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Special Examination

December 2002 **Report No. 02-67**

Intergovernmental Authorities Provide Public Benefits, But They Lack Accountability

at a glance

Intergovernmental authorities can provide a public benefit by facilitating government ownership and consolidated operations of small water utilities. This in turn can reduce costs for these utilities, the value of which may be used to meet capital expenditure requirements or passed on to customers through reduced utility rates.

However, there is insufficient accountability over the acquisition and operations of water utilities owned by an intergovernmental authority. In addition, the *Florida Statutes* do not ensure that counties and municipalities are able to acquire utilities owned by an intergovernmental authority.

Accountability over water utilities owned by an intergovernmental authority can be improved by

- requiring county or municipality approval of the acquisition of a water utility;
- allowing counties to request Public Service Commission involvement in disputed rate cases; and
- providing for future transfers of utilities to counties and municipalities.

Purpose

The Joint Legislative Auditing Committee directed the Office of Program Policy Analysis and Government Accountability to conduct a policy review of the Florida Governmental Utility Authority (FGUA), an intergovernmental authority created for the purpose of acquiring, financing, and operating water utilities.[1] The Legislature became concerned when FGUA began negotiating with Florida Water Services Corporation to purchase 156 water utilities in 25 counties. Subsequent to the committee's request, another intergovernmental authority, the Florida Water Services Authority was created, which entered into an agreement with Florida Water Services Corporation for the purchase of these utilities.

This policy review focuses on water utilities owned and operated by an intergovernmental authority formed under s. 163.01(7)(g)1., *Florida Statutes,* and examines

- the specific purpose of intergovernmental authorities as well as any public benefit derived therefrom;

[1] For the purposes of our examination, we define "water utility" to include water and wastewater utilities that serve residential customers.

- whether intergovernmental authorities are sufficiently accountable to the public and customers;
- whether it would be sound public policy for the Public Service Commission to have jurisdiction over an intergovernmental authority's services and rates; and
- alternative courses of action that would improve the accountability, efficiency, and economy of intergovernmental authorities. [2]

Background

Formation of intergovernmental authorities permitted by law

An intergovernmental authority is a governmental entity that is created through an interlocal agreement among two or more municipalities or counties. In 1997, the Florida Legislature permitted the formation of intergovernmental authorities for the purpose of acquiring and operating public facilities, including water utilities, which may serve populations outside of member governments' territorial boundaries. [3] These intergovernmental authorities are not subject to Public Service Commission regulation. [4]

As with the purchase of privately owned utilities by other governmental entities, the acquisitions by intergovernmental authorities include various functions (see Exhibit 1). Attorneys, consultants, and other professionals perform these functions for a fee. In addition, acquisitions by intergovernmental authorities are more complex than other utility acquisitions when they involve many utilities located in various counties. Consequently, additional activities such as obtaining objective opinions regarding the reasonableness and fairness of the price and costs of an acquisition also may be conducted.

Exhibit 1
Several Activities Are Typically Performed When a Water Utility Is Sold

Activity	Description
Engineering Due Diligence	Identifies the condition of the utility assets at time of sale and any additional capital improvements that may have to be performed after the acquisition
Financial Due Diligence	Identifies how much revenue will be generated by the utilities
Bond Financing	Provides the available debt financing alternatives and identifies the most cost-effective debt structure
Acquisition Counsel	Responsible for negotiation of the acquisition
Opinion on the Fairness of the Valuation[1]	An objective opinion regarding the reasonableness and fairness of the price and costs associated with the acquisition

[1] This function is not typically completed as part of a water utility acquisition.
Source: OPPAGA analysis.

On February 1, 1999, an intergovernmental authority, Florida Governmental Utility Authority (FGUA), was created via an interlocal agreement among four counties. [5] On April 15, 1999, FGUA acquired six water utilities from a private company, Avatar Holdings, Inc. In September 2001, FGUA began negotiations with another private company, Florida Water Services Corporation, to purchase all of its water assets in Florida. [6] This would be a major acquisition, as Florida Water Services Corporation is the state's largest private water utility company. As shown in Exhibit 2, Florida Water Services Corporation provides services to over 500,000 customers via 156 water utilities in 25 counties. Most of these water utilities are small, serving fewer than 3,300 customers. As with other water utilities in Florida, many of these small water utilities were built in conjunction with new housing developments to provide homeowners with water services.

[2] This examination does not evaluate utilities owned by counties and municipalities.

[3] Chapter 97-236, *Laws of Florida*, amended s. 163.01, *F.S.*

[4] As specified in s. 163.01(7)(g)1., *F.S.* However, the exemption of an intergovernmental authority from commission jurisdiction as it pertains to the approval of an acquisition as a matter of right [s. 367.071(4)(a), *F.S.*] may need to be clarified.

[5] FGUA's membership initially included Brevard, Polk, Lee, and Sarasota counties. Members are now Citrus, Nassau, and Polk counties.

[6] Florida Water Services Corporation is a wholly owned subsidiary of ALLETE, Inc.

Exhibit 2
Florida Water Services Corporation Owns 156 Utilities in 25 Counties

County	Number of Utilities	County	Number of Utilities
Bradford	2	Marion	16
Brevard	2	Martin	6
Charlotte	4	Nassau	2
Citrus	16	Orange	1
Clay	3	Osceola	9
Collier	4	Pasco	4
Duval	4	Polk	5
Flagler	2	Putnam	16
Hernando	2	Seminole	13
Highlands	2	St. Johns	2
Hillsborough	5	Volusia	6
Lake	26	Washington	2
Lee	2	**TOTAL**	**156**

Source: Florida Water Services Corporation.

On September 17, 2002, before FGUA was able to establish an acquisition agreement with Florida Water Services Corporation the cities of Gulf Breeze and Milton, Florida formed an intergovernmental authority, the Florida Water Services Authority. On September 19, 2002, this new authority entered into an agreement with Florida Water Services Corporation for the purchase of its utilities.

Regulation of water in Florida is fragmented

In Florida, several entities are responsible for regulating the quality, supply, and cost of water. The specific regulatory entities vary depending on whether the utility is privately or government owned.

The Department of Environmental Protection has primary responsibility for regulating the quality and supply of water

The Department of Environmental Protection is responsible for regulating the quality and supply of water in Florida. Drinking water quality regulation (in terms of chemical, biological, and other forms of contamination) is dictated by the federal Safe Drinking Water Act. The Department of Environmental Protection works to ensure compliance with these federal requirements as well as state regulations. [7]

The Department of Environmental Protection also manages the supply of water used in Florida through the state's five water management districts. These districts issue consumptive use permits, which authorize water to be withdrawn from surface and groundwater supplies for reasonable and beneficial uses such as drinking water, agriculture, industry, and power generation. The water use permitting process helps to ensure good quality, affordable water for all residents, while protecting the state's water resources.

