentives to replace existing infrastructure may be able to be managed via an infrastructure mechanism (see below) for utilities with large service areas and ongoing capital programs. Therefore, the ROE adder may be useful for smaller utilities or those with inconsistent capital investments, so long as they are rate base/rate of return regulated.

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

i. As noted above, the leverage formula used to establish the ROE for water and wastewater utilities has long been inadequate to reflect the investment risk vis-à-vis that of publicly traded electric and gas utilities, and the ROEs granted to electric and gas utilities in Florida.

IV. Used and Useful Adjustments (Rules 25-30.431, 25-30.432, and 25-30.4325, Florida Administrative Code)

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

i. Section 367.081(2)(a)1, Florida Statutes, includes a "used and useful in the public service" standard. Similarly, as it related to electric and gas utilities, Section 366.06(1), Florida Statutes, uses the same "used and useful in serving the public" standard.
ii. Although the standards are the same, the Commission has much more granularly applied that standard through rulemaking for water and wastewater utilities. While this might have had some historical basis when water and wastewater utilities were constructed and owned by the developer of the system served by the utility, that is largely no longer the case. Thus, the used and useful Rules are out of date, no longer necessary, and should be repealed.
iii. If this Rule is intended to address only linear infrastructure, under current Commission policies most collection and distribution systems are 100% used and useful. To the extent they are not, considering any infrastructure replacement as 100% used and useful may give some incentive/relief to the utility to timely replace its aging assets.

V. System Consolidation

A. How can economies of scale be maximized?

i. Allowing acquisitions the opportunity to be placed on existing uniform rates of the acquirer will provide long-term benefits to all customers as capital investments arise across the service territory. Facilitating consolidation of tariffs provides simplicity and efficiency for administrative functions, transparency to customers, and results in an equitable sharing of costs. The inclusion of an acquisition into a uniform tariff rate group can be authorized in the order approving the acquisition or can be dictated through a phase-in approach if deemed reasonable.
ii. The Commission should incentivize regionalization of systems, for both investor-owned and publicly owned systems in the State, and especially for small systems. The aforementioned improvements to the acquisition adjustment Rule will also support the need for regionalization of water and wastewater systems in the State, generating economies of scale.
iii. Allowing revenue requirements to be consolidated for water/wastewater systems provides flexibility to manage rate pressures within the utility's overall operating footprint. West Virginia, New Jersey, and Pennsylvania have, in different ways, allowed "combined service" utilities to reallocate

portions of water or wastewater service revenue requirements to the other service group[4].

B. How can rate impacts be minimized?

i. See above for discussion on generating economies of scale.
ii. In addition, the Commission should allow acquiring utilities the opportunity to recover costs vital to supporting adequate service for the acquired system – such as needed capital investments or catch-up maintenance – on an interim basis after acquisition but before the next rate case for the system. For example, acquirers of troubled systems in need of capital investment can be authorized to defer carrying costs (return and depreciation costs) on initial capital investments, or otherwise initiate a surcharge. The latter is allowed in West Virginia for acquiring utilities.[5]

C. How can the Commission improve regulatory efficiency?

i. Elimination paper copies of filing documents will simplify and streamline the filing process, reducing redundant information production while lowering costs. Most states, catalyzed by the pandemic, have become more comfortable with electronic filing and servicing processes.
ii. The Commission should revisit minimum filing requirements for its various filings for any superfluous, redundant, or low-value items. The Commission Staff should review the requirements and determine if certain information is commonly not referenced in the evidentiary record or otherwise not prioritized in its review of filings and submit a report to the Commission of the requirements it deems least valuable.
iii. The Commission should incentivize the use of limited proceedings by establishing a reasonable deadline to complete review by the Commission. The Commission should however take care not to establish overly rigorous methods or processes in these filings to avoid unnecessarily increasing their complexity, which would in turn make them a less desirable regulatory tool.

D. What regulatory processes are obstacles to consolidation of systems?

i. The ability to include the rates of the acquired utility into consolidated rate tariff of the acquiring utility complicates the consolidation of systems in the State. As an example, Texas passed legislation that supports the application

[4] WV ST § 24–2–4g(c); In the Matter of the Petition of New Jersey Am. Water Co., Inc. for Approval of Increased Tariff Rates & Changes for Water & Sewer Service; Change in Depreciation Rates & Other Tariff Modifications, No. PUC 09799-2011N, 2012 WL 2499338, at *9 (May 1, 2012); 66 Pa.C.S.A. § 1311(c)
[5] WV Code 24-2H-9.

of an existing tariff rate being applied to acquired systems under the "filed rate doctrine"[6].

ii. The Commission should recognize that, by their nature, consolidated (uniform) rates involve subsidization and simplify the uniform rate calculation and standards.

VI. Cost Recovery Mechanisms

Should the Commission develop an annual cost recovery mechanism that would facilitate the accelerated replacement of identified water distribution and wastewater collection/transmission pipe and infrastructure that has reached the end of its useful life or has a high consequence of failure? If so, how would such a mechanism be structured?

i. The use of a program like the GRIP program approved for gas utilities and the SWIM previously proposed by Sunshine Water Services in its last rate case should be implemented. See attached a draft rule. The draft rule incorporates best practices from similar mechanisms in states such as North Carolina, Pennsylvania, and Texas. Similar mechanisms to the attached exist for water and wastewater utilities in 24 states.

VII. Utility Reserve Fund (Rule 25-30.444, Florida Administrative Code)

Should the Commission consider modifications to increase use of the Utility Reserve Fund Rule?

i. This is the longest Commission Rule, and would only apply to small, under-capitalized utilities, those that do not have the sophistication to comply with its onerous requirements. As a result, we do not believe any utility has ever sought to utilize this Rule.

ii. Alternatively, the Commission should substantially simplify this Rule, based on feedback from its small, regulated utilities.

VIII. Other Topics For Discussion

Are there any proposals for new policies or practices that participants would like to present for discussion?

1) Eliminating the requirement to notify existing customers of territory amendment or deletion will avoid unnecessary and potentially confusing communications with customers to whom the change does not impact.
2) Eliminating the requirement to publish notices in the newspaper, and instead initiating communication through other, modern means – such as e-mails, social media – or through relatively inexpensive bill inserts.

[6] T.A.C. Chapter 13, Subchapter H, Section 13.3011.

3) The Commission should update the amount of the meter test deposit, which is currently based upon 1986 costs. The Commission should consider this cost to be set on a utility-by-utility basis.
4) The Commission should not require prior approval for a utility to accept credit card payment when the utility does not impose a service charge, and the service charge imposed by the credit card company or payment processor is disclosed.

Sunshine Water Services appreciates the Commissions attention and consideration on these topics and the ability for the utilities to provide their perspective and expertise to help guide the regulatory policies and framework in the State of Florida.