

## ENVIRONMENTAL PROTECTION AGENCY

[FRL-5958-8]

### Guidance and Information for States on Implementing the Capacity Development Provisions of the Safe Drinking Water Act

**AGENCY:** Environmental Protection Agency.

**ACTION:** Public review draft.

**SUMMARY:** The Environmental Protection Agency is publishing, for public comment, draft "Guidance for States on Implementing the Capacity Development Provisions of the 1996 Amendments to the Safe Drinking Water Act." The Agency is also announcing the availability of the following related draft documents for public review and comment: Information for States on Implementing the Capacity Development Provisions of the Safe Drinking Water Act, and Information for the Public on Participating with States in Preparing Capacity Development Strategies.

**DATES:** Comments must be received by April 6, 1998.

**ADDRESSES:** Send comments to Peter E. Shanaghan, Small Systems Coordinator, Mail Code 4606, Environmental Protection Agency, 401 M Street S.W., Washington, D.C. 20460 or E-mail shanaghan.peter@epa.epamail.gov.

**FOR FURTHER INFORMATION CONTACT:** Peter E. Shanaghan, 202-260-5813 or shanaghan.peter@epamail.epa.gov.

**SUPPLEMENTARY INFORMATION:** The 1996 Safe Drinking Water Act (SDWA) Amendments bring significant improvements to the national drinking water program. Capacity development is an important component of the Act's focus on preventing problems in drinking water. The capacity development provisions offer a framework within which States and water systems can work together to ensure that systems acquire and maintain the technical, financial, and managerial capacity needed to achieve the public health protection objectives of the SDWA.

The 1996 Amendments emphasize the technical, managerial, and financial capacity of water systems. By enhancing and ensuring the technical, financial, and managerial capacity of water systems, States will promote compliance with national primary drinking water regulations (NPDWRs) for the long term. To avoid a withholding in its Drinking Water State Revolving Fund (DWSRF) allotment, each State is required to obtain the legal

authority or other means to ensure that new community water systems and new nontransient noncommunity water systems demonstrate adequate capacity, and to develop and implement a strategy to assist existing systems in acquiring and maintaining capacity.

The draft guidance published and the draft information documents being made available today are the result of a thorough stakeholder consultation process initiated by the U.S. Environmental Protection Agency (EPA) and its National Drinking Water Advisory Council (NDWAC). The NDWAC was established by the original Safe Drinking Water Act as a diverse group of stakeholders to advise the Agency on drinking water issues. In order to most effectively advise EPA regarding implementation of the capacity development provisions of the SDWA Amendments of 1996, NDWAC established a Small Systems Working Group. The Small Systems Working Group met on four occasions between February and July, 1997, each two days in length, with the purpose of developing consensus recommendations on how EPA should implement the capacity development provisions of the SDWA Amendments of 1996. The Small Systems Working Group consisted of 22 members representing small public water systems, environmental and public health advocacy groups, State drinking water programs, public utility commissions, and other interest groups. The Small Systems Working Group recommended to NDWAC, which in turn recommended to EPA, that the Agency publish a combination of guidance and information to facilitate the implementation of the capacity development provisions of the 1996 SDWA Amendments. The working group, through the NDWAC, made specific substantive recommendations regarding the content of the draft guidance being published today and information documents being made available today.

#### Guidance and Information Documents

The guidance document being published today is in large part based on recommendations by the Small Systems Working Group and NDWAC. The document is entitled Guidance for States on Implementing the Capacity Development Provisions of the 1996 Amendments to the Safe Drinking Water Act, and includes the following major sections:

- Guidance for States on Ensuring that All New Community Water Systems and New Nontransient Noncommunity Water Systems Demonstrate Technical, Managerial, and Financial Capacity

- Guidance for States on Minimum Requirements for State Capacity Development Strategies (to Avoid DWSRF Withholding)

- Guidance for States on Assessment of Capacity for the Purposes of Awarding Drinking Water State Revolving Fund (DWSRF) Assistance

The draft information documents being made available today are also based in large part on specific recommendations by the Small Systems Working Group and NDWAC. The first document, entitled Information for States on Implementing the Capacity Development Provisions of the Safe Drinking Water Act, includes the following chapters:

- Information for States on Ensuring that All New Community Water Systems and New Nontransient Noncommunity Water Systems Demonstrate Technical, Managerial, and Financial Capacity
- Information for States on Preparing State Capacity Development Strategies
- Information for States on Assessment of Capacity (For Purposes of Awarding DWSRF assistance)

A second draft document recommended by the Small Systems Working Group and NDWAC, entitled Information for the Public on Participating with States in Preparing Capacity Development Strategies, is also being made available today.

#### Specific Issues for Commentors to Consider

There are two issues on which the Agency wishes to specifically solicit public comment. The first pertains to the proposed guidance being published today. Does the proposed guidance strike an appropriate balance between respecting State flexibility and discretion in implementation of the capacity development provisions, while ensuring adequate national level program accountability for SDWA implementation?

The second issue pertains to the draft information document for which a notice of availability is being published today. Does the document contain sufficient substantive information, and is the information appropriately organized, to facilitate State implementation of the capacity development provisions?

#### Statutory Basis for the Guidance and Information Documents

The following provisions of the Safe Drinking Water Act as amended comprise the statutory requirements for capacity development and provide the basis for the subsequent guidance and accompanying information documents:

- Section 1420(a): State Authority for New Systems—A State shall receive only 80 percent of the allotment that the State is otherwise entitled to receive under section 1452 (relating to State loan funds) unless the State has obtained the legal authority or other means to ensure that all new community water systems and new nontransient, noncommunity water systems commencing operation after October 1, 1999, demonstrate technical, managerial, and financial capacity with respect to each national primary drinking water regulation in effect, or likely to be in effect, on the date of commencement of operations.

- Section 1420(c): Capacity Development Strategy—(1) In General—Beginning 4 years after the date of enactment of this section, a State shall receive only—(A) 90 percent in fiscal year 2001; (B) 85 percent in fiscal year 2002; and (C) 80 percent in each subsequent fiscal year, of the allotment that the State is otherwise entitled to receive under section 1452 (relating to State loan funds), unless the State is developing and implementing a strategy to assist public water systems in acquiring and maintaining technical, managerial, and financial capacity.