The Public Service Commission and counties regulate the operations of privately owned utilities

Due to the high costs associated with construction and maintenance, water utilities are allowed to operate as monopolies through establishment of exclusive utility service territories. In lieu of competition, the operations of water utilities are subject to government regulation. Government regulation of water utility operations (i.e., rates and terms of service) is designed to balance the interests of customers and shareholders.

In Florida, either the Public Service Commission or the county where the utility is located regulates a privately owned water utility operating within a single county. [8] The commission regulates utility operations by establishing exclusive service territories, regulating the rates and profits of a utility, and placing an affirmative obligation on the utility to provide service to all who request it. Counties have the option of either regulating private water utilities themselves or transferring jurisdiction to the commission. As shown in Appendix A, 36 counties have transferred jurisdiction to regulate privately owned water

[7] In addition, the Department of Health and county health departments regulate very small water utilities that serve fewer than 25 people. The Florida Department of Agriculture and Consumer Services regulates bottled water and water vending machines.

[8] As specified in s. 367.171(7), *F.S.,* the commission has regulatory authority over all privately owned water utilities that operate in more than one county.

utilities to the commission. Counties that retain jurisdiction over the operations of privately owned water utilities are required to use the same regulatory methodology as the Public Service Commission. [9] Customers are ensured legal representation through the Office of the Public Counsel when either the Public Service Commission or counties exercise regulatory jurisdiction over privately owned utilities. [10]

Government owned utilities are self-regulated

Counties and municipalities that own water utilities are responsible for the rates and terms of service offered to customers. The only limitation on the jurisdiction of these local governments is when municipally owned utilities serve customers outside of their territorial boundaries. These local governments may assess surcharges to such customers, but state law limits this surcharge to 50% of the rates, fees, and charges assessed to the customers residing within the municipality's territorial boundaries. [11]

The operations of water utilities owned by an intergovernmental authority are also self-regulated. These intergovernmental authorities have the sole authority over the rates and terms and conditions of service that are provided to customers. Furthermore, unlike water utilities owned by municipalities, these utilities are not subject to state imposed limitations regarding the rates assessed to their customers.

Findings

Intergovernmental authorities can provide a public benefit

The purchase of water utilities by an intergovernmental authority can be beneficial if utilities are able to realize operating efficiencies and better meet capital expenditure needs. This can occur because of the financial benefits of government ownership and efficiencies associated with consolidated operations. However, accountability for such systems should be strengthened.

Intergovernmental authorities can realize many of the financial benefits associated with government ownership

Government ownership of a water utility can lower costs by allowing for reduced debt financing costs through issuance of tax-exempt bonds. Unlike privately owned utilities, intergovernmental authorities, as government entities, are able to issue tax-exempt bonds. [12] Tax-exempt bonds reduce the cost of financing capital improvements because they can be offered at lower interest rates, which can reduce the associated debt financing costs by 20% or more. The financial benefits available through tax-exempt bonds can be used to meet outstanding capital expenditure requirements or be passed on to customers through reduced utility rates.

Water utilities owned by an intergovernmental authority may also be exempt from some federal and local taxes. [13] For example, as shown in Exhibit 3, the Public Service Commission has estimated that the acquisition by an intergovernmental authority of all of the water utility assets currently owned by Florida Water Services Corporation would result in an annual reduction of $12,416,345 in federal, state, and local taxes. However, there are no assurances that the value of these reductions will be used to lower customer rates or improve services.

In addition, government owned utilities have access to some state and federal funding not available to privately owned utilities. Federal and state funding programs help water utilities to finance capital improvement needs associated with meeting environmental regulatory

[9] As specified in s. 367.171(8), *F.S.*

[10] As specified in s. 350.0611, *F.S.*

[11] This examination does not evaluate the sufficiency of the accountability mechanisms for utilities owned by counties and municipalities.

[12] While privately owned companies can issue a small amount of tax-exempt debt, their access to this market is extremely limited.

[13] Section 163.01(9), *F.S.,* provides that all of the privileges and immunities from liability and exemptions from laws, ordinances, and rules that apply to municipalities and counties shall apply to an intergovernmental authority. However, in a decision issued in the Ninth Judicial Circuit on August 27, 2002, now being appealed, the court declined to construe s. 163.01(9), *F.S.,* as addressing tax immunity and determined that FGUA owned property in Osceola County is subject to ad valorem taxation.

standards, replacing existing infrastructure, and increasing capacity to meet long-term growth requirements. For example, the Clean Water Act State Revolving Fund Program provides low interest loans for water pollution control activities and facilities. Eligibility for this program is established by federal law, which limits participation to government owned utilities, including those owned by inter-governmental authorities, for loans to control wastewater and storm water pollution.[14] In Fiscal Year 2001-02, this program issued nearly $130 million in grants to government owned utilities in Florida.

Exhibit 3
Transfer of Florida Water Services Corporation Utilities to an Intergovernmental Authority May Result in Significant Reductions in Tax Payments

	Taxes Paid by Florida Water Services
Federal Income Taxes	$ 5,188,658
State and Local Taxes	7,227,687
Total Taxes	**$12,416,345**

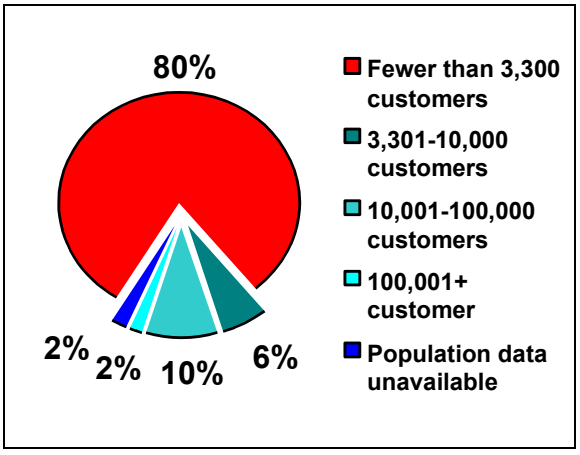
Source: Public Service Commission analysis of Florida Water Services Corporation reported data for 2001.

Conversely, government ownership of water utilities may have disadvantages. While Exhibit 3 shows some of the tax reductions associated with government ownership, it also demonstrates that if an intergovernmental authority were to acquire the assets of these privately owned utilities, state and local governments may lose $7,227,687 in annual tax receipts. The loss of these revenues would require governments to either increase other taxes or reduce services. In addition, government owned utilities may not realize the efficiencies that are associated with privately owned companies, which have the incentive to operate cost-effectively in order to maximize profits. However, privately owned water utilities are subject to government regulation over the rates and terms of service provided, which may limit the competitive effect of private ownership.

