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Guidance on Implementing the Capacity Development Provisions of the Safe Drinking Water Act Amendments of 1996

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PREFACE

The Safe Drinking Water Act (SDWA) as amended in 1996 brings 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: 1) to ensure that new community water systems and new nontransient noncommunity water systems demonstrate adequate capacity, and 2) to develop and implement a strategy to assist existing systems in acquiring and maintaining capacity.

This guidance is 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 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 recommended guidance and information.

The draft guidance and information was published for public comment on February 5, 1998. The comment period extended for 60 days, and approximately 50 parties submitted public comments. EPA has attached a response to all public comments as an appendix to this guidance. Persons who wish may obtain a copy of all comments submitted may send a written request to Peter Shanaghan, Small Systems Coordinator, Office of Ground Water and Drinking Water, 401 M Street SW, Washington, DC 20460 or call on 202-260-5813 or on email at shanaghan.peter@epamail.epa.gov.

The NDWAC recommended information is being published separately as *Information for*

States on Implementing the Capacity Development Provisions of the 1996 Safe Drinking Water Act Amendments. Another NDWAC recommended information document, *Information for the Public on Participating in the Preparation of Capacity Development Strategies*, is also being published separately. Both of these documents may be obtained by calling the Safe Drinking Water Hotline at 1-800-426-4791.

Section 1: Introduction to Technical, Managerial, and Financial Capacity of Water Systems

What is the overall purpose of this guidance document?

This guidance establishes national policy regarding implementation of the capacity development related provisions of the SDWA, as amended.

Sections 2 and 3 of this guidance describe how EPA will assess State capacity development programs for purposes of determining whether these programs meet the statutory requirements contained in section 1420 of the Act and therefore whether the Agency is required to withhold (according to sections 1420 and 1452(a)(1)(G)(i)) up to 20% of a State's share of DWSRF funding.

Section 4 of this guidance describes what States must document and submit to EPA to demonstrate compliance with section 1452(a)(3) of the Act. This provision prohibits any assistance under Section 1452, including direct grants from EPA, to systems lacking the technical, managerial, and financial capacity for SDWA compliance.

What is the statutory authority for this guidance document?

The authority to produce this guidance is contained in SDWA sections 1420 and 1452. First, under section 1420(d)(4), the Act directs EPA to publish guidance on legal authorities or other means for ensuring that all new community water systems and new nontransient, noncommunity water systems demonstrate adequate technical, managerial, and financial capacity.¹ Section 2 of this guidance fulfills this requirement. Second, section 1452(g)(3) requires the Agency to publish guidance and promulgate regulations as may be necessary to carry out the provisions of section 1452.² Section 1452(a)(1)(G)(i)³ requires EPA to withhold a percentage of a State's DWSRF grant unless the State has met the capacity development requirements of section 1420. The Agency has determined that guidance is necessary to implement the withholding provision in a fair, rational, and consistent manner.

What is water system capacity?

Water system capacity is the ability to plan for, achieve, and maintain compliance with applicable drinking water standards. Capacity has three components: technical, managerial, and financial. Adequate capability in all three areas is necessary for a system to have "capacity."

¹ Section 1420(d): *FEDERAL ASSISTANCE-(1) IN GENERAL. . . (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.*

² 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...*

³ Section 1452(a)(1)(G)(i): *NEW SYSTEM CAPACITY.- Beginning in fiscal year 1999, the Administrator shall withhold 20% 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)...*

What is water system capacity development?

Capacity development is the process of water systems acquiring and maintaining adequate technical, managerial, and financial capabilities to enable them to consistently provide safe drinking water. The SDWA's capacity development provisions provide a framework for States and water systems to work together to ensure that systems acquire and maintain the technical, managerial, and financial capacity needed to meet the Act's public health protection objectives.

How does the SDWA address capacity development?

The SDWA as amended establishes a focus on capacity development through two major provisions. First the law requires States to develop and implement programs to ensure that new systems demonstrate capacity and to assist existing systems in acquiring and maintaining capacity. States failing to develop and implement such programs will have up to 20% of their DWSRF allotment withheld.

Second, the law ties a water system's eligibility to receive assistance under Section 1452 to the system's technical, managerial, and financial capacity. In short, the law prohibits DWSRF assistance to a system which lacks the technical, managerial, and financial capacity to ensure compliance with SDWA requirements. The only exception for systems lacking capacity is if they agree to undertake changes in operations, such as changes in ownership, management, accounting, rates, etc. These would apply if the State determines that the changes are necessary to ensure that the system has the technical, managerial, and financial capacity to comply with the SDWA over the long term. Section 1452(a)(3) establishes the prohibition on assistance to a system lacking the capacity to ensure SDWA compliance unless the system agrees to restructuring changes to ensure it has the necessary technical, managerial, and financial capacity to comply with the Act over the long term.⁶

What are the requirements for state capacity development programs?

Section 1420 establishes the requirements for State programs. First, under section 1420(a), a State must develop a program to ensure that all new community water systems and new nontransient noncommunity water systems demonstrate the technical, managerial, and financial capacity to comply with all national primary drinking water regulations (NPDWRs) in effect, or

⁶ Section 1452(a)(3): *LIMITATION.- (A) IN GENERAL.- Except as provided in subparagraph (B), no assistance under this section shall be provided to a public water system that- (i) does not have the technical, managerial, and financial capability to ensure compliance with the requirements of this title; or (ii) is in significant noncompliance with any requirement of a national primary drinking water regulation or variance. (B) RESTRUCTURING.- A public water system described in subparagraph (A) may receive assistance under this section if - (i) the use of such assistance will ensure compliance; and (ii) if subparagraph (A)(i) applies to the system, the owner or operator of the system agrees to undertake feasible and appropriate changes in operation (including ownership, management, accounting, rates, maintenance, consolidation, alternative water supply, or other procedures) if the State determines that such measures are necessary to ensure that the system has the technical, managerial, and financial capability to comply with the requirements of this title over the long term.*

likely to be in effect on the date commencement of operations.⁷ Second, under section 1420(c), a State must, by August 6, 2000, be developing and implementing a strategy to assist PWSs in acquiring and maintaining technical, managerial, and financial capacity.⁸

Both sections 1420(a) and (c) and section 1452(a)(1)(G)(i) establish DWSRF withholding requirements for States not meeting the capacity development provisions of section 1420(a) and (c). States which fail to establish a functional program to ensure that systems commencing operations after October 1, 1999 demonstrate technical, managerial, and financial capacity will incur a 20% DWSRF withholding starting in fiscal year 1999. States which fail to develop and implement a strategy will incur a 10% withholding in fiscal year 2001, 15% withholding in fiscal year 2002, and 20% withholding for subsequent years.

To which water systems do the SDWA's capacity development provisions apply?

Section 1420(a), the new systems provision, applies to all new CWSs and all new NTNCWSs.

Section 1420(c), the capacity development strategy provision, applies to all PWSs, but States must consider which systems they will focus on.

Section 1452(a)(3), the prohibition of assistance to PWSs which lack capacity, applies to all PWSs eligible for DWSRF assistance, which are CWSs, nonprofit NTNCWS, and nonprofit TNCWS.

What is public water system (PWS)?

A PWS 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 daily at least 60 days out of the year." (40 CFR 141.2) This category includes community water systems (CWSs), nontransient noncommunity water systems (NTNCWSs), and transient community water systems (TNCWSs). There are approximately 172,000 PWSs nationwide.

⁷ Section 1420(a): *STATE AUTHORITY FOR NEW SYSTEMS.*- A State shall receive only 80% 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 regulations in effect, or likely to be in effect, on the date of commencement of operations.

⁸ Section 1420(c)(1): *CAPACITY DEVELOPMENT STRATEGY.*- Beginning four 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):...the Administrator...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).

What is a community water system (CWS)?

A CWS 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) About 55,000 CWSs serve more than 246 million people.

Slightly more than 86 % of CWSs are “very small” (serving fewer than 500 persons) or “small” (serving fewer than 3,300 persons). Although a significant majority of CWSs, these systems serve just over 10 percent of the CWS service population. CWSs can be privately owned or publicly owned. A substantial number of privately-owned systems are “ancillary systems” they provide water as an ancillary function of their principal business. An example is mobile home parks, which provide water as an adjunct to their principal business. Fifty-three percent of CWSs serving between 25 and 100 persons are ancillary systems. Only 0.1 percent of CWSs serving more than 10,000 persons are ancillary systems. See Figure 1.

What is a nontransient noncommunity water system (NTNCWS)?

A NTNCWS is “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) NTNCWSs are generally commercial or institutional establishments having their own water supply which serves 25 or more of the same people on a regular basis. Examples include schools, factories, office and industrial parks, and major shopping centers. Approximately 20,000 NTNCWSs across the nation serve some 6 million people. Over 96 % of NTNCWSs use ground water as their primary source. Ninety-nine percent of NTNCWSs are “very small” or “small”. Most are privately owned.

What is a transient, noncommunity water system (TNCWS)?

A TNCWS is a “non-community water system that does not regularly serve at least 25 of the same persons over six months per year.” (40 CFR 141.2) TNCWSs are generally commercial or not-for-profit establishments having their own water supply which serves 25 or more people per day, but not the same people on a regular basis. Examples include restaurants, roadside stops, campgrounds, and hotels.

What is technical capacity, and how can it be assessed?³

Technical capacity is the physical and operational ability of a water system to meet SDWA requirements. Technical capacity refers to the physical infrastructure of the water system, including the adequacy of source water and the adequacy of treatment, storage, and distribution infrastructure. It also refers to the ability of system personnel to adequately operate and maintain the system and to otherwise implement requisite technical knowledge.