- Section 1452(a)(1)(G)(i): New System Capacity—Beginning in fiscal year 1999, the Administrator shall withhold 20 percent of each capitalization grant made pursuant to this section to a State unless the State has met the requirements of section 1420(a) (relating to capacity development) and shall withhold 10 percent for fiscal year 2001, 15 percent for fiscal year 2002, and 20 percent for fiscal year 2003 if the State has not complied with the provisions of section 1420(c) (relating to capacity development strategies). Not more than a total of 20 percent of the capitalization grants made to a State in any fiscal year may be withheld under the preceding provisions of this clause. All funds withheld by the Administrator pursuant to this clause shall be reallocated by the Administrator on the basis of the same ratio as is applicable to funds allotted under subparagraph (D). None of the funds reallocated by the Administrator pursuant to this paragraph shall be allotted to a State unless the State has met the requirements of section 1420 (relating to capacity development).

- Section 1452(g)(3): Guidance and Regulations—The Administrator shall publish guidance and promulgate regulations as may be necessary to carry out the provisions of this section, including—(A) provisions to ensure that each State commits and expends funds allotted to the State under this section

as efficiently as possible in accordance with this title and applicable State laws; (B) guidance to prevent waste, fraud, and abuse; and (C) guidance to avoid the use of funds made available under this section to finance the expansion of any public water system in anticipation of future population growth. The guidance and regulations shall also ensure that the State and public water systems receiving assistance under this section, use accounting, audit, and fiscal procedures that conform to generally accepted accounting standards.

The Act also provides that the Environmental Protection Agency (EPA) will assist State capacity development efforts by providing information and guidance:

- Section 1420(d): Federal Assistance—(1) In General—The Administrator shall support the States in developing capacity development strategies. \* \* \* (4) Guidance for New Systems—Not later than 2 years after the date of enactment of this section, the Administrator shall publish guidance developed in consultation with the States describing legal authorities and other means to ensure that all new community water systems and new nontransient, noncommunity water systems demonstrate technical, managerial, and financial capacity with respect to national primary drinking water regulations.

- III. Guidance for States on Minimum Requirements for State Capacity Development Strategies (To Avoid DWSRF Withholding)
- IV. Guidance for States on Assessment of Capacity for Purposes of Awarding DWSRF Assistance

**I. Introduction to Technical, Managerial, and Financial Capacity of Water Systems**

The 1996 Safe Drinking Water Act (SDWA) Amendments bring significant improvements to the national drinking water program. Capacity development is an important component of the Act's focus on preventing problems in drinking water. The capacity development provisions offer a framework within which States and water systems can work together to ensure that systems acquire and maintain the technical, financial, and managerial capacity needed to achieve the public health protection objectives of the SDWA.

The 1996 Amendments emphasize the technical, managerial, and financial capacity of water systems. By enhancing and ensuring the technical, financial, and managerial capacity of water systems, States will promote compliance with national primary drinking water regulations (NPDWRs) for the long term. To avoid a withholding in its Drinking Water State Revolving Fund (DWSRF) allotment, each State is required to obtain the legal authority or other means to ensure that new community water systems and new nontransient noncommunity water systems demonstrate adequate capacity, and to develop and implement a strategy to assist existing systems in acquiring and maintaining capacity.

The capacity development provisions in the Act offer a simple, flexible framework within which States can organize their efforts to address the challenges facing small systems. Each state has extraordinary flexibility to implement a capacity development program that is uniquely tailored to its circumstances. The statute specifies that new systems must demonstrate technical, managerial, and financial capacity prior to commencing operation, and States must develop and implement strategies to assist public water systems in acquiring and maintaining technical, managerial, and financial capacity. The statute lists several specific issues which a State must consider, solicit public comment on, and include as appropriate in its capacity development strategy. The statute does *not* dictate which substantive components a State strategy must contain. Enhancing the technical, managerial, and financial

ACRONYMS

Acronym	Definition
CFR .....	Code of Federal Regulations.
CWS .....	Community Water System.
DWSRF ...	Drinking Water State Revolving Fund.
EPA .....	Environmental Protection Agency.
IUP .....	Intended Use Plan.
NDWAC ...	National Drinking Water Advisory Council.
NPDWR ...	National Primary Drinking Water Regulations.
NTNCWS or NTNC.	Nontransient, Noncommunity Water System.
PWS .....	Public Water System.
SDWA .....	Safe Drinking Water Act.
SDWIS .....	Safe Drinking Water Information System.
TNC or TNCWS.	Transient, Noncommunity Water System.

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- I. Introduction to Technical, Managerial, and Financial Capacity of Water Systems
- II. Guidance for States on Ensuring that All New CWSs and New NTNCWSs Demonstrate Technical, Managerial, and Financial Capacity

capacity of water systems offers great potential for correcting existing non-compliance and, more importantly, preventing future non-compliance with NPDWR's.

This section presents the background information necessary to understand the guidance documents that are provided in Sections II through IV. These draft guidance documents are designed to assist States in implementing the capacity development provisions of the Act.

Included in this introductory section are a discussion of the demographics of systems affected by the provisions, and working definitions of technical, managerial, and financial capacity that are used throughout the draft guidance and information documents.

### 1. System Demographics<sup>1</sup>

The capacity development provisions of the SDWA apply to several types of public water systems. Some provisions apply to all public water systems (PWSs), which include: (1) Community water systems (CWSs); (2) nontransient, noncommunity water systems (NTNCWSs); and (3) transient, noncommunity water systems (TNCWSs). Other provisions apply only to community water systems and nontransient, noncommunity water systems. It is important to note that the statute does not limit or focus the

capacity development provisions based on system size. However, as the following discussion makes clear, the overwhelming majority of water systems are small. Thus, as a practical matter, small systems will be a significant focus of capacity development efforts due to the sheer number of such systems.

A public water system is a "system for the provision to the public of water for human consumption through pipes or other constructed conveyances, if such system has at least fifteen service connections or regularly serves an average of at least twenty-five individuals" (Section 1401(4)(A) SDWA as amended). This category includes community water systems; nontransient, noncommunity water systems; and transient, noncommunity water systems. There are approximately 172,000 public water systems nationwide.

