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Via Email Only

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

Re: Valuation of Acquired Municipal Water & Wastewater Systems –
Act 12 of 2016 Implementation
Docket No. M-2016-2543193

Dear Secretary Chiavetta:

Please find my Reply Comments in the above-referenced proceeding, which are attached for electronic filing.

Respectfully submitted,

/s/ James H. Cawley
PA Attorney I.D. # 6896

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Valuation of Acquired Municipal Water & Wastewater Systems – Act 12 of 2016 Implementation	: : :	Docket No. M-2016-2543193

REPLY COMMENTS OF JAMES H. CAWLEY

These comments are in reply to the initial comments filed in response to the Commission's Tentative Supplemental Implementation Order entered on February 7, 2024 ("TSIO"), regarding proposed revisions to its current procedures when the selling municipal and buying public utility apply to proceed under Section 1329[1] in combination with the utility's Section 1102 application for approval of the acquisition.

I. THE ESSENTIAL PROBLEM IS EXCESSIVE PURCHASE PRICES FOR MUNICIPAL WATER AND SEWER SYSTEMS AND THE RESULTING UNJUST AND UNREASONABLE RATE INCREASES—NOT THE NEED TO ENSURE RISK-FREE INVESTMENTS BY UTILITIES, MARKET-BASED SALE RECEIPTS FOR MUNICIPALITIES, OR CONSOLIDATION OF MUNICIPAL SYSTEMS BY INVESTOR-OWNED PUBLIC UTILITIES.

Readers of the comments of Pennsylvania-American Water Company ("PAWC") and Aqua Pennsylvania, Inc. ("Aqua") would conclude that the TSIO was all about them. It is not about them nor the need to ensure that their acquisition investments are free of risk, or to ensure that municipalities receive top *market* dollars for their assets (which is incompatible with just and reasonable public utility ratemaking), or to ensure that financially healthy and well-managed

[1] Pennsylvania Public Utility Code Section 1329, 66 Pa.C.S. § 1329, Act of April 14, 2016, P.L. 76, No. 12 (hereinafter "Section 1329" or "Act 12").

municipal water and sewer systems are "consolidated and regionalized" into investor-owned public assets.

On the other hand, Section 1329 is all about them because it was fashioned, promoted, and defended by PAWC and Aqua to benefit themselves primarily and only incidentally the municipalities whose systems they acquire.

The TSIO is an attempt to make lemonade out of the lemon that is Section 1329.

Thus, Aqua's comments are replete with quibbles about the Section 1329 Application Filing Checklist, the licensed engineer's and the UVEs' methods and fees, clarifications and suggestions for submitting the Section 1329 application, acquisitions by non-public utility entities, and the like. They do not mention the high rates that Section 1329 has caused.

PAWC's comments rely heavily on the Commission's implementation orders and on "Section 1329 Success Stories" (citing two examples of their dozen Section 1329/1102 applications approved by the Commission). The comments then worry that the proposed "reasonableness review ratio" ("RRR") will become a binding norm rather than a mere guideline and suggest twenty-one other "factors" that should be considered (only one euphemistically recognizes the effect of higher *rates* on its customers, without using that "r" word: the "*Impact of the Transaction* on all relevant stakeholders (including the selling municipality, all customers of the buyer and the seller….) (emphasis added).

Each of these comments makes other suggestions, but the elephant in the room is ignored. The primary problem is the ultimate effect on rates of excessive purchase prices unchecked by the Commission's usual practice of approving a *reasonable* "positive acquisition adjustment"—i.e., an increase in the utility's rate base to recover an overpayment by the utility for an approved

acquisition of water or sewer facilities—where the depreciated original cost of the acquired facilities is less than the purchase price of the facilities.[2]

Of course, such acquisition adjustments occur (as in the decision just cited) in acquisitions under Section 1327, not Section 1329. Therein lies the problem. Section 1329 was specifically designed to avoid the inconvenient need for an acquiring utility to convince the Commission that the full difference between the depreciated original cost of the public or private system and the purchase price should be allowed as a positive acquisition adjustment (a very difficult task, indeed, in the case of a healthy system which does not need to be rescued and the utility needs no incentive to acquire it). Section 1329 avoids that troublesome process by excluding the Commission altogether by requiring it to adopt the lesser of the fair market value and the purchase price.

In truth, the Commission's Section 1329 implementation orders, quoted extensively by PAWC on pages 2-6 of its comments, are post hoc rationalizations for the supposed beauty and wonderment of Section 1329 with no basis whatsoever in the statute's text or legislative history. The misleading co-sponsorship memorandum of the prime sponsor of House Bill 1326 is the only legislative support for the Commission's inexplicable rapture for Act 12 of 2016.

