CATANIA & PARKER, L.L.P.
ATTORNEYS - AT – LAW

P.O. BOX 2029 ■ MEDIA, PA 19063
PHONE: (610) 565-8101 ■ FAX: (610) 565-7613

STREET ADDRESS:
230 N. Monroe St., 2nd Fl
Media, PA 19063

October 19, 2018

VIA ELECTRONIC FILING

Ms. Rosemary Chiavetta
Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, Pennsylvania 17105-3265

RE: Comment to Tentative Supplemental Implementation Order
Implementation of Section 1329 of the Public Utility Code
Docket M-2016-2543193

Dear Ms. Chiavetta:

Enclosed please find Chester Water Authority's Comment to the Tentative Supplementation Order, Implementation of Section 1329 of the Public Utility Code, Docket M-2016-2543193, which has been electronically filed.

Very truly yours,

FRANCIS J. CATANIA
230 North Monroe Street, 2nd Fl
PO Box 2029
Media, PA 19063
Solicitor for Chester Water Authority
fjc@fjccp.com

Chester Water Authority
P.O. Box 467
Chester, Pennsylvania 19016-0467
Tel: (610) 876-8185

October 19, 2018

Ms. Rosemary Chiavetta
Secretary
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, Pennsylvania 17105-3265

RE: Comment to Tentative Supplemental Implementation Order
Implementation of Section 1329 of the Public Utility Code
Docket M-2016-2543193

Dear Secretary Chiavetta:

Thank you for the opportunity to offer comments on the Commission's September 20, 2018 Order in the above captioned matter. Chester Water Authority ("Authority") is a healthy Pennsylvania Municipal Utilities Authority that provides life-sustaining water to 200,000 residents and businesses in southern Chester County, western Delaware County, and the City of Chester ("City"). The Authority exists to provide access to clean and affordable water to present and future ratepayers throughout Southeastern Pennsylvania, as confirmed by the 2012 amendments to the Municipal Authorities Act and the Pennsylvania Supreme Court's decision in *Pennsylvania Environmental Defense Foundation v. Commonwealth*, 161 A.3d 911 (Pa. 2017). Our Authority Board received an unsolicited offer to acquire our system from an investor owned utility and the Board rejected that offer. As a result of this experience, we have a direct understanding of the economic incentives created by Act 12, and we are very concerned about the potential consequences to customers of municipal systems that may be sold through Act 12 proceedings. In

addition, we believe that Act 12 unduly limited the Commission's ability to fully evaluate proposed Act 12 acquisitions by limiting your time to review and act on these Petitions to a mere six months. While we understand that the Commission cannot unilaterally alter the limit on the time allowed for a thorough review, we agree that Act 12 Petitions should be structured in a way that provides the Commission Staff and the Commissioners with a complete picture of the proposal.

The issues associated with the change in control of a public utility are large and should not be decided without full and adequate consideration. Indeed, both the Commonwealth and the Authority are fellow fiduciaries under Article I, Section 27 of the Pennsylvania Constitution for all constitutionally protected resources, such as water. As fiduciaries, the Authority and the Commonwealth are entrusted with conserving and maintaining constitutionally protected resources for the benefit of the people, including generations yet to come. *See Pennsylvania Environmental Defense Foundation*, 161 A.3d at 916 (citing Pa. Const. art. I, § 27).

We appreciate the changes the Commission has proposed to its Final Implementation Order issued on October 27, 2016 and to the related Checklist. We believe that the updates to the procedures offered in the Supplemental Implementation Order are sound, and we fully support your efforts to be certain that an adequate analysis of any Act 12 proposal is done before a decision is rendered by the Commission. A central facet of the Supplemental Implementation Order is the clarification of the requirements for a complete Section 1329 submission. To that end, we have several recommendations regarding the information required in the Checklist (Appendix A to the Order), the Standard Data Requests (Appendix B) and the Valuation Guidelines (Appendix C). We also applaud the Commission for issuing a template for pre-filed written testimonies to be offered by the Utility Valuation Experts ("UVE") (Appendix D).

The Commission should request information used by the UVE's to determine the asset inventory of the system under consideration. This should describe in detail the source information used to identify the property, physical assets and age of the utility systems being sold. The UVE's should also indicate whether or not the source documentation was supplemented by additional field investigations of any kind including any effort to verify that assets recorded in the seller's utility plant records remain used and useful. We note that Section 1327(a)(1) of the Public Utility Code requires a certification that the plant acquired is used and useful, but this requirement is not specifically reiterated in Section 1329. The differences the Commission has seen in system valuations possibly could be traced back to differences in the inventory valued by the UVE's. In addition, the Commission should request information regarding any assets that may represent contributed plant and a discussion by the UVE as to how the value of this plant was addressed in the valuation.