A community water system is "a public water system which serves at least 15 service connections used by year-round residents or regularly serves at least 25 year-round residents." (40 CFR 141.2) There are approximately 55,000 community water systems serving over 246 million people. About 87 percent of CWSs are classified as "very small" (serving fewer than 500 persons) or "small" (serving from 501 to 3,300 persons). Although the small and very small systems comprise a significant majority of CWSs, they serve just over 10 percent of the population served by CWSs. Community water

systems can be classified into two major ownership types—privately owned and publicly owned. Within the privately owned category, a substantial number of systems are "ancillary systems," i.e., they provide water as an ancillary function of their principal business or enterprise. An example is mobile home parks (Figure 1). Like NTNCWSs, they provide water to their customers, but provision of water is not their principal business. The incidence of ancillary systems varies significantly by system size. In small CWSs serving between 25 and 100 persons, over half (53 percent) are ancillary systems. In larger CWSs serving more than 10,000 persons, only 0.1 percent are ancillary systems.

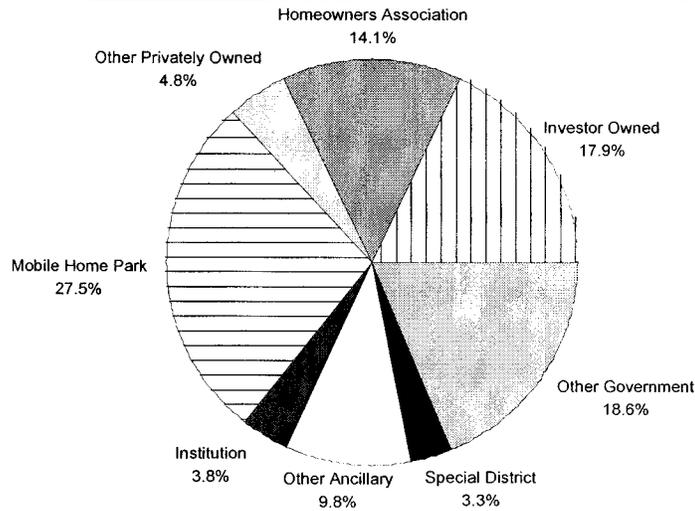
A nontransient, noncommunity water system is defined as "a public water system that is not a community water system and that regularly serves at least 25 of the same persons over 6 months per year." (40 CFR 141.2) Examples of establishments which are nontransient, noncommunity water systems include schools, factories, office/industrial parks, and major shopping centers. Most are privately owned. The approximately 20,000 NTNCWSs across the nation serve approximately 6 million people. Over 96 percent of NTNCWSs use ground water as their primary source. They typically are small systems; 99 percent of NTNCWSs are classified as "very small" or "small."

<sup>1</sup> Data Source: Safe Drinking Water Information System (SDWIS).

Figure 1 (Source: Community Water System Survey, EPA 815-R-97-001a, January, 1997)

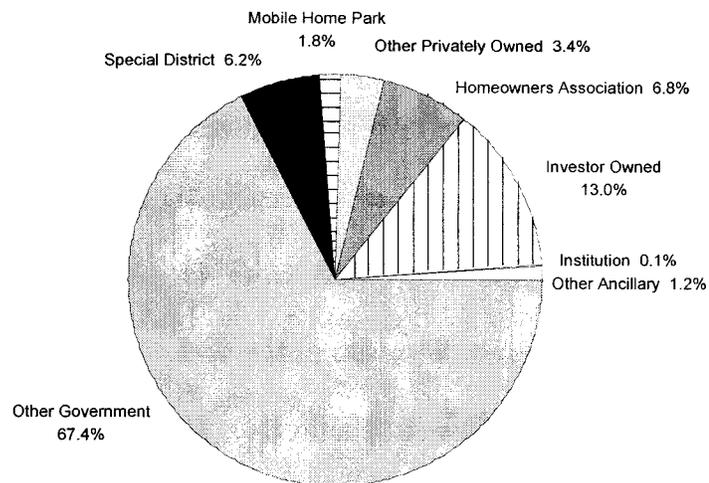
**Ownership of Systems Serving Population 25 - 500**

(Percent of Systems)



**Ownership of Systems Serving Population > 500**

(Percent of Systems)



## 2. Defining Capacity

In the context of the 1996 Amendments to the Safe Drinking Water Act, water system capacity refers to the overall capability or wherewithal of a water system to consistently produce and deliver water meeting all NPDWRs. Capacity encompasses the technical, managerial, and financial capabilities of the water system to plan for, achieve, and maintain compliance with applicable drinking water standards given available water resources and the characteristics of the service population.

Technical, managerial, and financial capacity are three general, highly interrelated areas of overall water system capability:

- Technical capacity refers to the physical infrastructure of the water system, including but not limited to the adequacy of the source water, infrastructure (source, treatment,

storage, and distribution), and the ability of system personnel to adequately operate and maintain the system and to otherwise implement technical knowledge.

- Managerial capacity refers to the management structure of the water system, including but not limited to ownership accountability, staffing and organization, and effective linkages to customers and regulatory agencies.

- Financial capacity refers to the financial resources of the water system, including but not limited to revenue sufficiency, credit worthiness, and fiscal controls.

## 3. Key Questions

Technical, managerial, and financial capacity are individual yet highly interrelated areas of a system's overall capability, as illustrated in Figure 2. A system cannot sustain acceptable