These rationalizations may apply to troubled systems but certainly not to healthy ones because allowing a premium over a healthy system's book value in the purchase price requires the acquired customers to pay a second time for their system, including the value of the contributed property, often with no improvement in service or quality.

[2] The concept and process is explained well in *Pa. Pub. Util. Comm'n v. Twin Lakes Utilities, Inc*., Docket No. R-2019-3010958, (Order entered March 26, 2020), *available at* https://www.puc.pa.gov/pcdocs/1659246.docx.

Financially healthy and well-managed municipal corporations and authorities may have good reasons for selling their systems, but it is unreasonable to expect the acquiring public utility's customers to pay an excessive price for their assets, especially when they often include considerable contributed property and the sale proceeds can be used for any purpose. For instance, in Aqua's acquisition of the system assets of East Whiteland Township, the Township manager testified that the sale proceeds would be used to reduce debt, develop a township campus, construct a new police station, implement road projects, and renovate its current township building. These are all doubtless worthy and necessary uses, but why should Aqua's customers in other municipalities, who have similar or more compelling needs, be forced to underwrite East Whiteland Township's needs?

The legislature and the Commission have accepted "socialization" of such costs when all the other utility customers help underwrite *utility plant* needed in a community when the addition is otherwise too costly for the customers in that community to bear alone (thus, single tariff pricing or STP was approved) or when the socialized costs are used to hasten utility distribution projects throughout the Commonwealth (thus, approval of the Distribution System Improvement Charge or DSIC). Most pertinently, socialization of costs is proper when a non-viable or distressed system needs rescuing and therefore a positive acquisition adjustment is granted to incentivize a public utility to acquire the system (see Section 1327(a)).

The key requirement is mutual benefit or the prospect of receiving mutual aid if needed *for an improvement in utility service*. A financially healthy and well-managed municipal water or sewer system does not meet that requirement yet Section 1329 confers the benefit anyway.

Nor is the Commission's enthusiasm and support for consolidation and regionalization in Pennsylvania's water and sewer industries any basis for the ratepayer scourge that is Section 1329.

That policy was adopted and implemented during my first tenure on the Commission from 1979-1985 and continued in my second tenure from 2005-2015 as a means to cure the problem of financially and managerially troubled water and sewer systems, NOT as a means to cure a non-existent problem of financially and managerially healthy municipal water and sewer systems. There is absolutely *nothing* in the legislative history of Act 12 to support the notion that municipal corporations or authorities need to be consolidated and regionalized, let alone healthy ones. The law was intended and has been used to acquire only healthy systems.

To be fair, the Commission has not meekly borne the exclusionary insult visited upon it by PAWC's and Aqua's promotion of Act 12, starting with its decision in *New Garden*,[3] which reconciled Sections 1329(c)(2) and 1329(g) with Sections 505 and 1103(b). The Commission has determined that Section 1329 contains no prohibitions on the ability of parties or the Commission to review UVE appraisals as to their reasonableness and to propose or adopt adjustments to them.[4] It has also determined that "the statutory appraisal process is not simply a formulaic mathematical exercise, nor is the Commission acting as some type of USPAP-compliance board" and ruled that "it would be inconsistent with the requirements of the Code and prior Commission orders to permit Aqua to simply present a rate base number, show that the appraisers chose numbers to fill in all the blanks in the formulas and based solely upon the judgments of the UVEs, and to not permit any review or challenges of those inputs, methods or judgments."[5]

[3] See my initial Comments at pages 19-21.

[4] *Application of Aqua Pennsylvania Wastewater, Inc., Pursuant to Section 1102 and 1329 of the Public Utility Code for Approval of its Acquisition of the Wastewater System Assets of Limerick Township*, Docket No. A-2017-2605434 (Order entered November 29, 2017) at 35-36.

[5] *Application of Aqua Pennsylvania Wastewater, Inc. Pursuant to Sections 1102, 1329 and 507 of the Public Utility Code for Approval of its Acquisition of the Wastewater System Assets of Cheltenham*

But these welcome assertions of authority address only the determination of the Fair Market Value, which experience has demonstrated serves only as a useful ceiling high enough to validate the always lower purchase price that, as the lesser of the two, becomes the ratemaking rate base without challenge.