A water system’s technical capacity can be determined by examining key issues and

³ Additional information on technical capacity can found within *Information for States on Implementing the Capacity Development Provisions of the Safe Drinking Water Act Amendments of 1996*.

questions, including:

- *Source water adequacy.* Does the system have a reliable source of drinking water? Is the source of generally good quality and adequately protected?
- *Infrastructure adequacy.* Can the system provide water that meets SDWA standards? What is the condition of its infrastructure, including well(s) or source water intakes, treatment, storage, and distribution? What is the infrastructure's life expectancy? Does the system have a capital improvement plan?
- *Technical knowledge and implementation.* Is the system's operator certified? Does the operator have sufficient technical knowledge of applicable standards? Can the operator effectively implement this technical knowledge? Does the operator understand the system's technical and operational characteristics? Does the system have an effective operation and maintenance program?

What is managerial capacity, and how can it be assessed?⁴

Managerial capacity is the ability of a water system to conduct its affairs in a manner enabling the system to achieve and maintain compliance with SDWA requirements. Managerial capacity refers to the system's institutional and administrative capabilities.

Managerial capacity can be assessed through key issues and questions, including:

- *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 organized and staffed? Do personnel understand the management aspects of regulatory requirements and system operations? Do they 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?

What is financial capacity, and how can it be assessed?⁵

Financial capacity is a water system's ability to acquire and manage sufficient financial resources to allow the system to achieve and maintain compliance with SDWA requirements.

⁴ Ibid.

⁵ Ibid.

Financial capacity can be assessed through key issues and questions, including:

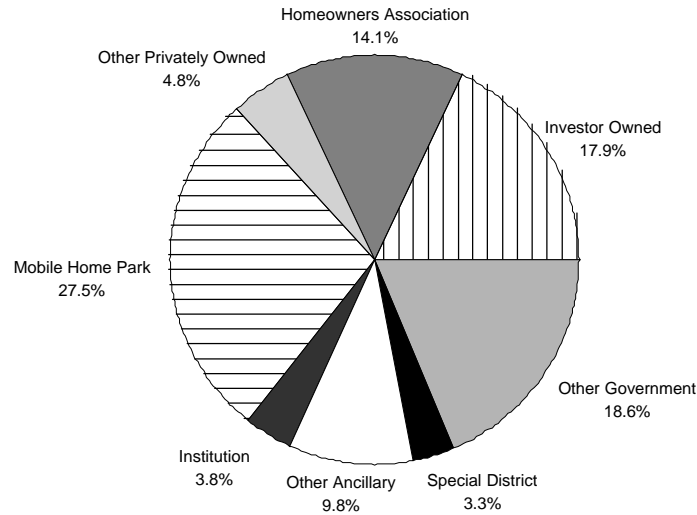
- *Revenue sufficiency.* Do revenues cover costs? Are water rates and charges adequate to cover the cost of water?
- *Credit worthiness.* Is the system financially healthy? Does it have access to capital through public or private sources?
- *Fiscal management and controls.* Are adequate books and records maintained? Are appropriate budgeting, accounting, and financial planning methods used? Does the system manage its revenues effectively?

How are technical, managerial, and financial capacity related?

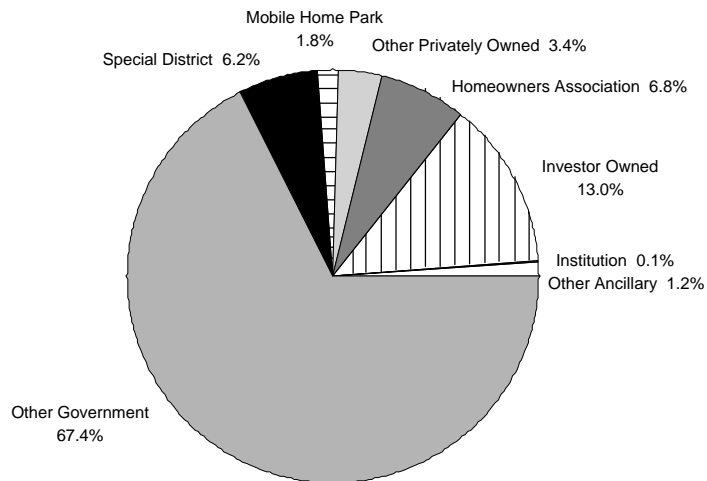
Many aspects of water system operations involve more than one kind of capacity. Infrastructure replacement or improvement, for example, requires technical knowledge, management planning and oversight, and financial resources. A deficiency in any one area could disrupt the entire effort. The relationship between the three areas of capacity is illustrated in Figure 2. Additional information on technical, managerial, and financial capacity and how they relate to one another can be found in *Information on Implementing the Capacity Development Provisions of the Safe Drinking Water Act Amendments of 1996*.

FIGURE 1

Ownership of Systems Serving Population 25 - 500
(Percent of Systems)



Ownership of Systems Serving Population > 500
(Percent of Systems)



Note: Percentages do not add to 100% due to rounding.

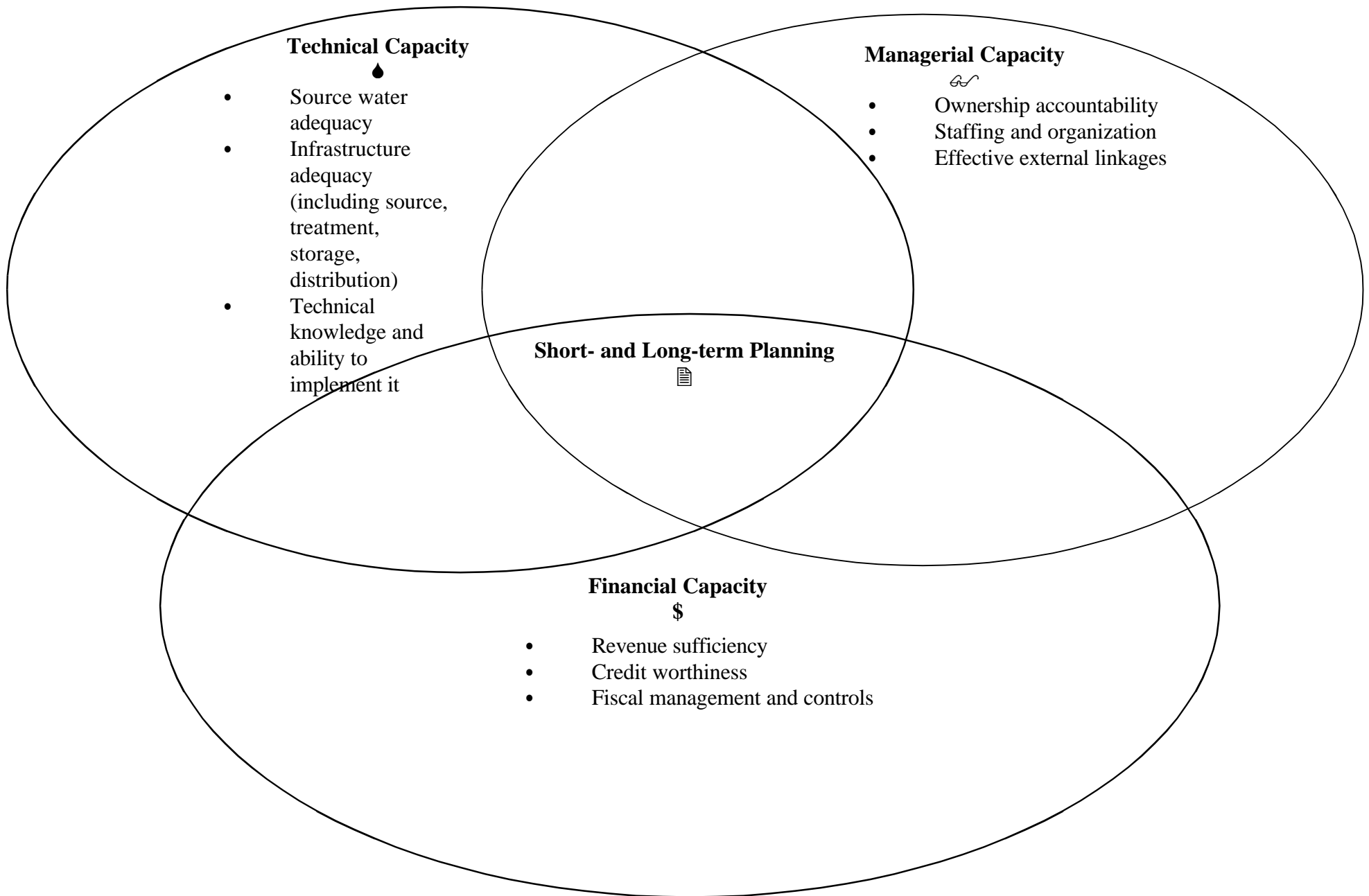


Figure 2
Technical, Managerial, and Financial Capacity

Section 2: Guidance on DWSRF Withholding Determinations Related to State Programs For Ensuring that All New CWSs and NTNCWSs Demonstrate Technical, Managerial, and Financial Capacity

What is the purpose of this guidance?

This guidance establishes national policy regarding implementation of the DWSRF withholding related to new system capacity under sections 1420(a) and 1452(a)(1)(G)(i) of the SDWA as amended. This guidance describes how EPA will assess State new system capacity programs for purposes of determining whether these programs meet the statutory requirements contained in section 1420(a) and therefore whether the Agency is required to withhold 20% (according to sections 1420 and 1452(a)(1)(G)(i)) of a State's share of federal DWSRF funding.