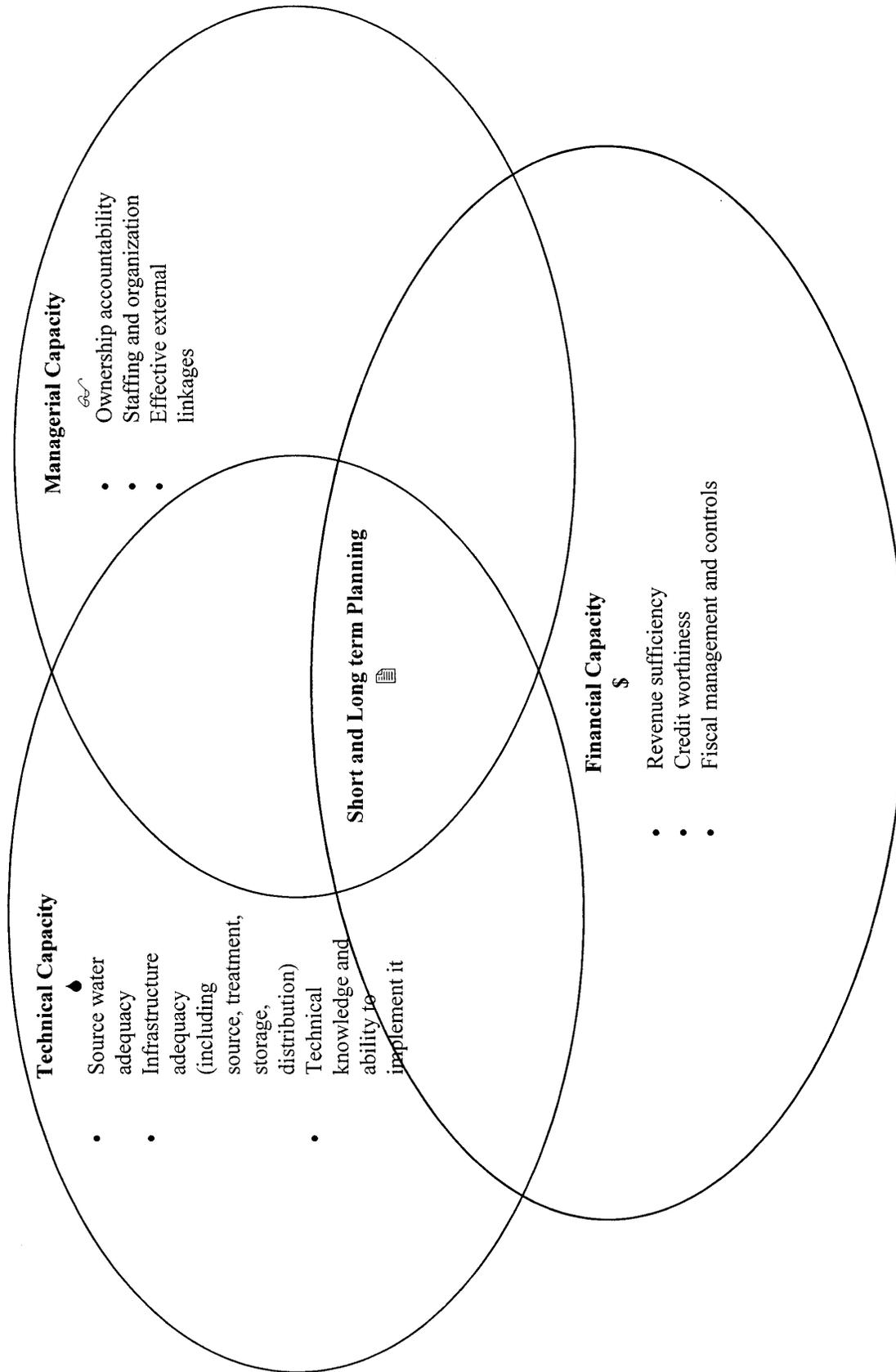
performance without maintaining adequate capability in all three areas. Indicators of capacity within each area can be framed by key sets of issues and questions, including but not limited to the following:

### Technical Capacity

- *Source water adequacy.* Does the system have access to a reliable and sufficient source of water? Is the source water of adequate quality? Is the source adequately protected?

- *Infrastructure adequacy.* Can the system provide water that meets SDWA standards? What is the condition of the system's infrastructure, including well(s) and/or source water intakes, treatment, storage, and distribution? What is the life expectancy of the system's infrastructure? Does the system have a capital improvement plan?

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**Figure 2**  
**Technical, Managerial, and Financial Capacity**

• *Technical knowledge and implementation.* Does the system have a certified operator? Is the system operated with technical knowledge of applicable standards? Are personnel able to implement this technical knowledge effectively? Do the operators understand the technical and operational characteristics of the system? Does the system have an effective operation and maintenance program?

#### Managerial Capacity

• *Ownership accountability.* Are the system owner(s) clearly identified? Can they be held accountable for the system?

• *Staffing and organization.* Are the system operator(s) and manager(s) clearly identified? Is the system properly staffed and organized? Do personnel understand the management aspects of regulatory requirements and system operations? Do personnel have adequate expertise to manage water system operations? Do personnel have the necessary licenses and certifications?

• *Effective external linkages.* Does the system interact well with customers, regulators, and other entities? Is the system aware of available external resources, such as technical and financial assistance?

#### Financial Capacity

• *Revenue sufficiency.* Do revenues cover costs? Are rates and charges for water service adequate to cover the cost of service?

• *Credit worthiness.* Is the system financially healthy? Does it have access to financial capital through public or private sources?

• *Fiscal management and controls.* Are adequate books and records maintained? Are appropriate budgeting, accounting, and financial planning methods used? Does the system manage its revenues effectively?

Many aspects of water system operations involve more than one kind of capacity. A program of infrastructure replacement and improvement, for example, requires technical knowledge, management planning and oversight, and financial resources. In other words, a water system with adequate capacity draws on strengths in all three capacity areas—technical, managerial, and financial.

### II. Guidance for States on Ensuring That All New CWSs and New NTNCWSs Demonstrate Technical, Managerial, and Financial Capacity

The Safe Drinking Water Act (SDWA) Amendments of 1996 (Pub.L. 104-182) authorize a Drinking Water State

Revolving Fund (DWSRF) to help public water systems finance the infrastructure needed to achieve or maintain compliance with SDWA requirements and to achieve the public health protection objectives of the Act. Section 1452 authorizes the Administrator of the U.S. Environmental Protection Agency (EPA) to award capitalization grants to the States. Under section 1420(a) of the Act, the Administrator is directed to withhold a portion of a State's allotment under section 1452 unless the State "has obtained the legal authority or other means to ensure that all new community water systems and new nontransient, noncommunity water systems commencing operation after October 1, 1999, demonstrate technical, managerial, and financial capacity with respect to each national primary drinking water regulation in effect, or likely to be in effect, on the date of commencement of operations." Section 1452(a)(1)(G)(i) discusses the process of withholding funds under the Act's provisions related to new system capacity.

Section 1420(d)(4) instructs the EPA Administrator to publish "guidance developed in consultation with the States describing legal authorities and other means to ensure that all new community water systems and nontransient, noncommunity water systems demonstrate technical, managerial, and financial capacity with respect to national primary drinking water regulations." This guidance document fulfills this requirement.

