Capacity Development – More than Viability Under a New Name
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Good afternoon. It's a pleasure to be with you this afternoon and I would like to thank Commissioner Kiesling and the Water Committee for inviting me to speak to you today.

I do have to warn you before I start, though, that I am both a lawyer and a consultant. Now I've been told that all lawyers think that they know more than consultants, and all consultants think that they know more than lawyers. Which means, of course, that each and every one of you is convinced that you know more than I do. And you may be right.

I feel honored to be a member of this panel – and I know that these folks all know a lot more than I do. I have to tell you that I've known Wendell Holland literally since I started doing utility work over 13 years ago. He was the staff attorney for the Pennsylvania Commission on my first case as an attorney with the Pennsylvania Consumer Advocate's office back in 1983.

A lot has changed since Wendell and I were staff attorneys 13 years ago. And I'm not just talking about our hair color and waistlines. Thirteen years ago, commissions and public advocates were concerned about nuclear power plant construction, excess electric capacity, rumors of deregulation in the natural gas markets, the possible break-up of AT&T. Water utilities were all but ignored. In the Consumer Advocate's office back then, I think there were only three water companies that we even followed – out of the more than 300 PUC-regulated systems in Pennsylvania. I think NARUC had a water committee back then, but NASUCA didn't. And there probably wasn't a whole lot for a water committee to do back in 1983.

As I said, a lot has changed in the past 13 years.

But one thing that hasn't changed is that many small water systems are in trouble and need help to provide safe, adequate, and reliable service to their customers. And that's what we're here to discuss this afternoon.

[slide: Capacity Development vs. Viability]

For several years now, we have been discussing the "viability" of small water systems. With the enactment of the Safe Drinking Water Act Amendments of 1996 last summer, we have to change not only our vocabulary, but also our whole way of thinking about small water systems.

"Viability" was a pass-fail sort of way of looking at small systems. Either they passed – they were "viable" – or they failed – they were "non-viable." A lot was written about ways to develop rankings for water systems – scores that you could use to see if a system passed or failed. In short, viability looks like an answer. But it can lead to two major problems: a false sense of security and a failure to identify important opportunities for improvement.

The SDWA Amendments discarded the term viability and replaced it with "capacity development." At first glance, you might think that this is just a new term for the bureaucrats to toss around. It also gives us a chance to say things like: the term "viability" is not longer viable. But I wouldn't do that. No, this new terminology is more significant. Capacity development takes us away

from the search for a definitive answer. Instead, it forces us to focus on something more important: the process of *developing the capacity* in water systems to reliably serve their customers, both at present and in the future.

With capacity development as our framework, systems don't pass or fail. Every small water system has strengths and weaknesses. The purpose of capacity development is to build on the strengths to try to eliminate the weaknesses. And in order to do that, you have to find ways to identify those strengths and weaknesses.

[Slide: States will need to …]

Congress recognized that in order for this process to succeed, States would have to do a lot of the work – it simply cannot be done from here in Washington. I've shown on this slide some of the items and issues that States have to examine in developing capacity development programs. There's a lot here – and many of these are things that State environmental protection or health departments can't do on their own. With no offense to those agencies, most of them just don't know a whole lot about finances, taxes, ratemaking, affordability, and the like. That's where your commissions will enter the picture.

[Slide: The Capacity Development Process]

It's also clear that this capacity development process is not a simple one. In fact, I've broken it down into four separate processes, all of which must be put in place.

Capacity development requires a fresh look at public policy and the legal and regulatory environment. It requires the collection and analysis of data, so that informed decisions can be made. It requires state and local governments to change some of what they do so that they can better monitor the progress that small water systems are making. And it must be realized that this is not a short-term endeavor – you cannot turn small water systems into model businesses overnight; you cannot develop partnerships between small and larger systems in a few days; and you cannot change the legal and regulatory environment in a matter of weeks. Once you start down the road to capacity development, you are in for the long haul – it will take years to see measurable progress; it will take decades to eliminate the major problems.

[Slide: A Policy Process]

The policy process, which I think must come first, needs to begin with the identification of the interested stakeholders – and, yes, as Peter mentioned, your commissions are near the top of everyone's list of interested stakeholders.

These stakeholders will then work together to identify the barriers that impede the ability of small systems to reliably serve their customers. And then you will work to find ways to remove some of those barriers.

This stakeholder group should become the linchpin of an important policy process. About six years ago, a stakeholder group was formed in Pennsylvania. It took a while to get all of the stakeholders identified and seated at the table. Then it took time for people to start trusting each other enough to engage in an honest exchange of ideas; putting aside some of their parochial interests to actually start to work together to solve some problems.

[slide: Possible Stakeholders]

I've shown on this slide just some of the possible stakeholders that will need to be considered in your states. And there may be many more.

The results in Pennsylvania have been important, but slow. Changes don't occur overnight, but they do occur. Legislation has been enacted, regulations have been changed, the PUC and the primacy

agency have begun working together much more closely, and large water systems have become more sensitized to the needs of smaller systems.