What is the statutory authority for this guidance?

Section 1420(d)(4) of the SDWA as amended requires EPA to publish this guidance.

To whom does this guidance apply?

This guidance applies to all States that receive grants to capitalize DWSRF's under Section 1452.

How will EPA use this guidance?

EPA will use this guidance to determine whether or not a State has met the requirements of section 1420(a). States failing to meet these requirements will incur a withholding of 20% from their DWSRF allotment for fiscal year 1999 and beyond.

What does section 1420(a) of the SDWA as amended require a State to do?

A State must develop and implement a fully functional program to ensure that all new CWSs and new NTNCWs commencing operations after October 1, 1999 demonstrate technical, managerial, and financial capacity to comply with regulations in effect or likely to be in effect on the date of commencement of operations.

What constitutes a "new system"?

New systems include both CWSs or NTNCWSs being newly constructed as well as systems which do not currently meet the definition of a PWS but which expand their infrastructure and thereby grow to become CWSs or NTNCWSs. Systems not currently PWSs and which add additional users and thereby become CWSs or NTNCWSs without constructing any additional infrastructure are not "new systems" for purposes of section 1420(a) of the SDWA as amended.

The Agency has considered a number of alternative definitions for "new system". A definition of "new system" which encompasses only newly constructed systems would overlook those systems which grow through physical expansion to become PWS's. The Agency believes that there are a significant number of such systems and that they should be treated as equivalent to newly constructed systems. On the other hand, a definition of "new system" that encompassed any system which acquired enough users to qualify it as a PWS would be unreasonable since it would capture systems such as small businesses which become PWS's simply by virtue of adding a few new employees, even though they make no physical modification whatsoever to their water system.

What must a State document in order for EPA to determine that 20% withholding from the State's DWSRF allotment is not required?

The State must document that it has implemented, or will implement by October 1, 1999, a fully functional program to ensure that new systems demonstrate technical, managerial, and financial capacity. The documentation must include:

- A basis of authority for ensuring that all such systems show technical, managerial, and financial capacity. This could include State regulations, policies, or other implementing authorities.
- Identification of at least one control point at which the State will execute its authority.
- A plan for program implementation which includes provisions for evaluating and verifying program implementation in the future.

For a summary of these requirements, please see Table 1.

What is a “basis of authority”?

Section 1420(a) requires a State to show that it has the “legal authority or other means” to ensure that all new CWSs and NTNCWSs demonstrate technical, managerial, and financial capacity with respect to NPDWRs in effect, or likely to be in effect, on the date of commencement of operations. Thus, a “basis of authority” is the legal authority or other means that serve as the legal basis of the State program. The “basis of authority”, by definition, would also include the implementing authorities (regulations, policies, guidance, etc.) that allow the basic legal authority to be exercised.

What are some examples of a “basis of authority”?

A basis of authority could include State laws, regulations, policies, or other effective and demonstrable means. For example, authority granted to the State primacy agency to implement the federal Safe Drinking Water Act may serve as the basis of authority upon which to develop a fully functional program to ensure new system capacity. Or, authority granted to a State water resource management agency, through allocating water rights or controlling land development, may provide a sufficient basis of authority on which to build a fully functional new system capacity program. Under either example, the authority should provide the applicable State agency with enforceable authority to ensure the demonstration of new system capacity, whether through regulations, policies, guidance, or other implementing authorities. Additional examples of the basis for such authority are provided in EPA’s *Information for States on Implementing the Capacity Development Provisions of the 1996 Safe Drinking Water Act Amendments of 1996*. See Table 2 for examples of bases of authority.

What needs to be documented relative to the “basis of authority”?

- The State must document the actual implementing authority and underlying statutory authority to ensure the demonstration of new system capacity.
- The State must specify which agency is responsible for ensuring the demonstration of new system capacity. This could be the State SDWA primacy agency, or any other designated agency, but there must be a responsible agency (or combination of agencies with a clearly defined lead agency).

- The responsible State agency (or combination of agencies) must possess and demonstrate the *actual authority* to ensure that all new CWSs and new NTNCWSs demonstrate the technical, managerial, and financial capacity to comply with all applicable SDWA requirements. Collaborative arrangements among agencies for ensuring demonstration of new system capacity must be documented through memoranda of understanding.

Can the “basis of authority” for ensuring the demonstration of new system capacity rest at the county or local level?

The State is ultimately responsible for meeting the SDWA’s capacity requirements. Therefore, the State must have the final authority to determine whether a new system has demonstrated technical, managerial, and financial capacity. However, in some States local governments may exercise authorities, such as planning and zoning, which help form an effective basis for a program requiring demonstration of capacity by new systems. EPA encourages States to work closely with local governments in developing the State’s new system capacity program. When appropriate, local authorities, exercised at the local level, could be an effective component of an overall State program. However, the State must have the ultimate authority to determine whether or not a new system has demonstrated capacity. For additional information see *Information for States on Implementing the Capacity Development Provisions of the Safe Drinking Water Act Amendments of 1996*.

Who must certify that the State’s authority is sufficient to ensure the demonstration of new system capacity?

The State Attorney General (or a delegated department attorney) must certify, in writing, that the state has the legal authority or other means to require demonstration of technical, managerial, and financial capacity of new systems commencing operation after October 1, 1999 and that the State’s mechanism for implementing this authority is duly enforceable.

What is a “control point”?

A control point is a crux in a new system’s development at which a State (or other unit of government) can exercise its authority to ensure the demonstration of new system capacity. Although local governments can be an important part of the process, each State shall demonstrate to EPA that it has one or more clear control points of its own.

A control point or set of control points taken together must allow for review of the entire scope of the proposed new system development. Generic control points in the new system development process are described in EPA’s *Information for States on Implementing the Capacity Development Provisions of the Safe Drinking Water Act Amendments of 1996*.

What are some examples of “control points”?

Please see Table 2 of this document for examples of control points and their associated bases of authority.

What must the plan for program implementation contain?

The plan for program implementation must show how the State’s program will be put into effect to ensure that new systems commencing operations after October 1, 1999 demonstrate technical, managerial, and financial capacity. The plan for program implementation must include a schedule, with major milestones, for adoption and full implementation of necessary regulations, policies, or other authorities to ensure that new systems commencing operation after October 1,

1999 demonstrate technical, managerial, and financial capacity. EPA strongly encourages states to consider how they will assess and evaluate the success of their program in the years to come.

What will the schedule be for fiscal year 1999 withholding under sections 1420(a) and 1452(a)(1)(G)(i)?

Decisions regarding the new systems capacity related withholding for fiscal year 1999 will be made by EPA at the time of award of the State's fiscal year 1999 capitalization grant. A State will avoid a 20% withholding for fiscal year 1999 if, at the time of the grant award during fiscal year 1999, the State has the necessary "basis of authority" (statutory authority or other means) and is in the process of administrative rulemaking, or is otherwise developing implementing authorities with a realistic schedule (based upon the state's past performance in rulemaking or development of implementing authorities) and expectation to have a fully functional program in place by October 1, 1999.

A State will face a "holdback" of 20% of its FY'99 allotment if, at the time of the grant award during fiscal year 1999, the State lacks a "basis of authority" and/or a realistic schedule for developing implementing authorities in order to have a fully functional program in place by October 1, 1999.

The 20% holdback will become a permanent withholding of 20% of its FY'99 allotment if the State has not demonstrated, by September 30, 1999, that it will have a fully functional program in place on October 1, 1999 to ensure the demonstration of technical, managerial, and financial capacity by new CWSs and new NTNCWSs commencing operation after October 1, 1999.

Will unobligated funds from previous fiscal years be subject to the withholding?

No, unobligated funds from previous fiscal years will not be subject to withholding.

What is a "holdback", and what is its purpose?

A "holdback" is an informal, potentially temporary withholding of 20% of a State's DWSRF allotment. Unlike a formal "withholding", a holdback does not entail a permanent loss of 20% of the DWSRF allotment, nor does it initiate reallocation of those funds under section 1452 of the Act. Instead, "heldback" funds are made available to the State upon an EPA finding that a State has met, or will meet, the conditions under sections 1420(a), 1452(a)(1)(G)(i), and this section of the guidance by the end of fiscal year 1999.

The purpose of the "holdback" is to allow States additional time, before formal withholding would apply, to assemble the statutory authority and implementing authorities needed to institute a fully functional program by October 1, 1999.

In what situations would the holdback apply?

The "holdback" would apply in two situations. First, 20% of a State's DWSRF allotment will be "heldback" if the State lacks the necessary statutory authority to implement a fully functional program by October 1, 1999. Second, 20% of a State's DWSRF allotment will be "heldback" if the State has the statutory authority but is uncertain whether rulemaking or implementing authority could be completed by October 1, 1999.

However, "heldback" funds will be awarded when and if, during FY'99, a State demonstrates statutory authority and schedule for administrative rulemaking or other implementing authority to conform with the October 1, 1999 deadline for having a functional program in place.

For what period does the “holdback” apply?

The “holdback” applies only to fiscal year 1999. The statute would not allow the holdback concept to be applied in any subsequent fiscal year. Section 1420(a) establishes a definite point in time, October 1, 1999, after which states must have functioning programs in place to ensure the demonstration of capacity by any new CWS or new NTNCWS commencing operation. Any state lacking such a program at that definite point in time will lose 20% of its DWSRF allotment. Both Sections 1420(a) and 1452(a)(G)(i) make clear that the withholding provision is applicable in FY’99 and each subsequent fiscal year. Thus, a withholding determination must be made by EPA each fiscal year. For FY’99, the state has until September 30, 1999 to demonstrate that it will have a fully functioning program by October 1, 1999. For FY’00, and subsequent fiscal years, there can be no holdback, since if there were that would mean that a state would not have in place a fully functional program for some part of the fiscal year but would still receive 100% of its allotment for that fiscal year. The law is clear that the fully functional program must be in place on October 1, 1999. If a state implements a fully functional program after October 1, 1999 then the first full subsequent fiscal year would be the first opportunity for the state to once again receive 100% of its DWSRF allotment.