Intergovernmental authorities facilitate consolidated operations of small utilities, which can lead to operating efficiencies that may benefit customers

Currently, water services are provided to Floridians by over 4,500 utilities. As shown in Exhibit 4, most of these utilities are small, serving fewer than 3,300 people. All of these utilities are facing similar challenges related to increased regulatory requirements, population growth, resource scarcity, and aging infra-structures. Small water utilities, which do not realize the operating efficiencies of larger utilities, are likely to have greater difficulty meeting these challenges.

Exhibit 4
Most of Florida's Water Utilities Are Small, Serving Fewer Than 3,300 Customers



Source: OPPAGA analysis of Department of Environmental Protection data.

Consolidating water utilities can produce operating efficiencies resulting from economies of scale that can lead to lower prices, improved services, and increased regulatory compliance. The number of customers served by a water utility is an important determinant of how much people pay for water service. Larger utilities can spread their fixed costs (including pumping, treatment, and distribution infrastructure) across more customers, resulting in lower prices. Efficiencies associated with consolidated operations can be realized by physically merging

[14] An exception to this requirement is that non-governmental parties are eligible for loans to control storm water pollution related to agricultural operations.

a small utility with an adjacent larger one. Efficiencies also can be realized when utilities are not in close proximity because activities such as customer service and billing can be combined to produce more cost effective operations.

Consolidating operations among small utilities also may result in improved services and compliance with regulatory requirements. Centralizing operational activities such as billing and customer service may result in improved levels of service because of the enhanced ability to obtain advanced technology and employ personnel with specific expertise. Compliance with regulatory requirements also may improve because the value of cost reductions associated with government ownership and consolidated operations can be used to finance required plant and equipment modifications.

Intergovernmental authorities are an effective means of consolidating the operations of small water utilities regardless of geographic proximity. The authority can contract with a private firm to provide centralized operations and maintenance services for all utilities. The proposed sale of water utilities owned by Florida Water Services Corporation to an intergovernmental authority may allow these utilities to continue to realize operational efficiencies associated with consolidated operations, while also gaining the financial benefits of government ownership.

Intergovernmental authorities lack accountability

Although intergovernmental authorities may provide a public benefit, additional accountability provisions need to be established for these entities. This would help ensure that utility customers' interests will be fairly represented when an intergovernmental authority negotiates to buy and subsequently owns and operates a utility. In addition, counties and municipalities should be allowed to acquire utilities after an intergovernmental authority purchases them.

There are no assurances that customers will be represented when an intergovernmental authority acquires and operates a water utility

Water utilities owned by an intergovernmental authority are not regulated by either a state or local governmental entity that ensures all customers are represented. Customers served by privately owned water utilities are assured representation through the regulatory process of either the Public Service Commission or their county. Similarly, customers residing within the territorial boundaries of a government owned utility are assured representation through their local government.

However, Florida law specifically exempts the acquisition and operations of water utilities that are owned by an intergovernmental authority from regulation by the Public Service Commission or a county.[15] Further, s. 163.01(7)(g)1., *Florida Statutes,* authorizes an intergovernmental authority to acquire and operate a utility that serves customers outside of the territorial boundaries of the member local governments.[16] As a result, customers living in a county or municipality that is not a member of an intergovernmental authority would have no one to represent their interests if the authority increased rates or changed service levels.

Moreover, even for those customers that are represented by member governments, there are no assurances of sufficient accountability because current statutes do not guarantee members the power to approve a utility acquisition or a change in customer rates.[17] For example, a member government may object to a proposed utility acquisition or rate increase affecting its residents, but be outvoted by the other members.

[15] As specified in s. 163.01, *F.S.*

[16] A member government is a county or municipality that is a party to the interlocal agreement forming an intergovernmental authority.

[17] Article VIII, Section 4 of the Florida Constitution addresses transfer of powers between counties, municipalities, and special districts. However, the applicability of this section to an intergovernmental authority is unclear.

Customer representation by elected government officials in the acquisition of a utility is important because the purchase price and terms of sale will determine the rates that customers will pay for services upon transfer to an intergovernmental authority. For utility sales among privately owned companies, either county or Public Service Commission approval is required. [18] This approval process determines the revenues that will be available to finance the acquisition, which helps to ensure that the rates and terms of service will continue to be fair and equitable. Intergovernmental authorities are not required by state statute to obtain approval to purchase utilities. Without an approval mechanism, customers will not be assured representation in the acquisition process, including negotiation of the purchase price and terms of sale.

Local governments expressed concerns regarding lack of representation for affected customers during the negotiations to purchase Florida Water Services Corporation water utilities. Specifically, local governments voiced concerns over their lack of involvement in the determination of the price and terms and conditions of service for each of the utilities within their territorial boundaries.

The *Florida Statutes* do not ensure that counties and municipalities can acquire utilities owned by an intergovernmental authority

A related problem is that counties and municipalities may not be able to subsequently acquire utilities owned by an intergovernmental authority. Currently, the *Florida Statutes* provide that local governments may acquire privately owned water utilities either through direct negotiations or by exercising their power of eminent domain. [19] For some communities, local control over water utilities helps facilitate effective long-term future growth planning. In addition, communities may favor local ownership as a way to improve accountability, because it would ensure that customers are represented through their elected officials.

However, it is uncertain whether a local government has the right to exercise the power of eminent domain when an intergovernmental authority owns a utility. This issue should be explicitly resolved in the *Florida Statutes*.

Options to Improve Accountability

We identified three changes to Ch. 163, *Florida Statutes*, that would improve accountability for utility acquisitions and operations by an intergovernmental authority:

- requiring the county or municipality where the majority of customers reside to approve the acquisition of a privately owned water utility by an intergovernmental authority;
- allowing counties where customers served by an intergovernmental authority reside to request Public Service Commission involvement in disputed rate cases; and
- allowing for future transfers of utilities owned by an intergovernmental authority to the county or municipality where the majority of customers reside.