This guidance document—developed in consultation with States and other stakeholders—provides the criteria that EPA will use in evaluating State implementation of the requirements of section 1420(a) of the Act. The criteria are (1) demonstration of statutory or regulatory basis of authority, (2) demonstration of control points in the new system development process at which the authority will be exercised, and (3) initially, a plan for evaluating the program on an ongoing basis; then in subsequent years an annual description of actual program implementation and effectiveness. To supplement this guidance, EPA is making available for public review an informational document entitled *Information for States on Implementing the Capacity Development Provisions of the Safe Drinking Water Act*. Chapter One of this document contains options States can consider in developing a program that ensures that all new community and new nontransient, noncommunity water systems demonstrate technical, managerial, and financial capacity. This document is

available through the Safe Drinking Water Hotline, and can be obtained by calling 1-800-426-4791.

## 2. The Statutory Background

### General Issues

The SDWA Amendments establish an integrated environmental law. Links among different parts of the law create a tapestry of provisions; prevention programs are integrated with, and essential to the success of, new regulatory flexibilities. One of these prevention programs is capacity development. The Amendments require States to ensure that all new community and nontransient, noncommunity systems commencing operation after October 1, 1999 demonstrate technical, managerial, and financial capacity. Ensuring capacity, which prevents costly noncompliance, facilitates the regulatory flexibility of the Amendments.

Read in the context of the Amendments, the statutory basis for the criteria that are presented below is clear. First, when the statute says a State must have the "legal authority or other means" to ensure the capacity of new systems, it means that the State must have the authority to intervene in the process of new system development to obtain the necessary demonstration of technical, managerial, and financial capacity. The conference committee report makes clear that the phrase "legal authority or other means" means that States must have the "actual authority" to ensure the capacity of new systems.

In other words, as described more fully in the criteria, the States must be able to demonstrate that they have, and can exercise, authority to prevent the creation of new community or nontransient, noncommunity systems that do not have technical, managerial, and financial capacity. This implies, and to make functionally effective may require, that there must be some "control point" at which a State can say "no" to the development of a new system that does not have adequate capacity.

Second, the guidance recognizes a central theme found throughout the Amendments—an approach to State programs that is flexible and recognizes the diversity of State strategies to achieve the objectives of the Amendments. In programs dealing with new system creation, a State may involve a variety of State and local governmental agencies. This guidance accepts the diversity of approaches. It requires only that there be a clear, unambiguous demonstration of State authority to ensure that no new

community or nontransient, noncommunity system will be created if it lacks adequate capacity. Section 1420(a) of the statute emphasizes that the requirement is effectively a performance standard when it says that the Administrator shall withhold a portion of a State's allotment unless the State has obtained the legal authority or other means "to ensure" the intended result.

How this statutory mandate is achieved is up to the State. The statute does not require that a particular State agency (e.g., the primacy agency) be responsible; it simply requires that some State agency be responsible. It does not preclude delegation of authority to make the decision to other agencies or to local governments. The statute does, however, require that there be clear State authority to ensure that new systems have adequate technical, managerial, and financial capacity.

Third, the statutory emphasis on all three aspects of capacity—technical, managerial, and financial—requires a comprehensive view of capacity. To comply with this requirement, it is not enough for a State to focus on only one aspect, e.g., technical capacity. Section I of this document provides some suggested parameters for each of the three areas of capacity.

Finally, section 1420 makes explicit that the definition of system capacity be forward looking. Under section 1420(c), for example, States are required to develop a strategy to assist systems in "acquiring and maintaining" all three areas of capacity. Thus, to demonstrate capacity, the system must have technical, managerial, and financial capacity on the first day of operation and over time. When States evaluate the capacity of new systems, they must assess both current and future capacity. The criteria shown below are to help States develop an effective program that ensures its new community and nontransient, noncommunity water systems conform with the requirements of the Safe Drinking Water Act.

EPA expects that States will provide, either as part of their DWSRF capitalization grant applications, or as a separate submittal, a full description, explanation, and documentation of their programs for ensuring a demonstration of new system capacity. The Agency will use the criteria discussed in this guidance to evaluate whether the State's program meets the requirements of the SDWA, as amended. EPA is required to begin DWSRF withholding related to new system capacity in fiscal year 1999. Any capitalization grant award made in fiscal year 1999 is subject to the capacity development withholding

(including fiscal year 1998 funds awarded in fiscal year 1999). Thus State capitalization grant applications submitted for award in fiscal year 1999, for fiscal year 1999 funds or fiscal year 1998 unawarded funds, must contain a full description, explanation, and documentation of the States program for ensuring a demonstration of new system capacity. Once a State has successfully demonstrated a basis of authority and control points at which the authority will be exercised, the State should include these demonstrations in the operating agreement of its capitalization grant application, but need not include it in each subsequent capitalization grant application (or as a separate submission) unless the basis of authority or control points have changed. However, documentation of ongoing program implementation must be provided in all subsequent capitalization grant applications or as part of the DWSRF annual review.

### 3. Criteria

For the first year of implementation, EPA will base its withholding decision on whether a State can demonstrate a statutory or regulatory basis of authority to prevent the creation of new community water systems and new nontransient, noncommunity water systems which lack capacity, demonstrate control points for the exercise of that authority, and provide a plan for program implementation and evaluation on an ongoing basis. For subsequent years, if the authority and control points remain unchanged, the withholding decisions will be based on whether the State is consistently implementing its program.

#### A Basis of Authority

Under section 1420(a), EPA shall withhold 20% of a State's capitalization grant under section 1452 unless the State has obtained the "legal authority or other means" to ensure the demonstration of capacity by new community water systems and new nontransient, noncommunity water systems commencing operation after October 1, 1999. This authority must provide the State with the capability to intervene in the process of new system development in order to obtain necessary assurances of technical, managerial, and financial capacity. As explained in the introduction, the phrase "legal authority or other means" means that States must have the "actual authority" to ensure that new systems have adequate capacity. To meet the requirements of this provision, States must identify and demonstrate this authority. Examples of "legal authority

or other means" are provided in Chapter Two of the EPA document Information for States on Implementing the Capacity Development Provisions of the Safe Drinking Water Act. Implicit in the requirements of section 1420(a) are the following:

- The State must specify which agency of State government is responsible for ensuring that new systems demonstrate capacity. This agency could be the State SDWA primacy agency. The State, at its sole discretion, may decide which agency is responsible, but there must be a responsible agency.

- The State agency responsible for making determinations of technical, managerial and financial capacity need not always be the SDWA primacy agency. Certification authority for new investor-owned systems, for example, may rest with the State public utility commission. Collaborative arrangements among agencies for controlling new system development must be documented through statutory or other means (such as memoranda of understanding).