What is a formal “withholding”, and under what conditions would it apply?

A formal “withholding” means that 20% of a State’s DWSRF allotment will be withheld and reallocated according to section 1452 of the Act.

For a State which fails to demonstrate a fully functional program, which includes statutory authority and implementing regulations or other authorities by September 30, 1999, 20% of that State’s allotment will be formally withheld.

How will formal withholding determinations be made for fiscal years 2000 and beyond?

Withholding will apply to the specific fiscal year allotment, and withholding determinations will be based on the program status as of October 1 of the fiscal year in which funds become available. For example, for fiscal year 2000 funds, withholding decisions will be based on State program status as of October 1, 1999. This does not mean that regions will actually make the withholding decisions on October 1. Rather, it means that whenever the capitalization grant is awarded during the fiscal year, the region will evaluate what the status of the states new system capacity program was on October 1 of the fiscal year.

A State will face a 20% withholding if it fails to demonstrate a fully functional program. Also, for States which had demonstrated a fully functional program in the previous fiscal year, a State will face a 20% withholding for the current fiscal year if it fails to demonstrate full, ongoing implementation of its new systems program.

The details of the applicable DWSRF withholding are given in table 3 of this document.

What documentation must a state provide to demonstrate full, ongoing implementation of its new systems program?

In the fiscal years following a state’s initial documentation of a fully functional program a state must document that it is requiring a demonstration of technical, managerial, and financial capacity by every new CWS and every new NTNCWS. This documentation of ongoing implementation of the new systems program may be included with a given years capitalization grant

application or it may be provided in an entirely separate submittal. Documentation could consist of summary statistics regarding the number of proposed new CWS's and NTNCWS's and the results of their required capacity demonstrations.

Table 1: Minimum Requirements for Ensuring that All New CWSs and NTNCWSs Demonstrate Technical, Managerial, and Financial Capacity

Minimum Requirements	State Responsibility
Basis of Authority	The State must show that it has the “legal authority or other means” to ensure the demonstration of technical, managerial, and financial capacity by new CWSs and new NTNCWSs commencing operation after October 1, 1999. The State must demonstrate both the underlying statutory or other legal authority and the actual implementing authority (regulations, policies, etc.). The State attorney general must certify that the State has the legal authority or other means to require demonstration of technical, managerial, and financial capacity of new systems commencing operation after October 1, 1999 and that the State’s mechanism for implementing this authority is duly enforceable.
Control Points	The State must demonstrate that it has one or more clear control points in the new system development process at which it can exercise its authority to ensure the demonstration of capacity by new systems.
Program Implementation	The State must present a plan for program implementation which includes a realistic schedule for having in place by October 1, 1999 a fully functional program to ensure that all new CWSs and new NTNCWSs commencing operation after 10-1-99 demonstrate technical, managerial, and financial capacity. In each subsequent fiscal year the State must demonstrate ongoing implementation of a fully functioning program.

Table 2: Potential Authorities and Control Points for Ensuring the Technical, Managerial, and Financial Capacity of New Water Systems

A.	B.	C.
Basis of Authority (Statutory or Other)	Agency Vested with Authority	Control Points for Ensuring New System Capacity
State Authority for Drinking Water Quality	State drinking water primacy agency	Facility plan review and permit*
		Operating permit*
		Operator certification
		Construction requirements for wells
		Source water protection plans
		System planning requirements
State Authority for Economic Regulation of Public Utilities	State public utility commissions (PUCs)	Certificate of convenience and necessity*
		Approval of system’s investments (ratebase)
		Approval of system’s financial structure (debt and equity)
		Approval of initial rates and rate design
		System planning requirements
State Authority for Water Resource Management	State water resource agency	Withdrawal and source development permits*
		Approval of water rights
		System planning requirements
		Approval of environmental impact assessment.
State Authority for Revolving Loan Funds	State financial assistance agency	Eligibility and approval of grants and loans
State Authority for Planning and Growth Management	State planning, growth management, or development agency	Review and approval of plans*
	Regional planning councils (intrastate)	Review and approval of plans
State Enabling Authority for Local Government	Secretary of State (or other State agency)	Authorization of local governments and districts
		Subdivision and platting regulations
	State financial control agency	Authorization of local government financing (public systems)
State Authority for Public Safety	State fire marshal (or other agency)	Permits and approvals related to fire protection codes
Local Governmental Authority for Land-Use, Planning, and Finances	Municipalities, counties, and special districts	Subdivision, zoning, and land-use approvals*
		Construction permits and approvals
		Franchise approval*
		Local planning approvals
		Authorization of local government financing
Federal Rural Utilities Authority	Rural Utilities Service	Approval of grants and loans
Interstate Authorities and Compacts	River basin commissions	Basin withdrawal permits*
		Basin planning and resource management requirements
State Authorities to Regulate Related Businesses	Banking regulators	Loan approval by commercial lenders
	Insurance regulators	Insurance approval by insurers

*principal approval processes for creating a water system.

Table 3: DWSRF Withholding for New Systems Capacity Programs

Year	Avoid 20% Withholding	20% Holdback	20% Withholding
FY 1999			
<p>Withholding applies to FY 1999 allotment.</p> <p>Unobligated funds from previous fiscal years will not be subject to the withholding.</p>	<p>If State has statutory authority and is in the process of administrative rulemaking, or is otherwise developing implementing authorities with a realistic schedule and expectation to have a fully functional program by October 1, 1999.</p>	<p>If State lacks statutory authority, or</p> <p>If State has statutory authority and is uncertain if rulemaking (or development of other implementing authorities) could be completed by October 1, 1999.</p> <p>Heldback funds are awarded when and if , during FY'99, a State demonstrates statutory authority and schedule for administrative rulemaking or other implementing authority to conform with October 1, 1999 requirement.</p>	<p>If State fails to demonstrate a functional program (statutory authority and implementing regulations or other authorities) by September 30, 1999.</p>
FY 2000 and beyond			
<p>Withholding will apply to the specific fiscal year allotment. Withholding decisions will be based on the program status as of October 1 of the fiscal year funds become available.</p> <p>For example, for FY 2000 funds, withholding decisions will be based on State programs as of October 1, 1999.</p>	<p>If State demonstrates a fully functional program (in the case of previous year withholding), or</p> <p>If State demonstrates full ongoing implementation of new systems program (if the State had previously demonstrated a fully functional program).</p>	<p>N/A</p>	<p>If State fails to demonstrate a fully functional program (in the case of previous year withholding), or</p> <p>If State fails to demonstrate full, ongoing implementation of its new systems program (if it had previously demonstrated a fully functional program).</p>

Section 3: Guidance on DWSRF Withholding Determinations Related to State Capacity Development Strategies

What is the purpose of this guidance?

This guidance establishes national policy regarding implementation of the DWSRF withholding related to capacity development strategies under sections 1420(c) and 1452(a)(1)(G)(i) of the SDWA as amended. This guidance describes how EPA will assess whether States have met the capacity development strategy requirements of section 1420(c) and therefore whether the Agency is required to withhold a percentage of a State's DWSRF allotment.

What is the statutory authority for this guidance?

The basis for this guidance is the EPA Administrator's authority to issue guidance and regulations under section 1452(g)(3) as necessary to implement the provisions of section 1452 of the SDWA. This guidance is necessary to implement the DWSRF withholding provisions of section 1452(a)(1)(G)(i) of the SDWA, as amended.

To whom does this guidance apply?

This guidance applies to all States operating a DWSRF and seeking to avoid a 10% withholding of their DWSRF allotment in fiscal year 2001, 15% in fiscal year 2002, and 20% in each subsequent fiscal year.

How will EPA use this guidance?

EPA will use this guidance to determine whether a State has met the requirements outlined in section 1420(c). States that fail to do so are subject to withholdings of DWSRF allotments equaling 10% in FY 2001, 15% in FY 2002, and 20% in each subsequent fiscal year.

What does section 1420(c) of the SDWA as amended require a State to do?

In general, the State must be developing and implementing a strategy to assist PWSs in acquiring and maintaining capacity to comply with the Act by August 6, 2000. Section 1420 requires that States consider, solicit public comment on, and include as appropriate in its capacity development strategy several listed elements in the Act. Section 1420(c) also contains ongoing reporting requirements related to capacity development with which States must comply. For a more detailed discussion of what States must do to comply with section 1420(c), see Table 4 of this guidance.

What are the elements that a State must consider, solicit public comment on, and include as appropriate in its capacity development strategy?

Section 1420(c)(2) requires that States, in preparing their capacity development strategies, consider, solicit public comment on, and include as appropriate the following:

- A. The methods or criteria that the State will use to identify and prioritize the PWSs most in need of improving technical, managerial, and financial capacity.
- B. A description of the institutional, regulatory, financial, tax, or legal factors at the Federal, State, or local level that encourage or impair capacity development.

- C. A description of how the State will use the authorities and resources of this title or other means to assist public water systems in complying with NPDWRs, encourage the development of partnerships between public water systems to enhance the technical, managerial, and financial capacity of the systems, and assist public water systems in the training and certification of operators.
- D. A description of how the State will establish a baseline and measure improvements in capacity with respect to NPDWRs and State drinking water law.
- E. An identification of the persons that have an interest in and are involved in the development and implementation of the capacity development strategy (including all appropriate agencies of Federal, State, and local governments, private and nonprofit PWSs and PWS customers).