Intergovernmental authorities should be required to obtain approval from affected counties or municipalities to acquire a water utility

State statutes should be modified to compel intergovernmental authorities to obtain affirmative consent from the county or municipality where the majority of customers reside as a condition of acquiring a water utility. Should a county or municipality not provide approval, the sale of that specific utility would be exempted from the proposed acquisition agreement. The requirement to obtain affirmative consent as a condition of sale will provide accountability, similar to that associated with county or Public Service Commission approval of privately owned utilities, by helping ensure that affected customers are represented through their local government. For example, in

[18] As required in s. 367.071, *F.S.*

[19] As defined in ss. 127.01(1)(a) and 166.401(1), *F.S.,* eminent domain is the right of a county or municipality to appropriate property, except for state or federal property, for any county or municipal purpose.

response to the concerns raised by local governments over lack of representation in the Florida Water Services Corporation acquisition process, the Florida Governmental Utility Authority made the purchase of each utility contingent upon receiving approval from the local government where the majority of the customers reside. Local governments were given the opportunity to express their opposition to the acquisition of specific utilities by passing a formal resolution.

Moreover, giving local governments this kind of opportunity provides assurances they are included in the negotiation of the purchase price and terms of sale. Local government involvement in the negotiation process would help to ensure that the financial benefits of government ownership (e.g., lower costs due to tax-exempt debt financing and exemption from some federal and local taxes) are passed on to customers through reduced rates or improved services.

The Public Service Commission should arbitrate disputes over rates and services provided by intergovernmental authorities

There are two potential ways to increase public accountability for the rates and services provided by intergovernmental authorities:

- giving the Public Service Commission authority to regulate these entities or
- retaining local jurisdiction but authorizing counties to request commission arbitration services when agreement cannot be reached regarding rates and terms of service.

The preferable option is allowing for local control and giving counties the ability to petition the commission on behalf of their citizens for arbitration services.

One way to provide accountability to customers served by utilities owned by an inter-governmental authority would be to require Public Service Commission regulation of these utilities. While this would ensure accountability, there are disadvantages associated with this option that make it less preferable. First, this option would be more costly. The commission funds its regulatory activities by assessing each utility a fee of 4.5% of gross revenues. If all Florida Water Services Corporation utilities were owned by an intergovernmental authority and fully regulated by the commission, the estimated regulatory assessment to these utilities would be $5,022,455 annually. This option also would be inconsistent with the local control provision of current statutes, which authorizes counties the option of regulating private utilities within their jurisdiction.

The preferred option would be to authorize counties with customers served by an intergovernmental authority to petition the Public Service Commission on behalf of their citizens for arbitration services in instances of rate and service disputes. This option would provide an avenue for public accountability while promoting local control and reducing the costs associated with state regulation. With this option, customers who do not agree with the rates and terms of service provided by an intergovernmental authority would request their county commission to petition the Public Service Commission for arbitration services. As with all rate determination cases heard by the commission, the Office of the Public Counsel would have the authority to provide legal representation for customers.[20] To implement this option, the Public Service Commission will need to develop and promulgate administrative rules governing the process and determine the fee needed to fund dispute resolution service. The process used to develop administrative rules ensures that all affected parties will have the opportunity to comment on any proposed rule before promulgation.

The ability of counties and municipalities to acquire water utilities owned by an intergovernmental authority should be ensured

The *Florida Statutes* should be clarified to ensure provisions exist that allow for future transfers of utilities to the county or municipality where the majority of customers reside. In those instances when the authority and local government

[20] As specified in s. 350.0611, *F.S.*

cannot agree on the terms and conditions of the acquisition, the local government should be provided the right to redress through the Public Service Commission. As with rate and terms of service disputes, the costs assessed to local governments should reflect the amount required to recover all associated costs and be established through the administrative rulemaking process.

Recommendations

To help ensure that water utilities owned by an intergovernmental authority are sufficiently accountable to the public and ratepayers, we recommend that the Legislature amend s. 163.01(7)(g)1., *Florida Statutes*, as discussed below.

- Require that the affirmative consent of the county or municipality where the majority of customers reside be obtained as a condition of acquisition of a water utility by an intergovernmental authority. The requirement to obtain approval as a condition of purchase will provide greater accountability in these utility acquisitions because affected customers would be assured representation through their local government.
- Authorize Public Service Commission involvement over the rates and terms of service offered by a utility when agreement cannot be reached. The ability to request commission involvement in disputes over the rates and terms of service offered by a utility should be provided to any county with customers served by an intergovernmental authority. To ensure public participation, the administrative rulemaking process should be used to structure the process and determine the fee for dispute resolution services.
- Ensure that the county or municipality where the majority of customers reside is able to subsequently acquire utilities owned by an intergovernmental authority. In those instances when the authority and the county or municipality cannot agree on the terms and conditions of the acquisition, the applicable local government should be provided the right to redress through the Florida Public Service Commission. As with rate and terms of service disputes, the costs assessed to local governments should reflect the amount required to recover all associated costs, with the specific structure determined through the administrative rulemaking process.

Agency Response

Pursuant to s. 11.51(5), *Florida Statutes,* the Florida Water Systems Authority and the Florida Governmental Utility Authority were provided the opportunity to comment on a draft copy of our report. The Florida Water Systems Authority chose to respond with comments from participants in the authority's acquisition of Florida Water Services Corporation. The comments describe additional potential benefits of intergovernmental authorities and identify concerns regarding our proposed recommendations to improve accountability. Due to the extensive nature of the comments, we are unable to include them in our published report. However, they can be viewed in their entirety as an addendum to our electronic document through our website.

In summary, while the comments provided by the authority concur that additional accountability is needed, particularly for rate setting, they also identify concerns with recommendations that utility purchases by intergovernmental authorities be contingent upon the affirmative consent of local governments and that local governments be assured the right subsequently to purchase utilities owned by intergovernmental authorities. The comments contend that these options for improving accountability would result in conflicts of interest between local governments that may be competing for the purchase of a utility and that allowing local governments to approve utility acquisitions usurps the seller's right to negotiate the best price and terms for its stockholders and potentially devalues the asset. We believe that

our recommendations are consistent with the local control provision of current statutes and ensure that affected customers are represented through their local government.

The comments provided by the authority suggest alternatives to our recommendations such as limits on retained utility profits or representation on the authority's governing body. We do not consider limits on retained utility profits an appropriate mechanism due to differing definitions of operating and capital expenses. We also do not believe that requiring customer representation on the authority's governing body provides sufficient accountability, because intergovernmental authority membership can be limited to a select group and may not include the power to approve a utility acquisition or a change in customer rates.

FLORIDA WATER SERVICES AUTHORITY
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December 18, 2002

To Whom It May Concern:

Florida Water Services Authority (FWSA) regrets that the Office of Program Policy Analysis and Government Accountability (OPPAGA) chose not to include these comments in *The OPPAGA Draft Report.* Nonetheless, we are submitting this response to provide a different perspective.