With respect to the UVE Guidelines, the Cost Approach should identify the original cost of land when first dedicated to utility service. Because the value of land is not depreciable, the current value of land should not be included in the valuation of the acquired system, nor, as the Commission notes, should the value of land be factored by the ENR index or any other index. The UVE should also explain what depreciation rates were used to estimate accrued depreciation and if those rates differ from the Commission authorized rates for the Buyer, an explanation should be provided.

We recommend that the Commission include in the Standard Data Requests a requirement for the Buyer and Seller to provide a bill comparison for a typical residential customer at the rates of the Seller at the time of the acquisition and at the approved standard tariff pricing rates of the Buyer including all applicable surcharges, like the Distribution System Improvement Charge, at

the time of the acquisition. We understand that it is common practice for buyers in these cases to offer the sellers some form of rate covenant that defers rate increases to some date in the future. These covenants often deflect the public's attention from the differences in rates for service and the ultimate impact that will be felt in the customer's pocketbook when rates are eventually equalized. Indeed, in *Tanya J. McCloskey, Acting Consumer Advocate v. Pennsylvania Public Utility Commission*, No. 1624 C.D. 2017 (Pa. Cmwlth. Oct. 11, 2018), the Commonwealth Court recently found that the Commission must address the impact on rates when deciding whether there is a substantial public benefit to a public utility's acquisition of a water system. There, the Commission determined that it did not have to consider the impact that an acquisition would have on rates because, at the time of the Section 1329 proceeding, the public utility had not yet proposed changes in its rates. The Commonwealth Court reversed on appeal, holding that by approving the sale and deferring consideration of the impact on rates to a later rate base proceeding, the Commission would be unable to weigh all of the factors for and against the transaction, as required by Section 1102.

The Commission should require the Buyer to provide a pro forma income statement for the acquired system as a stand-alone entity at the rates of the Seller at the time of the acquisition and reflecting the anticipated expenses of the Buyer, including the full cost of capital associated with the purchase price. Various items of the Standard Data Requests address components of a typical income statement, and we think it is reasonable for the Commission to receive a presentation from the Buyer that indicates what the true financial implications of the transaction will be to the Buyer without rate relief.

To the extent that the stand-alone pro forma income statement shows a loss, the Commission should require the Buyer to provide a narrative discussion concerning the impact of

the pro forma loss on existing customers of the Buyer's system and the rates that those customers are likely to pay until rates of the acquired system are increased to the point where present rate revenues are sufficient to recover the full cost of providing service without subsidies from the Buyer's existing customers.

For both water and wastewater systems located within the Delaware River Basin, the Commission should require the Buyer and Seller to provide copies of the current Dockets authorizing water diversions or wastewater discharges as appropriate.

To the extent that the Seller's system is operating under a Consent Order from either the PA Department of Environmental Protection or the US Environmental Protection Agency, the Commission should require the Buyer and Seller to provide copies of the Orders and explain the status of compliance with those Orders. In most cases, such Orders would create obligations for the Buyer that would lead to additional investments in the acquired system above and beyond the purchase price.

Similarly, with respect to wastewater systems, the Buyer and Seller should inform the Commission if the Department of Environmental Protection has issued any determinations of overload of conveyance or treatment capacity under Chapter 94 and if there have been such determinations, the Buyer and Seller should inform the Commission of those actions that will be necessary to resolve the overload condition.

While we have specific concerns about the financial implications of proposed Section 1329 acquisitions, we also believe it is important for the Commission to have on record an understanding of the steps taken by the Seller leading to the negotiation of the Agreement of Sale. To that end, the Seller should describe the process the Seller used to identify and select the Buyer. If the Seller

did not utilize a competitive bidding process or other similar means of identifying the Buyer, the Seller should explain why the award was made using a non-competitive process.

Copies of corporate resolutions of the stockholders or resolutions of the public bodies of each of the entities authorizing the transaction should also be provided to the Commission in the Section 1329 submission. In addition, to the extent that the sale of the system was approved in a general referendum of registered voters of the selling jurisdiction, provide a tally of the vote for and against the sale of the system. With respect to this last item, we are concerned that ratepayers of the system being sold may not have a voice in the process. This is particularly true in systems like ours that serve multiple municipal jurisdictions. Outside of Pennsylvania, it is not uncommon to see legislative requirements for a public referendum on the sale of public utilities. In New Jersey, for example, a municipality selling a water system serving more than 5% of the population of the municipality must have a referendum on the sale in a general election and the voters must approve the sale before it can move forward.[1]

In its analysis of any proposed Section 1329 transaction, the Commission should have available a comparison of the Fair Market Value established by the UVE's to the Purchase Price and the Original Cost Less Depreciation Value ("OCLD") of the acquired system. As the Commission notes in its Supplemental Order, Act 12 was intended to provide a favorable economic climate for municipal water and sewer system owners to sell systems to investor-owned concerns and for the buyers to have reasonable assurance that the purchase price would be recognized in rates.[2] The adopted procedure departed from traditional rate setting procedures and the valuation procedures that amount to settled law in the *Hope* and *Bluefield* cases.[3] The comparison we

[1] New Jersey Statutes Annotated; 40:62-3.1 and 40:62-5.
[2] Supplemental Order at Page 4.
[3] *Bluefield Water Works Co. v. Publ. Serv. Comm'n.*, 262 U.S. 679 (1923); *Federal Power Comm'n. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944)

recommend here would allow the Commission to see directly how far the Section 1329 Petition deviates from *Hope* and *Bluefield*. While Act 12 apparently created an exception to *Hope* and *Bluefield* for these specific cases, the ultimate rate implications of the Section 1329 valuation methods and the implications for present and future ratepayers cannot be ignored.