What must a State document to demonstrate that it has met the basic requirements of §1420(c)?

- A State must certify that it solicited public comments on the five elements listed above *as part of* the preparation of its capacity development strategy. The State must describe relevant public comments and its responses to them.
- The State must describe which of the listed elements (A-E) the State has included or excluded from its strategy, and why each element was included or excluded.
- The State must describe how the selected elements together can be rationally considered to constitute a strategy to assist PWSs in acquiring and maintaining technical, managerial, and financial capacity.
- The State must describe how it will implement its strategy and evaluate its progress toward improving PWS capacity.

What are the ongoing reporting requirements under the capacity development strategy provisions?

- Each year, as a stand-alone submittal or as part of the state's capitalization grant application, the state must provide documentation showing the ongoing implementation of the capacity development strategy.
- Every 3 years, the State must submit to EPA a list of CWSs and NTNCWSs that have a history of significant noncompliance and, to the extent practicable, the reasons for their noncompliance. States submitted their first list in August, 1997. The next list will be due August 6, 2000. The Agency has interpreted the statutory requirement in section 1420(b)(1) of "periodically update" to mean every 3 years. This interpretation is based upon consultation with the states and the Agency considers it reasonable given the requirement for a state report to the governor every 3 years in Section 1420(c)(3).

- By August 6, 2001 the State must report to EPA on the success of its enforcement mechanisms and initial capacity development efforts in helping CWSs and NTNCWSs having a history of significant noncompliance improve their capacity.
- Not later than 2 years after a State adopts a capacity development strategy, and every 3 years thereafter, the primacy agency must submit a report to the Governor on the efficacy of the strategy and progress made toward improving the technical, managerial, and financial capacity of PWSs in the State. The report shall also be made available to the public.

Will these reports be a factor in DWSRF withholding determinations?

Yes. Failure to produce any of the reports will constitute a basis for withholding since these reports, required under sections 1420(b)(3) and (c)(3), are considered part of the capacity development strategy.

However, EPA will not base withholding determinations on any type of judgements or inferences drawn from the reports regarding the relative merits or efficacy of a State capacity development strategy. Further, the statute in section 1420(c)(4) explicitly prohibits EPA from reviewing decisions of the State regarding any particular PWS, as part of a capacity development strategy. Such State decisions regarding individual PWSs may not serve as basis for withholding funds.

What should States that already have capacity development strategies do?

EPA commends States which have already developed and implemented programs and strategies to improve the technical, managerial, and financial capacity of PWSs. For purposes of complying with the requirements of section 1420(c), States which have existing strategies must certify that they considered and solicited public comment on the elements listed in section 1420(c)(2)(A-E). The purpose of this requirement is to solicit public involvement and ideas on the state strategy in light of the new opportunities for regulatory flexibilities (e.g., variances and exemptions) and in light of the new resources provided by the 1996 SDWA Amendments to develop, revise and implement capacity development strategies and technical assistance. If the State did not consider and solicit public comment on the listed elements at the time the strategy was developed, it will need to do so prior to October 1, 2000. In addition, the State is still required to meet the ongoing reporting requirements under sections 1420(b)(3) and (c)(3), listed above.

What is meant by a *history of significant noncompliance*?

A “history of significant noncompliance” means being in significant noncompliance (for any single contaminant or for different contaminants) during any three quarters of the previous 3 years. This definition was developed in consultation with the states at the Winter Meeting of the Association of State Drinking Water Administrators in February, 1997. It was the definition utilized for purposes of developing the first required state list which was due to EPA on August 6, 1997.

Under what conditions will fiscal year 2001 withholding occur?

For fiscal year 2001, the withholding determination will be based on the program status as of October 1, 2000. The withholding will apply to the fiscal year 2001 allotment. Unobligated funds from previous fiscal years will not be subject to withholding.

A State will avoid a 10% withholding from its DWSRF allotment if the State is developing and implementing a strategy to assist PWSs in acquiring and maintaining technical, managerial, and financial capacity. A State will incur a 10% withholding if it is not doing so.

Will there be a “holdback” associated with the capacity development strategy provision analogous to that associated with the new systems provision?

No. The statute establishes a date certain, August 6, 2000, by which states must be developing and implementing a capacity development strategy. Since the withholding for failure to develop and implement a strategy does not begin until FY’01 (starting October 1, 2000), a “holdback” would make no sense. If a state is not developing and implementing a strategy on October 1, 2000, then they have failed to meet the statutory requirement and would have 10% withheld from their allotment. The state could avoid a withholding the following fiscal year if they are developing and implementing a strategy on or before October 1, 2001.

Under what conditions will fiscal year 2002 withholding occur?

For fiscal year 2002, the withholding determination will be based on the program status as of October 1, 2001. The withholding will apply to the fiscal year 2002 allotment.

A State will avoid a 15% withholding of its allotment if it is developing and implementing a strategy to assist PWSs in acquiring and maintaining technical, managerial, and financial capacity. A State will incur a 15% withholding if it is not doing so.

Under what conditions will fiscal year 2003 and beyond withholding occur?

For fiscal year 2003 and beyond, the withholding determination will be based on the program status as of October 1 of the fiscal year. The withholding will apply to the fiscal year allotment.

A State will avoid a 20% withholding of its allotment if it is developing and implementing a strategy to assist PWSs in acquiring and maintaining technical, managerial, and financial capacity. A State will incur a 20% withholding if it is not doing so.

What will be the basis of withholding decisions in subsequent fiscal years after a state has demonstrated that it is developing and implementing a capacity development strategy?

Once a state has successfully demonstrated that it is developing and implementing a capacity development strategy, then in subsequent fiscal years it can avoid withholding by documenting ongoing implementation of the strategy. This documentation may be included with the capitalization grant application or it may be provided in an entirely separate submittal. Such documentation may consist of a concise narrative description of the major activities being conducted and planned for under the states capacity development strategy. See Table 5 for a summary of DWSRF withholding for capacity development strategies.

Table 4: Meeting the Requirements of Section 1420(c) - Capacity Development Strategy

Requirements	State Responsibility
Consideration of §1420(c)(2)(A-E)	The State must describe the issues it considered relative to each of the listed elements and explain why each element was included or excluded from its capacity development strategy.
Public Comment	The State must certify that it solicited public comment on the listed elements. The State must also describe all relevant public comment and its response.
Capacity Development Strategy	The State must show a rational basis for concluding that the chosen elements constitute a strategy to assist public water systems in acquiring and maintaining capacity.
Strategy Implementation	The State must describe its current strategy implementation and plans for future implementation. Each year, as a stand-alone submittal or as part of the state's DWSRF capitalization grant application, the state must provide documentation showing the ongoing implementation of the capacity development strategy.
Ongoing Reporting Requirements	<p>Not later than 2 years after the date on which a State first adopts a capacity development strategy, and every 3 years thereafter, the head of the State primacy agency shall submit to the Governor a report on the efficacy of the strategy and progress toward improving the capacity of public water systems in the State.</p> <p>Every 3 years, the State must submit to the EPA Administrator a list of CWSs and NTNCWSs that have a history of significant noncompliance, and to the extent possible, the reasons for noncompliance.</p> <p>By 2001, the State must submit to the EPA Administrator a report on the success of enforcement mechanisms and initial capacity development efforts in helping systems in significant noncompliance achieve and maintain capacity.</p>

Table 5: DWSRF Withholding for Capacity Development Strategies

Year	Avoid Withholding	Withholding
FY 2001		
Withholding will be based on the program status as of October 1, 2000. Withholding applies to FY 2001 allotment. Unobligated funds from previous fiscal years will not be subject to the withholding.	If State is developing and implementing strategy	EPA will withhold 10% of the State's allotment if the State is not developing and implementing a strategy.
FY 2002		
Withholding will be based on the program status as of October 1, 2001	If State is developing and implementing strategy.	EPA will withhold 15% of the State's allotment if the State is not developing and implementing a strategy.
FY 2003 and beyond		
Withholding will be based on the program status as of October 1 of the fiscal year.	If State is developing and implementing	EPA will withhold 20% of the State's allotment if the State is not developing and implementing a strategy.

Section 4: Guidance on Assessment of Capacity for Purposes of Awarding DWSRF Assistance

What is the purpose of this guidance?

This guidance clarifies what procedures a State must document relative to its assessment of technical, managerial, and financial capacity of PWSs seeking DWSRF loan assistance.

What is the statutory authority for this guidance?

The basis for this guidance is the EPA Administrator's authority to issue guidance and regulations under section 1452(g)(3) as necessary to implement the provisions of section 1452 of the SDWA. Section 1452(a)(3) prohibits DWSRF assistance to PWSs that do not have the technical, managerial, and financial capacity to comply with SDWA requirements.

To whom does this guidance apply?

This guidance applies to all States which operate a DWSRF program.

How will EPA use this guidance?

EPA will use this guidance to assure that States have in place and utilize procedures to make certain that, consistent with section 1452(a)(3)(A), systems receiving DWSRF assistance have the technical, managerial, and financial capacity to ensure compliance with SDWA requirements and that no system in significant noncompliance with a NPDWR receives assistance except as provided for in section 1452(a)(3)(B).

What limitations on DWSRF assistance does section 1452(a)(3)(A) impose?

Section 1452(a)(3)(A) imposes two significant limitations on DWSRF assistance to PWSs. First no assistance may be provided to a PWS that does not have the technical, managerial, and financial capacity to ensure compliance with the requirements of the SDWA. Second, no assistance may be provided to a PWS that is in significant noncompliance with any requirement of a NPDWR.