COMMENTS ON THE OPPAGA DRAFT REPORT:

Possible additional benefits of intergovernmental authority ownership of a utility vs. private ownership or municipal or county ownership:

* There are already several areas of the State experiencing severe water shortages. Early atte1tlPts to regionalize cooperation in the use of resources have had less-than-optimal results, and it seems likely that litigation will continue to increase as those areas with water readily available encounter claims from those areas which don't have an adequate supply. Fragmented ownership contributes to this problem. Consolidated ownership of utilities enables cooperation across geographic boundaries in the acquisition and use of water resources, especially at times of critical shortages, but also in planning for the long-term needs of the entire area served.

* The Florida water management districts have been increasingly emphasizing conservation as a necessary means of protecting scarce water resources. Consolidating operations among utilities can result in increased conservation education and other conservation efforts which would not be feasible for an individual utility.

* Consolidated ownership of utilities by an intergovernmental authority allows backup of personnel and equipment, as well as the sharing of emergency equipment that would be beyond the reach of each utility acting alone.

Comments regarding the premise that "counties and municipalities should be allowed to acquire utilities after an intergovernmental authority purchases them":

* OPPAGA does not give any reasons why this would be beneficial, and there are important reasons why it would be detrimental.

This premise completely overcomes many of the benefits of intergovernmental ownership. The economies of scale, improved service and regulatory compliance due to consolidated ownership, and the benefits cited in the 1st section above would all be moot if, after purchasing a utility system, municipalities and counties could force their part of the system to be siphoned off, leaving only those parts no one wants. This is entirely in opposition to the reasons for intergovernmental ownership in the first place.

* Intergovernmental authorities would have no ability to gain favorable financing if lucrative parts of the system could be taken from their ownership at will. No credible financing authority would issue bonds at favorable rates (or maybe at all) when the cash flow is unpredictable due to such a provision.

* Long-range planning for conservation, environmental compliance, upland disposal, capital improvements etc. would likewise be thrown into disarray if ownership of system segments was constantly at risk due to this proposal.

* Frequently, there would be a conflict of interest on the part of counties and municipalities who wish to acquire a utility from an intergovernmental authority. The desire to have the income and other benefits of ownership could easily conflict with the best interest of the customers.

Comments regarding the need for greater accountability:

* Strong arguments can be made for the need for additional accountability, but requiring "that the affirmative consent of the county where the majority of customers reside be obtained as a condition of acquisition of a water utility by an intergovernmental authority" is not the best way to gain that accountability.

o Frequently, there would be a conflict of interest between the county and another entity who wishes to acquire a utility. The county's desire to have the income and other benefits of ownership could easily conflict with the best interest of the customers.

o Citizens do not always see the county in which they live as the best entity for providing service or decision-making on their behalf.

o Regarding the statement, "Giving local governments this kind of opportunity provides assurances they are included in the purchase price and terms of sale" -- Especially when a utility is being sold by a private owner, this provision usurps the seller's right to negotiate the best price and terms for its stockholders and potentially devalues the asset. This is the antithesis of our free enterprise system, and has no place in State policy.

There are currently several lawsuits underway because the attempts of some cities and counties to interrupt the sale of Florida Water Services to Florida Water Services Authority have allegedly caused a devaluation of the system. Requiring that a county be made a

party to the negotiation by way of its veto power over a sale will result in costly litigation, while doing nothing to ensure that the best interests of the customers are served.

* Oversight by the DEP and water management districts remains unchanged when a utility is bought by an intergovernmental authority. The DEP and water management districts provide strong oversight regarding consumption, conservation, regulatory compliance, and the like. Any serious degradation of utility services would result in infractions of their regulations and possible resulting penalties.

* While Public Service Commission oversight does not apply to any utility under public ownership, other regulations - Sunshine Laws, public records laws, financial reporting, requirements for public hearings, etc. The net effect is increased transparency when a utility moves from private ownership to public ownership.

* The area of greatest need for increased accountability is in rate-setting and related functions.

o Public Service Commission oversight is no assurance that the system will be operated economically. Under Public Service Commission control, private owners are currently granted generous profits.

o One way of reducing potential abuse of the rate-setting privilege would be to place a limit on the amount of income (after all operating expenses, capital costs and reserves, and debt service expenses are covered) which the authority can retain from the system. A cap of 5% of the gross revenues/fees is a realistic level to consider, and is far less than some private utility owners have been granted by the PSC.

o Another possibility is requiring customer representation on the authority's governing body (which Florida Water Services Authority has already pledged to do). The OPPAGA proposal to involve the PSC in mediating disputes is another good way to increase accountability.

The proposed findings and recommendations of OPPAGA further omit any discussion of (1) the economic benefit to utility customers from the current legislative format based on economies of scale which leads to rate protection of customers, and (2) the long standing protection of government utility customers against unreasonable utility rate imposition that has been provided by the judicial branch of Florida Government. With both the current FGUA ownership and operation of its utility systems in Collier, Osceola, and Hillsborouqh County's and the FWSA proposed transaction, the customers receive substantial economies of scale from centralized administrative services, customer service, billing, engineering and operations that only statewide authority's can provide.

The regionalization of utility operations has long been championed by the Department of Environmental Protection and the U.S. Environmental Protection Agency. In addition, both Authority's secured

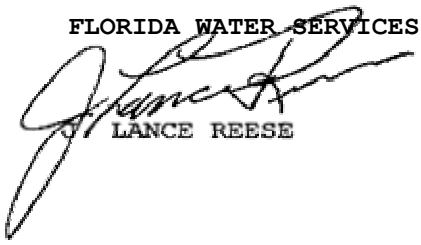
substantial capital projects financing dollars as a result of the acquisitions without raising the current customers rates. If the Authority's did not have primacy over their own rate regulation, the access to this capital financing would be restricted as the financial markets disfavor funding utilities that do not control their rates as a protection for bond holders. In the FWSA transaction, our expert consultants have estimated the impact of requiring the split-up of the utility system to individual local governments to require as much as a 25% increase in rates to customers by losing the economies of scale afforded by the FWSA integrated acquisition. With respect to the customer protection against unreasonable rates, the Florida court's have long protected local government utility customers from unreasonable actions by the local government in setting utility rates. This judicial protection is available to every customer of an Authority's utility regardless of where they are located. There are very specific parameters established by the court's for how a government can set utility rates. These parameters require government utilities to maintain rates within a range of reasonableness and are traditionally based on identifiable cost recovery methodologies. This system of judicial protection has been in place for over fifty years and has worked well to protect customers.