- The responsible State agency (or combination of agencies) must possess and demonstrate the "actual authority" to prevent the creation of a new system if the system cannot demonstrate adequate technical, managerial, and financial capacity. "Actual authority" may take the form of statutory authority, regulations, or other effective and demonstrable means of preventing the creation of a new system due to inadequate capacity.

- Active involvement of local and county entities is one means of addressing new system capacity concerns. The authority for obtaining the necessary assurances of technical, managerial, and financial capacity may be granted initially at the local level, but the State is ultimately accountable for meeting the capacity requirements of the Act, and must have the final authority to ensure new system capacity.

#### Demonstration of Control Points in the New System Development Process

A control point is a point at which a State (or other unit of government) can make an authoritative decision as to the adequacy of a new system, in terms of its technical, managerial, and financial capacity. Control points allow a State to exercise its legal authority or other means to ensure the capacity of new systems. They provide opportunities to prevent the creation of systems that lack technical, managerial, and financial capacity. Each State must demonstrate to EPA that it has one or more clear

control points. Many control points are possible at both the State and local levels of government. While actions by local governments can be an important part of the process, the State must have at least one control point that allows it to exercise its authority directly. The existence of this authority does not preclude the State from providing advice or technical assistance that could help to ensure that a system has adequate capacity.

Examples of generic control points in the new system development process are described in Chapter Two of the EPA document, *Information for States on Implementing the Capacity Development Provisions of the Safe Drinking Water Act*.

*Plan for Implementation and Evaluation of the New System Capacity Assurance Program*

States must develop plans for implementing and evaluating their capacity-assurance program for new systems. The EPA Administrator must make continuing year-by-year determinations with regard to withholding under section 1452(a)(1)(G)(i). Initially, State programs will be assessed prospectively; but evaluations of program implementation and effectiveness will become more important in succeeding years. States must therefore present a plan for program implementation and evaluation as part of their initial demonstration of authority for new systems under section 1420(a). The plan must outline a means of verifying program implementation and evaluating the program. In subsequent years, the State must describe ongoing program implementation and evaluation during the preceding year and plans for program implementation and evaluation during the current year.

### **III. Guidance for States on Minimum Requirements for State Capacity Development Strategies (to Avoid DWSRF Withholding)**

The Safe Drinking Water Act (SDWA) Amendments of 1996 (Pub.L. 104-182) authorize a Drinking Water State Revolving Fund (DWSRF) to help public water systems finance the infrastructure needed to achieve or maintain compliance with SDWA requirements and in achieving the public health objectives of the Act. Section 1452 authorizes the Administrator of the U.S. Environmental Protection Agency (EPA) to award capitalization grants to the States. Section 1420(c) of the Act directs the Administrator to withhold a portion of a State's allotment under section 1452 unless the State is "developing and

implementing a strategy to assist public water systems in acquiring and maintaining technical, managerial, and financial capacity."

This document provides the criteria that EPA will use in evaluating State capacity development strategies to implement the withholding requirements in section 1420(c) of the Act. Each State will have considerable flexibility in preparing its capacity development strategy. Only minimum criteria will be reviewed to ensure that the State meets the provisions of section 1420(c). The five criteria are (1) solicitation and consideration of public comments, (2) consideration of section 1420(c)(2)(A-E), (3) description of the capacity development strategy, (4) description of strategy implementation, and (5) required actions regarding systems in significant noncompliance. Chapter Three of *Information for States on Implementing the Capacity Development Provisions of the Safe Drinking Water Act* contains options on how States might meet these requirements. The basis for this guidance is the Administrator's authority to issue guidance and regulations relative to the State Revolving Loan Fund under section 1452(g)(3) the SDWA and the specific provisions of section 1420 of the Act.

EPA views the purpose of this guidance as helping to ensure that the wide and creative flexibility intended under the law for States in framing their capacity development strategies will be available in fact. Section 1452(a)(1)(G)(i) of SDWA states that EPA "shall withhold" up to 20% of a State's DWSRF allocation "if the State has not complied with the provisions of Section 1420(c)." Thus, some States might be unduly, but understandably, cautious in drafting their strategies if they were largely uncertain about how EPA was going to assess such compliance, and would not want to risk proceeding on a mistaken assumption that might place their DWSRF allocations in jeopardy. EPA believes that fidelity to Congress' intention in this regard and fairness to the States demands that EPA clarify in advance how the directives of Section 1452(a)(1)(G)(i) will be applied, and this guidance seeks to do so.

EPA expects that States will include in their DWSRF capitalization grant applications, or separately and in advance of its application, a full description and documentation of their capacity development strategy. The Agency will use the criteria discussed in this guidance to evaluate whether the State's strategy meets the requirements of the SDWA, as amended. EPA is required to begin DWSRF withholding

related to capacity development strategies in fiscal year 2001. Thus, State capitalization grant applications submitted for award in fiscal year 2001 must contain a full description and documentation of the State capacity development strategy or such description and documentation must be submitted separately and in advance of the capitalization grant application. Once a State has successfully demonstrated development of a capacity development strategy, the State should include this demonstration in the operating agreement of its capitalization grant application, but need not include this demonstration in each subsequent capitalization grant application or separate submittal, unless the strategy has changed. However, a full documentation of ongoing strategy implementation must be provided in both the initial and all subsequent capitalization grant applications, or as part of the DWSRF annual review, subject to these provisions.

### *2. Benefits of a State Capacity Development Strategy*

The SDWA Amendments strongly emphasize prevention of drinking water contamination. They seek to avoid new problems through a number of interrelated provisions, such as capacity development, operator certification, and source water protection. Achieving increased technical, financial, and managerial capacity can allow systems to take advantage of operator certification and source water protection and will help prevent compliance problems in the future. The Amendments' new prevention approach has two key elements:

- A clear State lead, with flexibility and resources to achieve results.
- A strong effort to provide information to the public and involve stakeholders in decision-making processes.

The Amendments seek to improve the ability of water systems to reliably provide safe water by requiring States to ensure adequate capacity in new systems and to assist existing systems in acquiring and maintaining capacity through a State capacity development strategy. This strategy is intended to be a plan for the State program to assist water systems in acquiring and maintaining the technical, managerial, and financial capacity to reliably deliver safe drinking water. The tools and approaches that States develop as part of their capacity development strategies will make the Act's implementation more workable, consistent, and effective. Some possible tools and approaches available to States are

described in Chapter Three of EPA's Information for States on Implementing the Capacity Development Provisions of the Safe Drinking Water Act.