Are there any exceptions to the limitations imposed by section 1452(a)(3)(A)?

Yes. Section 1452(a)(3)(B) allows systems lacking capacity to receive DWSRF assistance if the system agrees to undertake feasible and appropriate restructuring (such as changes in rates or management, consolidation, alternative supply, etc.) if the State determines that such restructuring is necessary to ensure that the system has the capacity to comply with SDWA requirements over the long term.

Section 1452(a)(3)(B) also allows a system in significant noncompliance to receive assistance if the use of the assistance will ensure compliance.

What must a State document to comply with the requirement that DWSRF loan assistance not be available to PWSs that lack technical, managerial, and financial capacity?

Each State must document the procedure it will use for evaluating the technical, managerial, and financial capacity of PWSs seeking DWSRF assistance. The procedure must, under any rational standard of judgement, be designed to objectively assess the technical, managerial, and financial capacity of water systems for long-term compliance with the requirements of the SDWA. This documented procedure must be available for public review before being finalized. Once the procedure is finalized, it must be documented in the State

DWSRF Operating Agreement. For more information on assessment of technical, managerial, and financial capacity, see *Information for States on Implementing the Capacity Development Provisions of the Safe Drinking Water Act Amendments of 1996*.

With each year's capitalization grant application or as a separate and previous submittal, the State must summarize the results of assessments of system technical, managerial, managerial, and financial capacity conducted in the preceding year. This information should include summary statistics on the numbers, types, and sizes of systems assessed and the outcome of the assessments. It should also include any changes in assessment methodology the State is planning to make.

What must a State document to comply with the provision that DWSRF assistance can be provided to a system in significant noncompliance only if the use of the assistance will ensure compliance?

Each State must document the procedure they will use for assessing whether DWSRF assistance will ensure compliance of systems in significant noncompliance. This documented procedure must be available for public review before being finalized. Once the procedure is finalized, it must be documented in the State's DWSRF Operating Agreement.

With each year's capitalization grant application or as a separate or previous submittal, the State must provide summary statistics on the numbers, types, and sizes of systems in significant noncompliance to which the State provided DWSRF assistance in the preceding year. The State should also summarize any changes in the assessment procedure it plans to make.

What must a State document to comply with the provision that DWSRF assistance can be provided to a PWS that lacks technical, managerial, and financial capacity if the system agrees to restructuring changes that the State determines are necessary to ensure system capacity for long term SDWA compliance?

Each State must document the procedure they will use for assessing what are feasible and appropriate restructuring changes that would be necessary to ensure that a system has the technical, managerial, and financial capacity to comply with SDWA requirements over the long term. This procedure must be available for public review before being finalized. Once the procedure is finalized, it must be documented in the State's DWSRF Operating Agreement.

With each year's capitalization grant application or as a separate or previous submittal, the State must provide summary statistics on the numbers, types, and sizes of systems that have been required to undertake restructuring changes in order to be eligible for DWSRF assistance. The State should also summarize any changes in the assessment procedure it plans to make.

For a summary of what a State must document to demonstrate that it has complied with section 1452(a)(3), please see Table 6.

NOTE: No assistance authorized under Section 1452, including direct grants from EPA, may be awarded to systems that lack capacity, unless such assistance will enable the system to obtain capacity.

Table 6: Minimum Requirements for Assessment of Capacity for Purposes of Awarding DWSRF Assistance

Requirements	State Responsibility
<p>Procedure to Assess Technical, Managerial, and Financial Capacity for Purposes of Awarding DWSRF Assistance</p>	<p>Each State must document the procedure it will use for evaluating the technical, managerial, and financial capacity of PWSs seeking DWSRF assistance. This documented procedure must be available for public review before being finalized. Once the procedure is finalized, it must be documented in the State DWSRF Operating Agreement.</p> <p>With each year’s capitalization grant application or as a separate and previous submittal, the State must summarize the results of assessments of system technical, managerial, managerial, and financial capacity conducted in the preceding year. This information should include summary statistics on the numbers, types, and sizes of systems assessed and the outcome of the assessments. It should also include any changes in assessment methodology the State is planning to make.</p>
<p>Procedure for Assessing Whether DWSRF Assistance Will Help to Ensure Compliance for Systems in Significant Compliance</p>	<p>Each State must document the procedure they will use for assessing whether DWSRF assistance will ensure compliance of systems in significant noncompliance. This documented procedure must be available for public review before being finalized. Once the procedure is finalized, it must be documented in the State’s DWSRF Operating Agreement.</p> <p>With each year’s capitalization grant application or as a separate or previous submittal, the State must provide summary statistics on the numbers, types, and sizes of systems in significant noncompliance to which the State provided DWSRF assistance in the preceding year. The State should also summarize any changes in the assessment procedure it plans to make.</p>
<p>Procedure for Assessing What Constitutes Feasible and Appropriate Restructuring Changes Necessary to Develop Adequate Technical, Managerial, and Financial Capacity.</p>	<p>Each State must document the procedure they will use for assessing what are feasible and appropriate restructuring changes that would be necessary to ensure that a system has the technical, managerial, and financial capacity to comply with SDWA requirements over the long term. This procedure must be available for public review before being finalized. Once the procedure is finalized, it must be documented in the State’s DWSRF Operating Agreement.</p> <p>With each year’s capitalization grant application or as a separate or previous submittal, the State must provide summary statistics on the numbers, types, and sizes of systems that have been required to undertake restructuring changes in order to be eligible for DWSRF assistance. The State should also summarize any changes in the assessment procedure it plans to make.</p>

ATTACHMENT 1

**Worksheet for Assessing State Programs for
Ensuring Demonstration of New System Capacity**

Suggestions for Regions

- Use this sheet to guide your review of proposed State programs for new system capacity.
- The questions contained within this worksheet focus on program functionality.
- The questions are designed to assist you in evaluating proposed State programs for purposes of making DWSRF withholding decisions.
- This is not a checklist. Using these questions, you should be able to identify major strengths and/or weaknesses of proposed State programs.

• In order to avoid a 20 percent Drinking Water State Revolving Fund (DWSRF) withholding, States must ensure that all new community water systems (CWSs) and all new nontransient, noncommunity water systems (NTNCWSs) commencing operation after October 1, 1999, demonstrate technical, managerial, and financial capacity.

Suggestions for States

- Use this sheet to help guide your description of your capacity development program for new systems.
- This sheet may help you in developing your capacity development program for new systems.
- The questions contained within this worksheet focus on program functionality and ensure that the requirements of the statute and guidance are met.
- This is not a checklist. Using these questions, you should be able to identify major strengths and/or weaknesses of your proposed program.

In order to avoid a 20 percent Drinking Water State Revolving Fund (DWSRF) withholding, States must ensure that all new community water systems (CWSs) and all new nontransient, noncommunity water systems (NTNCWSs) commencing operation after October 1, 1999, demonstrate technical, managerial, and financial capacity.

Plan for Implementation and Periodic Review

- . How will the State evaluate the implementation and on-going effectiveness of its new system capacity development program?

Overall Program Functionality

1. How does the State's proposed program ensure that new systems commencing operations after October 1, 1999 demonstrate technical, managerial, and financial capacity?

ATTACHMENT 2

**Worksheet for Assessing Proposed State Capacity Development
Strategies for Existing Public Water Systems**

Suggestions for Regions

- Use this sheet to guide your review of proposed State strategies for ensuring capacity in public water systems (PWSs).
 - The questions are designed to assist you in reviewing proposed State strategies for the purpose of making Drinking Water State Revolving Fund (DWSRF) withholding decisions.
 - This is not a checklist. However, using the following questions, you should be able to assess State compliance with the Capacity Development provisions of §1420(c) of the Safe Drinking Water Act (SDWA), as amended in 1996.
- In order to avoid a 10 percent DWSRF withholding in 2001, a 15 percent withholding in 2002, and a 20 percent withholding in subsequent fiscal years, States must develop and implement a strategy to assist PWSs in acquiring and maintaining technical, managerial, and financial capacity.

Suggestions for States

- Use this sheet to help guide your description of your capacity development strategy for existing public water systems (PWSs).
- This sheet may help you in developing your capacity development strategy for existing PWSs.
- The questions contained within this worksheet will help you to ensure that the requirements detailed in both §1420(c) of the Safe Drinking Water Act (SDWA) and the associated guidance are met.
- This is not a checklist. However, using the following questions, you should be able to identify the major strengths and/or weaknesses of your proposed capacity development strategy and make appropriate adjustments.

- In order to avoid a 10 percent DWSRF withholding in 2001, a 15 percent withholding in 2002, and a 20 percent withholding in subsequent fiscal years, States must develop and implement a strategy to assist PWSs in acquiring and maintaining technical, managerial, and financial capacity.

Program Elements

1. Describe how the State considered the appropriateness of each program element listed in §1420(c)(2)(A-E) in deciding whether or not to include the element in its capacity development strategy.

Strategy

1. Describe the basis on which the State believes that the program elements it has chosen, when taken as a whole, constitute a strategy to assist PWSs in acquiring and maintaining technical, managerial, and financial capacity.

Implementation

1. Describe the State's current implementation efforts for its capacity development strategy.
2. Describe the State's future plans for strategy implementation.

Future Considerations

1. Listing of systems with a history of significant noncompliance (§1420(b)(1)).
 - States must prepare, 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, to the extent practicable, provide reasons for the noncompliance of these systems. Under §1420(b)(3), failure to provide this report in will serve as a basis for withholding.