The proposed findings and recommendations of OPPAGA regarding acquisition of utilities by interlocal agreement violate well established principals of municipal power by giving a COUNTY the power to override a municipal decision on local utilities. The Florida Constitution specifically reserves such powers to the municipalities unless there is a county charter that specifically specifies that the county's powers supersede municipal powers. The drafters of the Florida constitution never intended for non-charter counties to be able to overrule municipal decisions that affected municipalities. As for charter counters, even then, the framers did not give counties the power over cities. Instead, charter counties could have such supreme powers ONLY if the charter, voted on by the people, gave the County supremacy over the cities within such county. As a practical matter, most county charters do not give the county supremacy. However, OPPAGA would overrule this long-standing rule by giving the County powers over utilities within the Cities by legislation, not by charter! In addition, the OPPAGA suggestions make no provision for situations where a County is competing with an interlocal agency or City for the acquisition of a utility. Clearly, placing the County in the position of getting to approve an acquisition gives the County an unfair advantage in the acquisition process. This frustrates competition and reduces the ability of those who might better run a utility for various reasons from having a fair chance to obtain a utility that an in-experienced County might want to purchase. Our system of government is based on trying not to give bureaucratic agencies the ability to unfairly compete with those who have more and better experience in running a business. If a County that has never run a utility decided it would like to have a utility, OPPAGA gives that county the supreme right to be the sole party negotiating for the acquisition, even if other, better managed, more efficient utilities could do a better job. What public policy can possibly be served by such a solution? The existing system has demonstrated that it works well. There is not one instance of any mistreatment of customers or rate setting abuse whatsoever. So, if it isn't broken, why change it? Why enhance the power of bureaucrats to increase their bureaucracies through and

unfair, totalitarian system where one party among those with an interest in acquiring the utility gets to decide the outcome of an otherwise competitive process?

Very truly yours,

FLORIDA WATER SERVICES AUTHORITY



J. LANCE REESE

FLORIDA GOVERNMENTAL UTILITY AUTHORITY

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December 19, 2002

Via Overnight Delivery

Ms. Debbie Gilreath, Staff Director
Office of Program Policy Analysis
and Government Accountability
Government Operations
111 West Madison Street, Suite 312
Tallahassee, Florida 32399-1475

Re: Draft Report

Dear Ms. Gilreath:

Thank you for providing the Florida Governmental Utility Authority ("FGUA") with a draft of your office's special examination ("Draft Report") of intergovernmental authorities created pursuant to Chapter 163, Florida Statutes ("Intergovernmental Authorities"). You and your department should be commended for the thorough and concise examination of a complex topic which is presented in the Draft Report.

We appreciate the Draft Report's recognition of the benefits for local governments provided by Intergovernmental Authorities, specifically concerning the transition of investor-owned utilities into local government ownership. As you may know, the FGUA recently completed the successful transition of assets into Sarasota County ownership. Thus, Lee County, Brevard County and Sarasota County each have utilized the FGUA to secure ownership of utility assets which previously were not available to them absent the initiation of condemnation proceedings. It is anticipated that FGUA assets located in Hillsborough County also will be transitioned to the County in the near future. Each of these transitions were anticipated and planned for during the process of creating the FGUA and completing prior acquisitions of investor-owned utilities.

In this regard, we note that the interlocal agreement establishing the FGUA and the interlocal agreements between the FGUA and non-member counties such as Collier County and Hillsborough County provide accountability of the FGUA to both member and non-member local governments regarding utility operations by providing the option to purchase the systems, rate setting oversight, capital budget review, local settings for hearings concerning rates, policies and services and other mechanisms designed to maintain such accountability.

We also note that, upon transition, all revenue received by the FGUA which is not spent to operate the utility systems while under FGUA ownership is turned over to the local governments together with the utility assets. Therefore, while a local government may not receive property tax dollars during interim ownership by the FGUA (see comments on page 5 of Draft Report), the local governments receive all revenue, past and future, derived from the utility operations upon transition. The full impact of a loss of tax revenue only occurs when the Intergovernmental Authority acts contrary to the FGUA process by (1) not providing for transition of assets into local government ownership; and (2) allowing "profits" from the utility system to be paid to members of the Intergovernmental Authority when utility assets are not located within the member's political boundaries. Finally, we note that local governments which acquire investor-owned utilities directly also lose property tax

revenue. However, the revenue is replaced by revenue obtained from the provision of utility service to customers. As just noted, the FGUA process turns all of such revenue over to the local government upon transition.

With regard to the options identified in the Draft Report to improve accountability of Intergovernmental Authorities, the FGUA agrees that a provision for notice to host local governments of a potential acquisition as well as the extension of the option to local governments to secure ownership of utility assets are necessary adjuncts of the transitional role to be played by Intergovernmental Authorities. However, we believe that requiring not only notice but affirmative acts of consent by all host local governments may be unduly restrictive in that many county and city governments do not currently own or regulate utilities. These governments, confronted by the myriad of issues associated with owning, regulating or participating as a member in an Intergovernmental Authority, may prefer to remain silent concerning a proposed acquisition. Even governments which own and operate utilities may prefer to take no position on an acquisition. If the law is changed to require affirmative consent, the numerous benefits of acquisition by an Intergovernmental Authority may be unnecessarily lost. In lieu of an affirmative consent, the FGUA supports the notice requirement set forth in Senate Bill 140 sponsored by Senator Nancy Argenziano, a copy of which is attached hereto for your consideration. This bill requires forty-five (45) days notice to host local governments of a pending acquisition and permits an acquisition to occur if local governments choose to be silent.

The concept of Public Service Commission involvement in disputed rate proceedings for Intergovernmental Authorities is a novel idea. The FGUA concurs with the Draft Report's finding that mechanisms in favor of local participation and control, i.e., membership in an Intergovernmental Authority or an Interlocal agreement with such an Authority, are preferred by local governments. It would not be economical or efficient to require Public Service Commission jurisdiction over Intergovernmental Authorities and, in fact, such jurisdiction could adversely impact the ability to issue bonds at the lowest interest rates otherwise possible. However, permitting a local government which is not a member of the Intergovernmental Authority to petition the Public Service Commission to serve as a non-binding arbitrator in the event of rate or service disputes may have merit. Efforts should be made to avoid a situation where Public Service Commission involvement becomes the rule and not the exception. Moreover, as with disputes concerning rates and services provided by any government owned water or wastewater utility, the circuit court with jurisdiction in the area where utility assets are located should remain the forum for ultimate disposition of such disputes.

Once again, we appreciate the opportunity to provide these comments and welcome any questions or requests for clarification.

Very truly yours,

Lea Ann Thomas
Chair

LAT/adg

Enclosure

By Senator Argenziano

3-234-03

A bill to be entitled

An act relating to the Florida Interlocal Cooperation Act of 1969; amending s. 163.01, F.S.; requiring notification of the host government if a separate legal entity seeks to acquire public facilities serving populations outside the jurisdiction of members of the separate legal entity; providing for the host government to respond within a specified period; providing that the host government may not prohibit such acquisition if it fails to respond within the specified period; defining the governing body constituting the host government for purposes of the act; authorizing the host government to reserve the right to review and approve rates, charges, and customer classifications; providing certain limitations; providing for retroactive application; providing an effective date.