Because the Commission is stuck with the formula devised by Aqua and PAWC, its only recourse (other than mitigating the purchase price by attaching public interest conditions to the RMRB under Section 1329(d)(3)(ii))[6] is to offset its exclusion from that process by recognizing the similarity between the positive acquisition adjustment process in Section 1327 and the review process in Sections 1102 and 1103 (relating respectively to the enumeration of acts requiring certificate and procedure to obtain certificates of public convenience). In both instances, the essential issue is identifying the benefits customers would receive from the purchase at a higher value.[7] In the Section 1327 proceeding, the acquisition adjustment is tempered by reasonableness; in the Section 1102 proceeding, including the RMRB from the Section 1329 process may cause higher rates that outweigh any purported benefits, which would justify the denial of the acquisition application.

Township and Contracts between Aqua Pennsylvania Wastewater, Inc. and Cheltenham Township, Docket No. A-2019-3008491 (Order entered November 5, 2019) at 40.

[6] Section 1329(d)(3)(ii) provides: "If the Commission issues an order approving the [Section 1329] application for acquisition, the order shall include: … additional conditions of approval as may be required by the Commission." It appears that the words "application for acquisition" refer to the Section 1329 application that is considered simultaneously with the Sections 1102/1103 proceeding because the immediately preceding Section 1329(d)(3)(i) requires the Commission's order to include "the ratemaking rate base of the selling utility, as determined under subsection (c)(2)." Section 1103(a) already authorizes the Commission to impose conditions on any approval: "The commission, in granting such certificate, may impose such conditions as it may deem to be just and reasonable. … Any holder of a certificate of public convenience, exercising the authority conferred by such certificate, shall be deemed to have waived any and all objections to the terms and conditions of such certificate."

[7] *See* James H. Cawley & Norman J. Kennard, A GUIDE TO UTILITY RATEMAKING 117 (Pa. PUC 2018), *available at* http://www.puc.pa.gov/General/publications_reports/pdf/Ratemaking_Guide2018.pdf .

Nothing will curb excessive purchase prices more than the prospect of having the acquisition denied or severely conditioned because the negotiated price in the Asset Purchase Agreement is determined to be so high as to impact rates excessively.

In short, the inanity of usurping the Commission's ratemaking authority by interjecting an unchallengeable Section 1308 ratemaking issue into a Section 1102/1103 acquisition proceeding is foiled by the Commission's broad discretion to determine whether the public interest is served by allowing the acquisition in the first place.

II. CONCLUSION

It is imperative that Act 12 be repealed. That is the only solution to such a one-sided[8] law completely at odds with fair and just utility ratemaking. The Commission's efforts to mitigate Act 12's unfair and unjust effects are laudable and welcome, but they are only band-aids on a festering wound. These comments and several others urging reforms are meant only as palliatives until the disease is eradicated.

The comments are replete with reasons why the notice, information disclosure, and review periods need strengthening.[9]

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[8] Act 12 is one-sided in favor of the public utility because it provides for RMRB inclusion in the acquiring utility's rate base (Section 1329(c)(1)); Allowance for Funds Used During Constructions (AFUDC) (Section 1329(f)(1)) as defined in Section 1329(g); Distribution System Improvement Charge (DSIC) for additions until the next rate case; depreciation expense deferral for later recovery if the maximum DSIC has been reached (Section 1329(f)(2); reimbursement of closing costs, including engineer and appraisal fees (Sections 1329(a)(4), (b)(3), and (d)(1)(iv). The acquired customers and the utility's other customers get to pay these costs.

[9] *See*, *e.g.*, Comments of OCA, pages 2-9; Comments of Yordan, Frissora, and Swift, pages 5-10; Comments of Ferguson at 2-3; Comments of 22 Organizations; Comments of Mrozinski, pages 1-2; Comments of several residents of New Garden Township, pages 1-2; Comments of Rep. John Lawrence in their entirety; Comments of Sauer, pages 1-2; Comments of Ruth and William Carl; Comments of the Pennsylvania State Association of Township Supervisors, page 1; Comments of the Pa. Municipal Authorities Association, pages 2-3; Comments of the Bucks County Association of Township Officials,

The comments also contain disturbing descriptions of public utility tactics to obtain signed Asset Purchase Agreements before the municipality's customers learn the details (rarely with adequate information and rarely in time to adequately review or object).[10] The TSIO is a good start (but only a start) to curbing these utility abuses perpetrated to gain market share.

Respectfully submitted,

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pages 2-3; Comments of 415 Pennsylvania residents; and the Comments of Chester Water Authority, pages 2-4.

[10] See especially the Comments of Yordan, Frissora, and Swift, pages 5-10, describing what occurred in Willistown Township.