Note: A system is considered to have a history of significant noncompliance if it has violated one or more National Primary Drinking Water Regulations (NPDWRs) in any three quarters within the last three years.

2. Report to the EPA Administrator (§1420(b)(2)).
 - States must submit a report to the EPA Administrator by August 6, 2001, that details the success of enforcement mechanisms and initial capacity development efforts in helping those PWSs listed as having a history of significant noncompliance to improve their technical, managerial, and financial capacity. Under §1420(b)(3), failure to provide this report in FY 2001 will serve as a basis for withholding.
3. Report to the State Governor (§1420(c)(3)).
 - Not later than two years after a State develops a capacity development strategy, and every three years thereafter, each State's primacy agency must submit a report to the State's Governor and to the public that details the efficacy of the State's capacity development strategy and that outlines the progress made towards improving the technical, managerial, and financial capacity of PWSs in the State. Under §1420(c)(1), failure to provide this report in will serve as a basis for withholding.

Note: EPA encourages States to include the methodology they plan to use to assess the efficacy of their capacity development strategy as part of their strategy. The inclusion of assessment methodology is not mandatory and will not be a basis for withholding DWSRF funding in FY 2001.

ATTACHMENT 3

**Response to Comments Received on Proposed Guidance
Published in the Federal Register on February 5, 1998**

Response to Comments

Capacity Development Guidance

Introduction

Many commentors were concerned with whether an appropriate balance could be struck between providing State flexibility while ensuring national program accountability in implementation. They stressed the need for EPA to acknowledge State program diversity in capacity development, and that only limited or no oversight by EPA would be necessary.

The Agency recognizes, respects, and encourages diversity in state capacity development programs. The guidance is designed to foster and facilitate the development of capacity development programs that are diverse in approach and which address the unique needs and circumstances of different states. However, while the law clearly contemplates such flexibility, it also clearly establishes what states must do regarding capacity development if they wish to avoid a capacity development related withholding from their DWSRF. The guidance provides a simple, objective framework for EPA to use in assessing whether or not a state has done what the law requires in order to avoid a capacity development related DWSRF withholding.

EPA has no desire or intention to expand oversight of state capacity development programs beyond what is necessary for purposes of making DWSRF withholding decisions.

Many commentors suggested that EPA needed to more clearly define and describe the role of guidance vis-a-vis regulation.

The purpose of this guidance is to explain how EPA interprets the capacity development provisions of SDWA, as amended, and, specifically, what States must do to avoid mandatory withholding of DWSRF funding under those provisions. Unlike regulation, guidance does not generally establish binding requirements apart from the statute it addresses. However, in the context of a statute that mandates grant withholding under certain circumstances, guidance interpreting those provisions effectively establishes conditions for the receipt of those funds and thus can have a mandatory effect similar to a regulation. Thus, in the context of a guidance that interprets a statute that mandates withholding of funds under certain conditions, there may not be a significant difference in operational effect between a regulation and a guidance which outlines how the agency will implement the mandatory withholding.

Some commentors were concerned that EPA misrepresented the stakeholder process which contributed to this guidance. Another commentor claimed that States were inadequately represented.

The Agency believes that its description of the stakeholder process which was published, on February 5, 1998, as part of the preamble to the draft guidance is accurate and does not misrepresent that process. Of the 22 members of the NDWAC Small Systems Working Group, only 2 submitted minority opinions to the full NDWAC. These minority opinions expressed the belief that EPA lacked the statutory authority to issue guidance related to capacity development strategies. The full NDWAC considered these minority opinions but voted overwhelmingly to

support the Working Groups majority recommendations.

The Agency believes that states were adequately represented on the Working Group. Of the 22 members, 5 represented state drinking water programs (4 were senior officials from state drinking water programs and 1 represented the Association of State Drinking Water Program Administrators).

Many commentors requested clarification on definitions of technical, managerial, and financial capacity and what is meant by “foreseeable future” in the definition of capacity.

The final guidance provides more detailed definitions of technical, managerial, and financial capacity. The Working Group generally felt, and EPA believes, that in defining and considering water system capacity, a long-term view is essential. For example, the SDWA establishes requirements for promulgation of a number of significant regulations over the next several years and sets up a process to continually identify and evaluate additional contaminants for possible regulation. Thus it is reasonable to consider the ability of a system to address additional, new regulatory requirements beyond those already in place when considering that systems capacity. Such an assessment is useful even if the details of future regulatory requirements are not yet known. If a system appears to have little or no ability to address any future additional regulatory requirements, then it may be appropriate to begin assisting that system in developing additional capabilities.

New Systems Guidance

Many of the commentors indicated that the definition of “new system” is unclear or ambiguous.

The final guidance clarifies the definition of “new system”. New systems include both CWSs or NTNCWSs being newly constructed as well as systems which do not currently meet the definition of a PWS but expand their infrastructure and thereby grow to become CWSs or NTNCWSs. Systems not currently PWSs and which add additional users and thereby become CWSs or NTNCWSs without constructing any additional infrastructure are not “new systems” for purposes of section 1420(a) of the SDWA as amended.

The Agency has considered a number of alternative definitions for “new system”. A definition of “new system” which encompasses only newly constructed systems would overlook those systems which grow through physical expansion to become PWS’s. The Agency believes that there are a significant number of such systems and that they should be treated as equivalent to newly constructed systems. On the other hand, a definition of “new system” that encompassed any system which acquired enough users to qualify it as a PWS would be unreasonable since it would capture systems such as small businesses which become PWS’s simply by virtue of adding a few new employees, even though they make no physical modification whatsoever to their water system.

Many commentors expressed concern or sought clarification regarding the basis for holdback or withholding decisions starting in FY'99.

A “holdback” is an informal, potentially temporary withholding of 20% of a State’s DWSRF allotment. Unlike a formal “withholding”, a holdback does not entail a permanent loss of 20% of the DWSRF allotment, nor does it initiate reallocation of those funds under section 1452 of the Act. The purpose of the “holdback” is to allow States additional time, before formal withholding would apply, to assemble the statutory authority and implementing authorities needed to institute a fully functional program by October 1, 1999.

Based upon the comments received, the Agency is including a number of significant changes in the final guidance. First, for any given fiscal year the withholding will apply to that year’s allotment only. Unobligated funds from previous fiscal years will not be subject to withholding. Second, for FY’99, the agency will not holdback funds from a state having the statutory authority for new systems but is in the process of rulemaking or otherwise developing implementing authorities (so long as the process for developing these implementing authorities is on a realistic schedule and the state expects to have a fully functional program by 10-1-99). Third, the Agency is clarifying that in FY’00 and beyond, the withholding decision will be based on the state program status on October 1 of the fiscal year.

A few commentors questioned the authority of EPA to use “control points” for purposes of making withholding determinations.

The statute is clear that states must have a program which achieves a specific result as of a date certain. That result is requiring demonstration of technical, financial, and managerial capacity by all new community water systems and new nontransient noncommunity water systems commencing operation after October 1, 1999. By asking the state to describe its control points, EPA is merely asking how the state plans to meet the statutory requirement. If the state fails to meet the statutory requirement, EPA must withhold 20% of the state’s DWSRF allotment. EPA will not judge the relative merits or likely efficacy of a state’s chosen control points, so long as the control points can be rationally judged to potentially achieve the statutorily required endpoint.

Several commentors express concern relative to “turnaround time.” Will there be sufficient time to address issues which arise during EPA review in time to receive 100% of monies.

The Agency strongly encourages states to work closely with their EPA Regional office starting early in the development of their new systems program. States can receive 100% of their allotment in FY’99 if they have the legal authority and a realistic (based on past performance) schedule for rulemaking or otherwise developing implementing authorities such that they expect to have a fully functional program in place by October 1, 1999.

Commentors requested that EPA allow states to grandfather existing authorities versus requiring extensive regulatory, statutory, etc. revisions.

States can use any existing authorities that might be appropriate to build a program. The statute focuses on the outcome states must achieve; new systems commencing operation after October 1, 1999 must be required to demonstrate capacity. If existing authority can accomplish this end result then it can certainly be used.

A number of comments from states and regions were received with opinions on whether requiring a statement of some type from the state Attorney General regarding the states legal authority for new systems should be required.

The Agency has carefully considered this issue and has concluded that an Attorney General's statement will be required. Such a decision is consistent with long standing Agency policy and practice relative to requirements for states to demonstrate legal authorities. Because the Attorney General is responsible for the entire body of state law, he/she is in the best position to certify that the authority being claimed is in fact available to be exercised. Therefore, the guidance requires that the State Attorney General (or a delegated department attorney) must certify, in writing, that the state has the statutory authority to require demonstration of technical, managerial, and financial capacity of new systems commencing operation after October 1, 1999 and that the State's mechanism for implementing this authority is duly enforceable.

A couple of commentors ask the basis for EPA assessing ongoing implementation in future years.

The withholding determination related to the new systems program must be made each year. Once a state has demonstrated a functional program, future years assessment is necessary to ensure ongoing implementation of the program. In the fiscal years following a state's initial documentation of a fully functional program a state must document that it is requiring a demonstration of technical, managerial, and financial capacity by every new CWS and every new NTNCWS. This documentation of ongoing implementation of the new systems program may be included with a given year's capitalization grant application or it may be provided in an entirely separate submittal. Documentation could consist of summary statistics regarding the number of proposed new CWS's and NTNCWS's and the results of their required capacity demonstrations.

The concept of "future capacity" raised a number of concerns from commentators.