Be It Enacted by the Legislature of the State of Florida:

Section 1. Paragraph (g) of subsection (7) of section 163.01, Florida Statutes, is amended to read:

163.01 Florida Interlocal Cooperation Act of 1969.--

(7)

(g)1. Notwithstanding any other provisions of this section, any separate legal entity created under this section, the membership of which is limited to municipalities and counties of the state, may acquire, own, construct, improve, operate, and manage public facilities, or finance facilities

on behalf of any person, relating to a governmental function or purpose, including, but not limited to, wastewater facilities, water or alternative water supply facilities, and water reuse facilities, which may serve populations within or outside of the members of the entity. Notwithstanding s. 367.171(7), any separate legal entity created under this paragraph is not subject to commission jurisdiction and may not provide utility services within the service area of an existing utility system unless it has received the consent of the utility. A separate legal entity that seeks to acquire any public facilities that serve populations outside of the jurisdiction of members of the entity must notify in writing each host government of the contemplated acquisition prior to any transfer of ownership, use, or possession of any utility assets to such separate legal entity. The potential acquisition notice must be provided in writing to the legislative head of the governing body of the host government and its chief administrative officer and provide the name and address of a contact person of the separate legal entity for the receipt of information on the contemplated acquisition. Within 45 days following receipt of the notice, the host government may adopt a membership resolution indicating its intent to become a member of the separate legal entity, a prohibition resolution to prohibit the acquisition by the separate legal entity of public facilities within its jurisdiction, an approval resolution prescribing any restrictions on the proposed acquisition required by the host local government, or take no action of any kind. If a host government adopts a membership resolution, the separate legal entity shall accept the host government as a member prior to any transfer of ownership, use, or possession of the public

facilities on the same basis as its existing members. If a host government adopts a prohibition resolution, the separate legal entity may not acquire the public facilities within such host government's territory without specific consent of the host government by future resolution. If a host government does not adopt a membership resolution, a prohibition resolution, or an approval resolution, the separate legal entity may proceed to acquire the public facilities after the 45-day notice period without further notice, except as otherwise agreed upon by the separate legal entity and the host government. The host government may not prohibit the acquisition of such public facilities if it has not responded to the legal entity within the 45-day notice period. For purposes of this paragraph, a "host government" is the governing body of the county if a majority of the retail utility customers to be served by the acquired public facilities within the county reside in the unincorporated area, or is the governing body of a municipality if the majority of the retail utility customers to be served by the acquired public facilities reside within the municipal boundaries. Any host government may, in its adoption of an approval resolution or a membership resolution or by resolution adopted subsequent to the closing of an acquisition, reserve the right to review and approve as fair and reasonable the rates, charges, and customer classifications adopted by the separate legal entity for the use of the acquired public facilities within the jurisdiction of the host local government. Such right of rate review and approval by the host local government is subject to the obligation of the separate legal entity to establish rates and charges that comply with the requirements contained in any

resolution or trust agreement relating to the issuance of bonds to acquire and improve the affected public facilities and such right does not affect the obligation of the separate legal entity to set rates at a level sufficient to pay debt service on its obligations issued in relation to the affected public facilities. This paragraph is an alternative provision otherwise provided by law as authorized in s. 4, Art. VIII of the State Constitution for any transfer of power as a result of an acquisition of public facilities by a separate legal entity from a municipality, county, or special district.The entity may finance or refinance the acquisition, construction, expansion, and improvement of such facilities relating to a governmental function or purpose through the issuance of its bonds, notes, or other obligations under this section or as otherwise authorized by law. The entity has all the powers provided by the interlocal agreement under which it is created or which are necessary to finance, own, operate, or manage the public facility, including, without limitation, the power to establish rates, charges, and fees for products or services provided by it, the power to levy special assessments, the power to sell or finance all or a portion of such facility, and the power to contract with a public or private entity to manage and operate such facilities or to provide or receive facilities, services, or products. Except as may be limited by the interlocal agreement under which the entity is created, all of the privileges, benefits, powers, and terms of s. 125.01, relating to counties, and s. 166.021, relating to municipalities, are fully applicable to the entity. However, neither the entity nor any of its members on behalf of the entity may exercise the power of eminent domain over the facilities or property of any existing water or wastewater

plant utility system, nor may the entity acquire title to any water or wastewater plant utility facilities, other facilities, or property which was acquired by the use of eminent domain after the effective date of this act. Bonds, notes, and other obligations issued by the entity are issued on behalf of the public agencies that are members of the entity.

2. Any entity created under this section may also issue bond anticipation notes in connection with the authorization, issuance, and sale of bonds. The bonds may be issued as serial bonds or as term bonds or both. Any entity may issue capital appreciation bonds or variable rate bonds. Any bonds, notes, or other obligations must be authorized by resolution of the governing body of the entity and bear the date or dates; mature at the time or times, not exceeding 40 years from their respective dates; bear interest at the rate or rates; be payable at the time or times; be in the denomination; be in the form; carry the registration privileges; be executed in the manner; be payable from the sources and in the medium or payment and at the place; and be subject to the terms of redemption, including redemption prior to maturity, as the resolution may provide. If any officer whose signature, or a facsimile of whose signature, appears on any bonds, notes, or other obligations ceases to be an officer before the delivery of the bonds, notes, or other obligations, the signature or facsimile is valid and sufficient for all purposes as if he or she had remained in office until the delivery. The bonds, notes, or other obligations may be sold at public or private sale for such price as the governing body of the entity shall determine. Pending preparation of the definitive bonds, the entity may issue interim certificates,

which shall be exchanged for the definitive bonds. The bonds may be secured by a form of credit enhancement, if any, as the entity deems appropriate. The bonds may be secured by an indenture of trust or trust agreement. In addition, the governing body of the legal entity may delegate, to an officer, official, or agent of the legal entity as the governing body of the legal entity may select, the power to determine the time; manner of sale, public or private; maturities; rate of interest, which may be fixed or may vary at the time and in accordance with a specified formula or method of determination; and other terms and conditions as may be deemed appropriate by the officer, official, or agent so designated by the governing body of the legal entity. However, the amount and maturity of the bonds, notes, or other obligations and the interest rate of the bonds, notes, or other obligations must be within the limits prescribed by the governing body of the legal entity and its resolution delegating to an officer, official, or agent the power to authorize the issuance and sale of the bonds, notes, or other obligations.