### 3. Criteria

EPA will use the following criteria to evaluate whether or not a State has complied with the capacity development strategy requirements of the SDWA, as amended. States not complying with the statutory requirements face withholding of a portion of their DWSRF allotment, as discussed previously.

#### Solicitation and Consideration of Public Comment

The Act provides that the States, in preparing their capacity development strategies, "shall consider, solicit public comment on, and include as appropriate" the elements listed in section 1420(c)(2)(A-E). To meet its statutory obligations with regard to public comment, a State must:

- Certify that it pro-actively solicited public comments on the listed elements, and that the process of soliciting public comment occurred as part of the preparation of its capacity development strategy.

- Describe all significant public comments and the State's response to those comments.

#### Definitions

For the purposes of this requirement, several terms must be defined.

A "proactive process" is a process that has the following characteristics:

- The State notified the general public—through appropriately visible channels—of the opportunity to provide comment on elements A-E as part of the State's preparation of its capacity development strategy.

- The State identified, before soliciting public comments, the groups that might be interested in the preparation of a capacity development strategy. These groups are likely to be of the same type as those identified in section 1420(c)(2)(E).

- The State ensured that each of the identified groups received a request for public comment on the listed elements.

- The State provided an accessible mechanism for receiving public comment.

'Significant public comment' is any public comment that contributes to or addresses in a substantive manner the development of a comprehensive State strategy. Significant public comment includes comments that suggest changes to, or express support for, any State position. 'Response' to significant public comment is the State's

description of the manner in which it used or did not use all significant public comments in preparing its capacity development program. The response must clearly outline how and why the State decided to use or not to use such comments.

#### States With Existing Strategies

Some States have implemented or are implementing capacity development strategies. Having a strategy does not exempt a State from its responsibility to solicit and consider public comments on that strategy. Each State that has a strategy must solicit and consider public comment on the State's treatment of the listed elements (i.e., elements listed in section 1420(c)(2)(A-E)) in its strategy. One means of doing this is by including the existing strategy in the Intended Use Plan (IUP) and taking effective steps to highlight the opportunity for comments on the substantive elements of the strategy. Each State with an existing strategy must certify that it used a proactive process to solicit public comment, and the State must describe all significant public comments and its response to each of them.

#### Consideration of Section 1420(c)(2)(A-E)

Under section 1420(c)(2) the State "shall consider, solicit public comment on, and include as appropriate" each of the listed elements A through E. These five elements require the State to consider:

- Methods or criteria that the State will use to identify and prioritize systems most in need of improving technical, managerial, and financial capacity (section 1420(c)(2)(A)).

- A description of the institutional, regulatory, and financial, tax, or legal factors at the Federal, State, or local level that encourage or impair capacity development (section 1420(c)(2)(B)).

- How the State will use the authority and resources of the SDWA or other means to assist public water systems in complying with drinking water regulations, encourage the development of partnerships between public water systems to enhance technical, managerial, and financial capacity of systems, and assist in the training and certification of operators (section 1420(c)(2)(C)).

- A description of how the State will establish the baseline and measure improvements in capacity with respect to drinking water regulations (section 1420(c)(2)(D)).

- Procedures to identify persons interested and/or involved in the development and implementation of the

capacity development strategy (section 1420(c)(2)(E)).

To comply with this requirement, the State must describe the issues it considered relative to each of the listed elements and explain why it included or excluded each element from its capacity development strategy.

#### Description of the Capacity Development Strategy

EPA must review two aspects of a State's capacity development strategy. First, a State must develop a strategy. This means that there must be a rational basis for concluding that the elements chosen by the State—when taken together and considered as a whole—constitute a strategy that is likely "to assist public water systems in acquiring and maintaining technical, managerial, and financial capacity" (section 1420(c)(1)). A State must describe the manner in which the selected elements fit together and achieve the statutory objective. EPA will not evaluate the desirability or potential effectiveness of each element. The Agency will, however, evaluate whether there is a rational basis for concluding that the State has a strategy, as required by section 1420(c)(1).

Second, to complete the report as specified in section 1420(c)(3), a State must describe its plan and means for assessing and measuring its progress toward improving the technical, managerial, and financial capacity of the public water systems in the State.

Further, this section requires the State agency responsible for executing the capacity development strategy to prepare a triennial report to the Governor on "the efficacy of the strategy and progress made towards improving the technical, managerial, and financial capacity of public water systems in the State." The State will not meet this requirement if its strategy does not include some means of assessment.

#### Description of Strategy Implementation

EPA will defer to each State's determination of how the State will implement its plan. Initially, each State only must describe its current strategy implementation efforts, as well as its plans for future strategy implementation. In subsequent years, the State must describe the actual strategy implementation during the preceding year and plans for strategy implementation during the current year.

#### Required Actions Regarding Systems in Significant Noncompliance

As required by section 1420(b), each State must prepare, periodically update, and submit to the EPA Administrator a

list of community water systems and nontransient, noncommunity water systems that have a history of significant noncompliance. States must also indicate, to the extent practicable, the reasons for this noncompliance.

Each State must also submit, by August 6, 2001, a report to the Administrator on the success of enforcement mechanisms and initial capacity development efforts in helping community water systems and nontransient noncommunity water systems with a history of significant noncompliance to improve technical, managerial, and financial capacity. Both requirements must be met as part of the implementation of a State's capacity development strategy.

#### Definitions

For the purposes of this requirement, several terms must be defined.

"Periodically update" is defined as once every 3 years. The first list was due to the Administrator by August 6, 1998. Subsequent lists will be due to the Administrator every three years.

A "history of significant noncompliance" means being in significant noncompliance during (at least) any 3 quarters of the previous 3 years.