The law requires only that systems be required to demonstrate capacity with respect to regulations in effect or likely to be in effect on the date of commencement of operations. However, the Agency strongly encourages states to consider system capacity in the context of the foreseeable future. EPA believes, that in defining and considering water system capacity, a long-term view is essential. For example, the SDWA establishes requirements for promulgation of a number of significant regulations over the next several years and sets up a process to continually identify and evaluate additional contaminants for possible regulation. Thus it is reasonable to consider the ability of a new system to address additional, new regulatory

requirements beyond those already in place when considering that systems capacity. Such an assessment is useful even if the details of future regulatory requirements are not yet known. If a new system appears to have little or no ability to address any future additional regulatory requirements, then it may be appropriate to work with the developer of the system to ensure that the system will have the capacity it needs for the long term.

Some commentors expressed concern about proposed requirements for program evaluation.

The Agency has deleted the proposed requirements for program evaluation. However, the Agency continues to strongly encourage states to consider how they will assess and evaluate the success of their program in the years to come.

Capacity Development Strategy Guidance

Many commentors stated their belief that EPA does not have statutory authority to issue guidance related to capacity development strategies.

The basis for this guidance is the EPA Administrator's authority to issue guidance and regulations under section 1452(g)(3) as necessary to implement the provisions of section 1452 of the SDWA. This guidance is necessary to implement the DWSRF withholding provisions of section 1452(a)(1)(G)(i) of the SDWA, as amended. This guidance establishes national policy regarding implementation of the DWSRF withholding related to capacity development strategies under sections 1420(c) and 1452(a)(1)(G)(i) of the SDWA as amended. This guidance describes how EPA will assess whether States have met the capacity development strategy requirements of section 1420(c) and therefore whether the Agency is required to withhold a percentage of a State's DWSRF allotment.

Many commentors expressed concern regarding the proposed scope of EPA review of state strategies.

The Agency believes that it has proposed the narrowest and most limited review possible which is still consistent with the requirements of the statute. Section 1420 requires that States develop and implement a strategy to assist public water systems in acquiring and maintaining technical, managerial, and financial capacity. In preparing the strategy, the statute requires that states consider, solicit public comment on, and include as appropriate several listed elements in the Act. Section 1420(c) also contains ongoing reporting requirements related to capacity development with which States must comply. The Agency's proposed review of state capacity development strategies is narrowly focused on ensuring that these statutory requirements are met.

Several commentors suggested that the proposed requirement that States proactively solicit public comment and provide their response to all significant comments seemed overly prescriptive.

The Agency agrees that the terms “proactively” and “significant” may be subjective and therefore has deleted them. The requirement now reads “a state must certify that it solicited public comments...The state must describe relevant public comments...”.

Some commentors suggested that use of the term “rational basis” was unclear and overly subjective.

The Agency does not agree with the assertion that a “rational basis” test is subjective. The guidance merely states that the state must describe how the selected elements together can be rationally considered to constitute a strategy to assist PWSs in acquiring and maintaining technical, managerial, and financial capacity. Section 1420(c)(1) clearly establishes the requirement that a state develop and implement a strategy to assist PWSs in acquiring and maintaining capacity. The guidance simply asks states to describe a rational basis on which their proposed strategy meets the statutory requirement. The Agency does not propose to, in any way, review the relative merits or potential efficacy of a state strategy. The Agency needs only to have a rational basis on which to conclude that the state has in fact met the statutory requirement and therefore the Agency is not required to withhold a percentage of the states DWSRF allotment.

Some commentors suggested that EPA define federal factors which may encourage or impair capacity development, so as to save States the effort of having to do so.

The Agency believes that only individual states are capable of defining the federal factors they find to encourage or impair capacity development. ***Information for States on Implementing the Capacity Development Provisions of the 1996 SDWA Amendments*** provides some ideas on the types of issues at the federal, state, and local level that might be considered.

A number of commentors stressed that capacity development strategies should not be required to cover every public water system in the State, and that the State should have the flexibility to focus on which public water systems are most in need of assistance.

The statute simply requires that a state develop and implement a strategy to assist public water systems in acquiring and maintaining technical, managerial, and financial capacity. The statute further requires that in preparing the strategy, the state must consider, solicit public comment on, and include as appropriate the methods or criteria that the state will use to identify and prioritize the public water systems most in need of improving capacity. The Agency believes that state strategies should be capable of addressing all types of public water systems but that the state need not attempt to develop a strategy which addresses every individual system. Rather, the state should identify and prioritize those specific systems or classes of systems most in need of improving their technical, managerial, and financial capacity.

Some commentors stated that the strategy should only be required to solve existing compliance problems, and not prevent future compliance problems, while others suggested that States

should go beyond merely looking at systems with a history of significant noncompliance (SNC).

As noted earlier the statute simply requires states to develop and implement a strategy to assist PWSs in acquiring and maintaining capacity. There is no statutory requirement regarding which systems a strategy must address. States are free to focus their attention and resources where they believe it will yield the greatest return. However, the Agency strongly believes that the capacity development strategy offers states a very powerful tool to help prevent noncompliance. Prevention of noncompliance is a major theme of the 1996 SDWA amendments and is reflected in numerous provisions of the law. Public health protection is much better served by preventing noncompliance than by waiting for it to occur and then trying to correct it.

Some commentors inquired as to what action a State should take against a system which lacks some element of capacity.

The Agency believes strongly that capacity development programs should seek to build and enhance the underlying institutional capabilities of systems. Systems which appear to have limited capacity should receive a high priority for technical and other assistance to help them assess how best to acquire and maintain the capacity they need. The Agency notes that the statute speaks of “acquiring and maintaining” capacity. Clearly Congress understood that adequate system capacity is a dynamic concept and that capacity is not a simple matter of “having it” or “not having it”.

A number of commentors expressed concern regarding the proposed requirements for documentation of the strategy and documentation of ongoing strategy implementation.

The Agency has simplified and streamlined the strategy documentation and reporting requirements. Documentation regarding the strategy itself may be provided as a stand-alone submittal or as part of the states capitalization grant application. Similarly, documentation regarding ongoing strategy implementation may be provided as a stand-alone submittal or as part of the states capitalization grant application.

Some commentors expressed concern over the contents and role of EPA review of the report to the governor and the reports to the Administrator required under section 1420.

For purposes of DWSRF withholding determinations, EPA’s review of these reports will only extend to whether or not the reports have been prepared and submitted as required by the statute. Failure to produce any of the reports will constitute a basis for withholding since these reports, required under sections 1420(b)(3) and (c)(3), are considered part of the capacity development strategy.

However, EPA will not base withholding determinations on any type of judgements or inferences drawn from the reports regarding the relative merits or efficacy of a State capacity development strategy. Further, the statute in section 1420(c)(4) explicitly prohibits EPA from reviewing decisions of the State regarding any particular PWS, as part of a capacity development strategy. Such State decisions regarding individual PWSs may not serve as basis

for withholding funds.

There are three major reports required. Every 3 years, the State must submit to EPA a list of CWSs and NTNCWSs that have a history of significant noncompliance and, to the extent practicable, the reasons for their noncompliance. States submitted their first list in August, 1997. The next list will be due August 6, 2000. The Agency has interpreted the statutory requirement in section 1420(b)(1) of “periodically update” to mean every 3 years. This interpretation is based upon consultation with the states and the Agency considers it reasonable given the requirement for a state report to the governor every 3 years in Section 1420(c)(3).

By August 6, 2001 the State must report to EPA on the success of its enforcement mechanisms and initial capacity development efforts in helping CWSs and NTNCWSs having a history of significant noncompliance improve their capacity.

Not later than 2 years after a State adopts a capacity development strategy, and every 3 years thereafter, the primacy agency must submit a report to the Governor on the efficacy of the strategy and progress made toward improving the technical, managerial, and financial capacity of PWSs in the State. The report shall also be made available to the public.

A number of commentors questioned the definition of “history of significant noncompliance”.

A “history of significant noncompliance” means being in significant noncompliance (for any single contaminant or for different contaminants) during any three quarters of the previous 3 years. This definition was developed in consultation with the states at the Winter Meeting of the Association of State Drinking Water Administrators in February, 1997. It was the definition utilized for purposes of developing the first required state list which was due to EPA on August 6, 1997. The Agency believes the definition has proven effective and useful and we expect to retain it.

Assessment for SRF

A number of commentors expressed concern relating to the documentation and reporting requirements associated with the limitations on DWSRF assistance imposed by Section 1452(a)(3)(A).

Section 1452(a)(3)(A) imposes two significant limitations on DWSRF assistance to PWSs. First no assistance may be provided to a PWS that does not have the technical, managerial, and financial capacity to ensure compliance with the requirements of the SDWA. Second, no assistance may be provided to a PWS that is in significant noncompliance with any requirement of a NPDWR. Section 1452(a)(3)(B) allows systems lacking capacity to receive DWSRF assistance if the system agrees to undertake feasible and appropriate restructuring (such as changes in rates or management, consolidation, alternative supply, etc.) if the State determines

that such restructuring is necessary to ensure that the system has the capacity to comply with SDWA requirements over the long term. Section 1452(a)(3)(B) also allows a system in significant noncompliance to receive assistance if the use of the assistance will ensure compliance.

In order to ensure that this provision is implemented, the Agency believes it is necessary to require states to document the procedures they will use to make the necessary judgements about systems. The Agency also believes that to ensure ongoing implementation of these provisions states should be required to report each year on the numbers of systems to which these procedures were applied and the outcomes of the assessments.

A number of commentors expressed concern about whether SNC-listed PWSs could be funded for projects unrelated to the cause of SNC as long as an enforceable agreement was in place to address SNC issue.

The Agency believes that sufficient flexibility exists in the statute and guidance to allow states to make special case-by-case determinations.