3. Bonds, notes, or other obligations issued under subparagraph 1. may be validated as provided in chapter 75. The complaint in any action to validate the bonds, notes, or other obligations must be filed only in the Circuit Court for Leon County. The notice required to be published by s. 75.06 must be published in Leon County and in each county that is a member of the entity issuing the bonds, notes, or other obligations, or in which a member of the entity is located, and the complaint and order of the circuit court must be served only on the State Attorney of the Second Judicial Circuit and on the state attorney of each circuit in each

county that is a member of the entity issuing the bonds, notes, or other obligations or in which a member of the entity is located. Section 75.04(2) does not apply to a complaint for validation brought by the legal entity.

4. The accomplishment of the authorized purposes of a legal entity created under this paragraph is in all respects for the benefit of the people of the state, for the increase of their commerce and prosperity, and for the improvement of their health and living conditions. Since the legal entity will perform essential governmental functions in accomplishing its purposes, the legal entity is not required to pay any taxes or assessments of any kind whatsoever upon any property acquired or used by it for such purposes or upon any revenues at any time received by it. The bonds, notes, and other obligations of an entity, their transfer and the income therefrom, including any profits made on the sale thereof, are at all times free from taxation of any kind by the state or by any political subdivision or other agency or instrumentality thereof. The exemption granted in this subparagraph is not applicable to any tax imposed by chapter 220 on interest, income, or profits on debt obligations owned by corporations.

Section 2. <u>The acquisition requirements contained in the amendments to section 163.01(7)(g)1., Florida Statutes, provided in this act which condition the acquisition by a separate legal entity of public facilities that serve populations outside of the members of the entity on the provision by such separate legal entity of a potential acquisition notice to all host governments and on the granting to a host government the opportunity to adopt a membership resolution, a prohibition resolution, or an approval resolution shall be retroactively applied and substantial</u>

compliance with such acquisition requirements shall be a specific condition of any acquisition subsequent to September 1, 2002, of public facilities by a separate legal entity created by interlocal agreement pursuant to section 163.01(7)(g)1., Florida Statutes, pursuant to an acquisition agreement entered into prior or subsequent to September 1, 2002.

Section 3. This act shall take effect upon becoming a law and shall apply retroactively to September 1, 2002.

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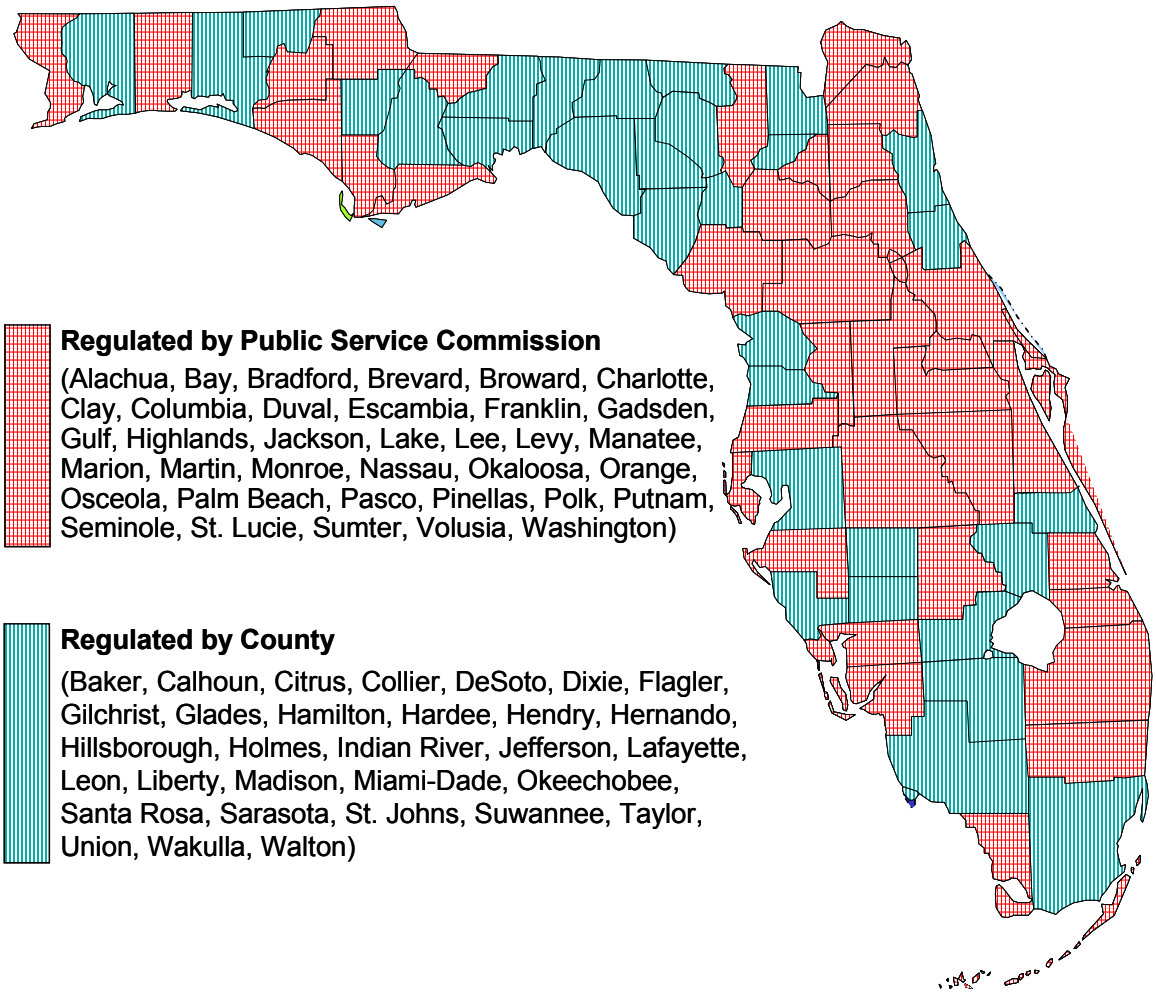
SENATE SUMMARY

Provides a procedure by which a separate legal entity may acquire public facilities serving populations outside the jurisdiction of members of the separate legal entity. Requires that the county or municipality be notified of the contemplated acquisition. Requires that the county or municipality respond within 45 days following the notice. Authorizes the county or municipality to reserve the right to review and approve rates, charges, and customer classifications. Provides for the act to apply retroactively to September 1, 2002. (See bill for details.)

Appendix A

The Public Service Commission Regulates Private Utilities in 36 Counties



Source: Public Service Commission.

The Florida Legislature

Office of Program Policy Analysis and Government Accountability

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