#### IV. Guidance for States on Assessment of Capacity for Purposes of Awarding DWSRF Assistance

The Safe Drinking Water Act (SDWA) Amendments of 1996 (Pub.L. 104-182) authorize a Drinking Water State Revolving Fund (DWSRF) to help public water systems finance the infrastructure needed to achieve or maintain compliance with SDWA requirements and to achieve the public health objectives of the Act. Section 1452 authorizes the Administrator of the U.S. Environmental Protection Agency (EPA) to award capitalization grants to the States. The States, in turn, provide assistance to eligible water systems. Under section 1452(a)(3)(A), a State may not provide assistance to a system that lacks the technical, managerial, or financial capability<sup>2</sup> to maintain SDWA compliance, or is in significant noncompliance with any requirement of a National Primary Drinking Water Regulation (NPDWR) or variance. Two exceptions to this requirement are provided in section 1452(a)(3)(B). This provision allows States to provide assistance to a system that is in significant noncompliance if the use of the financial assistance from the

DWSRF will ensure compliance. If the system lacks adequate capacity the state may provide DWSRF assistance if the owner or operator of the system agrees to undertake feasible and appropriate changes in operation to ensure technical, managerial, and financial capacity to comply with the SDWA over the long term.

As part of its Capitalization Grant Application, each State must explain how it will review the technical, managerial, and financial capability of all systems that receive assistance. This requirement is separate from the capacity development strategy required under section 1420(c) of the Act. The basis for this guidance is the Administrator's authority to issue guidance under section 1452(g)(3) of the Act.

This guidance document—developed in consultation with States and other stakeholders—provides the minimum requirements for State assessment of a system's technical, managerial, and financial capacity for the purposes of distributing DWSRF funds. To ensure the implementation of section 1452(a)(3)(A), a State must describe its procedures for assessing technical, managerial, and financial capacity at present and for the foreseeable future; whether DWSRF assistance will help to ensure compliance (if a system is not in compliance); and whether the system has a long-term plan to develop adequate capacity (if a system lacks capacity).

EPA recognizes that assessing system capacity is an iterative process, which may change as a State annually prepares its capacity development strategy and evaluates the strategy's success. This guidance provides a phased approach for States to develop and describe their assessment procedures. Initially, States must describe the procedures they will use to assess system capacity. In subsequent years, States must summarize the results of the previous year's assessment and describe any changes to the procedures for assessing technical, managerial, and financial capacity. This allows States to change their assessment procedures to meet the needs of their capacity development strategies. Tools and approaches that States can use to assess system capacity are described in Chapter Four of EPA's Information for States on Implementing the Capacity Development Provisions of the Safe Drinking Water Act.

In developing procedures to assess system capacity, States should recognize that these assessments are to be part of a systematic process that will better enable the State to carry out other tasks required by, or vital to, the law and the

drinking water program. By examining the broad goals of the program and of its strategy, a State can select the assessment tools and approaches that will most benefit its overall program. Viewing each component of the capacity development process—including the method for assessing systems—as one part of an integrated whole will enable a State to develop a comprehensive, integrated strategy for capacity development that will make the law's implementation more workable, consistent, and effective. EPA will use the criteria presented below to evaluate State DWSRF capitalization grant applications. Chapter Four of EPA's Information for States on Implementing the Capacity Development Provisions of the Safe Drinking Water Act contains options States can consider in preparing the substance of their assessment procedures.

#### 2. Criteria

##### Procedure To Assess Technical, Managerial, and Financial Capacity

Section 1452(a)(3)(A) of the Amendments specify that a State may not provide assistance to a system that lacks the technical, managerial, and financial capability to ensure SDWA compliance. To comply with this provision, a State must have a procedure to assess the technical, managerial, and financial capacity of water systems at present and for the foreseeable future.

EPA, based upon specific recommendation by the NDWAC, is proposing that a State's procedures to assess technical, financial, and managerial capacity for the purpose of determining whether to award DWSRF assistance be placed in the Intended Use Plan (IUP) of the State's capitalization grant application. This is to ensure adequate opportunity for public review and comment on these procedures prior to implementation.

To meet its statutory obligations under this provision initially, a State must provide in its IUP:

- An assurance that it will assess the technical, managerial, and financial capacity of water systems, and
- A brief description of the procedures that will be used to conduct the assessment of capacity at present and for the foreseeable future.

To meet its statutory obligations under this provision in subsequent years, a State must summarize as part of its capitalization grant application, or as part of the DWSRF annual review, the results of its assessment from the previous year and describe any changes

<sup>2</sup>The term *capability* is synonymous with "capacity" for the purposes of this provision of the Act.

to its procedures for assessing capacity at present and for the foreseeable future.

**Procedure for Assessing Whether DWSRF Assistance Will Help to Ensure Compliance (If a System Is Not Presently in Compliance)**

Section 1452(a)(3)(A) prohibits provision of DWSRF assistance to any system in significant noncompliance with a national primary drinking water regulation or variance unless the use of the financial assistance from the DWSRF will ensure compliance.

To determine which systems are eligible for assistance under section 1452(a)(3)(A), a State must develop a procedure to assess whether such assistance will help to ensure compliance in a system that is presently in significant non-compliance.

To meet its statutory obligations under this provision initially, a State must provide as part of its IUP:

- An assurance that it will assess whether such assistance will help systems in noncompliance ensure that they come into compliance.
- A brief description of the procedures that will be used to conduct the assessment.

To meet its statutory obligations under this provision in subsequent years, a State must summarize, as part of its capitalization grant application, the results of its assessment from the previous year and describe any changes to its procedure for assessment.

**Procedure for Assessing Whether the System Has a Long-Term Plan to Undertake Feasible and Appropriate Changes in Operations Necessary to Develop Adequate Capacity (If a System Lacks Capacity)**

Section 1452(a)(3)(B) prohibits provision of DWSRF assistance to any system which does not have the technical, managerial, and financial capability to ensure compliance with SDWA, as amended, unless the owner or operator of the system agrees to undertake feasible and appropriate changes in operation to ensure technical, managerial, and financial capacity to comply with the SDWA over the long term.

To determine which systems are eligible for assistance under section 1452(a)(3)(B), a State must develop a procedure to assess whether the system has a long-term plan to undertake

feasible and appropriate changes in operations necessary to develop adequate capacity (if a system lacks capacity).

To meet its statutory obligations under this provision initially, a State must provide as part of its IUP

- An assurance that it will assess, for systems presently lacking capacity, whether the system has a long-term plan to undertake feasible and appropriate changes in operations necessary to develop adequate capacity.
- A brief description of the procedures that will be used to conduct the assessment.

To meet its statutory obligations under this provision in subsequent years, a State must summarize as part of its capitalization grant application the results of its assessment from the previous year and describe any changes to its procedure for assessment.

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