[Slide: An Informative Process]

I started in this process in Pennsylvania as a stakeholder – I was the Consumer Advocate's representative on the working group. But in the last couple of years, after I left that Office, my role has changed and I've been doing some of the research and analysis that is involved in the second important part of the capacity development process – collecting and analyzing information, so that we can start to identify systems that need help before they become seriously deficient.

Some of the results of our analytical work are reported in a paper that was published in January's *Journal American Water Works Association*. I won't try to summarize that work in a couple of minutes here. I'll simply offer that if you need a copy of that paper to please give me your card afterward and I'll make sure that you get a copy.

Instead, I'll mention one of the most important things we found when doing that work. State agencies collect a lot of information that they never share with other agencies – and that's a shame. We found that our primacy agency, of course, had a lot of information about water systems – where they were located, how many people they served, what type of source water was used, how much water was produced, estimates of the length of the distribution system, whether there was a certified operator, a history of violations, and much more. That information was rarely, if ever, shared with the PUC.

For its part, the PUC collected virtually none of this information for the systems it regulates, but had a lot of information about the system's investments and finances. And this was never shared with the primacy agency.

And one of the surprising pieces of the puzzle was that there was yet a third state agency that collected detailed financial information about municipally owned water systems. Even though these publicly owned systems did not have their rates regulated, they were required to send annual reports to the State, where they were basically just filed and never seriously analyzed or reviewed.

We obtained information from all three agencies so that, in total, we had data for well over 200 water systems of different sizes and different ownership types. We coupled these data with Census data for each system's service territory, as well as on-site assessments of many of the water systems. This on-site, field work was conducted by personnel from both the primacy agency and the PUC. Then we went to work analyzing the data to try to make some sense of it.

[Slide: Some Benchmarks of Small System Performance]

The analysis resulted in the development of benchmarks for small water system operations in Pennsylvania that you'll find reported in the *Journal* article. Here, I've shown the financial and demographic benchmarks that we developed for PUC-regulated systems in Pennsylvania. Importantly, many of these benchmarks are things that your commissions could readily measure and assess. Of course, I also have to caution that many of these will change from one State to another. These are benchmarks that indicate problems when the systems are compared with others in the State that appear to be doing a pretty good job. In different States, different indicators will jump out as being more important.

But remember, these benchmarks are not scores or rankings – we're not trying to give water systems passing or failing grades. We're trying to identify systems that might need help in certain key aspects of their operations, and make that identification before *problems* become *crises*. You can think of these as early warning signals that regulators and other interested stakeholders can use to help keep systems out of serious trouble.

[Slide: An Oversight Process]

These benchmarks also provide a basis for evaluating *business plans*. The business plan is a critically important element in assessing the likelihood that a *new* water system will be able to provide reliable service in the future. It also is an important tool for determining whether *existing* systems have weaknesses that, perhaps, should lead the system in a different direction – such as changing its rates, seeking new management, expanding its territory, and so on.

[Slide: Business Plan]

In early January, the National Research Council published an important book that everyone involved with small water systems should read, at least in part. The book, *Safe Water from Every Tap: Improving Water Service to Small Communities*, covers many of the public policy and technological issues relating to providing water service in smaller communities. One of the important recommendations of that report is that every small water system should be required to prepare a business plan. Here's a short quotation from that report:

"Every water utility should create a comprehensive plan that specifies how the utility will affordably meet present and future demands while complying with SDWA and other regulations. … The plan should include information on future trends in the service area, population and growth, land use policies, water demands, and other factors on both a short-term and long-term basis spanning 5 to 20 years. In addition, like any good business, water systems should make customer satisfaction a priority in the planning process and should involve customers in developing their plans." (pages 161-62)

Currently, in Pennsylvania the primacy agency requires that a business plan be submitted with an application for a new water supply permit. And the PUC is using the same business plan as one of the key factors in deciding whether a certificate of public convenience should be issued to new systems that are under its jurisdiction.

[Slide: An Ongoing Process]

The capacity development provisions in the SDWA Amendments will require State government to change the way that they think about small water systems. State primacy agencies and utility commissions will need to work closely together, and engage in cooperative efforts with other stakeholders.

A sound capacity development programs requires new types of data collection and analysis; a re-thinking of the role of field personnel; a renewed emphasis on technical and financial training for water system personnel; as well as support from legislators, utilities, consumer activists, and many others.

I have talked a little about Pennsylvania's program because it's one that I have participated in. But other states are also in various stages of developing comprehensive capacity development programs for their small water systems – Washington, Maryland, Connecticut, Alabama, and others are breaking new ground in this area. Texas, North and South Carolina, Montana, and several other States have begun bringing key stakeholders together to start addressing these problems. In all of these states, the utility commissions are playing a key role in helping to ensure that the customers of small water systems receive the same high-quality service that we expect from our larger water suppliers. And over the next 12 to 18 months, I expect that every state in the country will be engaged in a similar process. There's a lot of work to do.

As commissioners, it is important that you and your staff actively participate in this process. You need to devote the resources of your agency to ensure that financial analyses, rate reviews, affordability determinations, and funding criteria are developed in a manner that is in the public interest.

Thank you again for allowing me to join you today.