To the extent that the purchase price exceeds the OCLD value of the acquired system, the Buyer should provide a statement showing net positive benefits to the pre-acquisition customers of the Buyer and how those benefits fully or partially offset the additional costs to be paid by customers as a result of the acquisition. Examples of net positive benefits could include excess capacity purchased at a discount over the construction cost new value of similar capacity assuming that such capacity can be used by existing ratepayers. Conversely, if the acquisition results in shared costs of existing facilities in a way that allows the cost of service to existing ratepayers be reduced, the anticipated benefit should be described along with a discussion of the potential integration costs that are likely to be incurred to realize the benefit. Avoided cost arguments should not be accepted unless the Buyer can demonstrate that any potential avoided capital expense will result in a guaranteed decrease in the total planned capital investment costs of the acquiring entity. Simply allowing dollars saved on one project made redundant by an acquisition to be converted into dollars spent on another not previously planned project will wipe out any possible benefit that could have been realized by existing customers as a result of the acquisition.

At Page 5 and Page 6 in the Supplemental Implementation Order, the Commission links the value of municipal and authority systems to the genesis of the municipalities these systems serve. Here, the Commission is making a faulty assumption. This discussion presumes that a municipal authority or a municipality created the entire water system at once at the inception of the municipal entity and then made no further investment thereafter. This is a simplistic view that

is often far from correct, and it ignores the fact that many well run municipal and authority systems continuously and regularly invest in the renewal and replacement of equipment. New wells may be drilled, new storage tanks built, pipelines replaced or extended, meters replaced, services are renewed, and so on. All such investments, even if these are made at rates less than what could be considered necessary to sustain the system, add to the current value of the municipal assets at OCLD. A system that is like the one described by the Commission here probably is of little surviving value and will present a problem for the Buyer that the Buyer must be willing to solve by making accelerated investments in replacements and renewals. Why then should it be the policy of this Commonwealth to set a fictitious value above OCLD when a Buyer is motivated to invest quickly in replacements? This only causes the ratepayers of the system (both those in the Seller's system and in the Buyer's system) to effectively pay for the system at an inflated price and for its replacement. The amount paid by a Buyer over OCLD is essentially a penalty for ratepayers who have had no say in the transaction. At a minimum, if a premium value over OCLD is actually allowed to be included in rate base of the Buyer, the premium should be allocated to specific plant assets so that when these facilities are retired, the inflated value is removed from rate base and not left to earn a rate of return as a good will value of the system.

The Commission should require the Buyer to provide a calculation of the average rate base value per existing customer of the Buyer's system and compare this to the average value per customer represented by the purchase price and the customer base of the Seller system. Here, we believe that the Commission and interested parties in a Section 1329 proceeding should be able to see the likely impact that the proposed transaction will have on rates. The Commonwealth Court recently affirmed the importance of this transparency in its recent decision in *McCloskey*, No. 1624 C.D. 2017 (Pa. Cmwlth. Oct. 11, 2018), holding that because rate increases involve substantial

property rights, ratepayers are entitled to individualized notice of a proposed sale and an opportunity to participate in a Section 1329 proceeding. Acquisitions made at a premium over the current imbedded investment cost of the Buyer will only serve to put upward pressure on rates as the Buyer seeks to recover a return on and return of the purchase price. If that price cannot be supported by present rate revenues, rates will inevitably go up.

Copies of recent balance sheets of the acquiring public utility or entity and a pro forma balance sheet of the continuing company reflecting the acquisition should also be provided to the Commission in the filing. While small system acquisitions and mergers are unlikely to be material, larger acquisitions may have an impact on the acquiring entity.

Overall, these requirements would help to ensure transparency and inform whether a sale will truly be in the interests of ratepayers and the public generally, ***including generations yet to come***. *See PEDF*, 161 A.3d at 916 (citing Pa. Const. art. I, § 27). Similarly, they would help ensure that appropriate consideration is being paid for permanent loss of public control over critical water assets, and encourage serious consideration of alternatives to an outright Act 12 sale that may provide similar long-term benefits without a permanent loss of public control.

Thank you again for giving us the opportunity to comment on the Supplemental Implementation Order.

Very truly yours,

Francis J. Catania, Esq.
Catania & Parker, LLP
203 North Monroe Street, 2nd Floor
PO Box 2029
Media, PA 19063
610-565-8101
fjc@fjccp.com
Solicitor for Chester Water Authority