

**PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265**

Public Meeting held February 1, 2024

Commissioners Present:

Stephen M. DeFrank, Chairman
Kimberly Barrow, Vice Chair, Verbal Statement
Ralph V. Yanora
Kathryn L. Zerfuss, Statement
John F. Coleman, Jr.

Valuation of Acquired Municipal Water
& Wastewater Systems – Act 12 of 2016
Implementation

M-2016-2543193

**TENTATIVE SUPPLEMENTAL
IMPLEMENTATION ORDER**

BY THE COMMISSION:

Consistent with the Motion of Chairman Stephen M. DeFrank adopted on February 1, 2024, the Pennsylvania Public Utility Commission (Commission) enters this Tentative Supplemental Implementation Order regarding four revisions to the Commission’s existing procedures for applications filed under Section 1329 of the Pennsylvania Public Utility Code, 66 Pa.C.S. § 1329. We seek comments within 30 days of publication in the *Pennsylvania Bulletin* and reply comments within 45 days of publication in the *Pennsylvania Bulletin*. We direct the Law Bureau, with the assistance of the Bureau of Technical Utility Services, to review the comments, and all the information provided therein, and to present a Final Supplemental Implementation Order to the Commission for consideration.

DISCUSSION

On April 14, 2016, Governor Tom Wolf signed Act 12 of 2016 (Act 12) amending Chapter 13 of the Pennsylvania Public Utility Code by incorporating a new section: 66 Pa.C.S. § 1329. Section 1329 established a procedure for an acquiring public utility or entity (acquiring utility) and a municipal corporation or authority (selling utility) to use fair market valuation, instead of depreciated original cost, when the acquiring utility purchases a water and wastewater system located in the Commonwealth. Following passage of Act 12, the Commission issued a series of Implementation Orders to assist our administration of Section 1329.¹ To date, the Commission has received 27 applications under Section 1329.

Recently, Act 12 has elicited significant interest from the public and policy makers alike. Numerous pieces of legislation have been introduced in the General Assembly proposing to amend Section 1329.² Further, hearings have been recently held by the House Consumer Protection, Technology and Utilities Committee along with the Senate Democratic Policy Committee to discuss this topic.³ The Commission submitted official testimony and participated in both.

Given the Commission's experience gained since issuance of our last Supplemental Implementation Order in 2019, we find it appropriate to amend our procedures and guidelines to better inform the interested public of Section 1329 applications, to standardize the weights utilized by the utility valuation experts, and to provide the Commission with measures to interpret the reasonableness of acquisition prices. Specifically, we enter this Tentative Supplemental Implementation Order that

¹ Final Implementation Orders entered on October 27, 2016, and February 28, 2019, at the instant docket.

² Bills include but may not be limited to HB 626, HB 627, HB 628, HB 629, HB 1205, HB 1308, HB 1862, HB 1863, HB 1864, HB 1865, SB 432, and SB 866.

³ House Consumer Protection, Technology and Utilities Hearing held on December 12, 2023. Senate Democratic Policy Committee Hearing held on January 22, 2024.

includes four revisions to the Commission's existing Section 1329 procedures. We believe the time is right for the Commission to consider revisions that are within the Commission's purview. Therefore, we introduce the following proposals.

Public Hearings

When an acquiring utility and selling utility agree to use the procedure established by Section 1329, they should be required to schedule and conduct at least two in-person public hearings prior to executing the asset purchase agreement. These public hearings should address the proposed acquisition, describe the potential rate impacts, provide the opportunity for public comment and be held at venues within the municipal boundaries of the selling utility, or at the nearest reasonable venues with Commission notification.⁴ Such public hearings may include a public meeting held by the municipal government in which the transaction is on the agenda as well as other meetings or open houses hosted by either the acquiring utility or selling utility. The acquiring utility or selling utility should be required to notify the selling utility's customers of the public hearing. Examples of effective notice include local newspapers, community newsletters, faith community bulletins, public service announcements, social media posts shared with community groups and municipalities, local radio and television stations, posting in areas of high foot traffic, communications to local community groups, and posting shared with local community centers. Direct outreach to concerned residents may also be considered as notice, whether through a phone call, text, letter, or email. The Commission's Section 1329 Application Filing Checklist should be revised to include public hearings and should include an attestation that the public hearings were held.

We believe this modification will assist in better informing the public of the transaction between the acquiring utility and the selling utility. Hosting such hearings will give the public the opportunity to question both transacting parties, and better

prepare the public to participate in any eventual application at the Commission. Bolstering such public input opportunity before the filing of the proceeding is further supported given the six-month statutory time frame the Commission currently has to adjudicate perfected Section 1329 applications.

Rate Impact Notice

The acquiring utility and the selling utility should be required to verify, or declare under affidavit, the following three items within the initial application.

- Both parties acknowledge the selling utility is aware of the potential rate impacts the transaction may have on the selling utility's customers. This would include detailing the overall dollar and percentage impact implicated from stand-alone rates from the transaction price.⁵
- The selling utility has publicly communicated such implications on rates through notices issued to its existing customers.
- Both parties understand the Commission may shift rate allocations in a manner different from any commitments made in the underlying application.

As part of the Commission's Section 1329 Application Filing Checklist, this verification or affidavit would be a prerequisite to having a perfected application.

⁴ In-person hearings may also permit hybrid access via telephone or video streaming.

⁵ A stand-alone rate is one that does not include any Act 11 of 2012 water/wastewater cross subsidization.

We acknowledge the current Commission requirements for notice, which do include requirements to inform all potentially affected customers, including the customers of the selling utility.⁶ Nonetheless, we believe it is prudent to fortify the public notice requirements with this additional information. This information should prove particularly informative for the selling utility and its customers, as it will make it more certain both have a clear and informed understanding of the stand-alone rate implications from the transaction.

Default Weights For Appraisals

Act 12 directs appraisers, or utility valuation experts (UVEs), to establish a fair market value of the selling utility by utilizing the cost, market, and income approaches for valuation. The results of these three are then weighed in portions determined at the discretion of the UVE. While the vast majority of UVE appraisals are weighed evenly, review of previous applications does show a minority that weigh appraisals unevenly.

We submit that the UVEs should weigh each valuation result evenly: one-third for cost, one-third for market, and one-third for income. Establishing such default weights will eliminate the ability of any UVE to artificially inflate or deflate the results of any appraisals that come in high or low, respectively. Furthermore, this should help to level the competitive bidding landscape of acquiring utilities by standardizing the process. We believe the Commission is empowered to establish such default weights by the Uniform Standards of Professional Appraisal Practice.⁷

Finally, we believe applicants should be availed an opportunity to seek Commission authority to deviate from these default weights with good cause shown.

⁶ See February 28, 2019 Implementation Order.

⁷ 2024 Uniform Standards of Professional Appraisal Practice (USPAP) Standards 1-4, Effective January 1, 2024.

Such good cause for deviation would need to be included in the acquiring utility's Section 1329 application.

Reasonableness Review Ratio

We believe it is sound for the Commission to annually publish a "Reasonableness Review Ratio," or RRR. This ratio would not be binding, but rather, a guidepost that the Commission can use when it analyzes and eventually makes a final determination on the overall prudence of various Section 1329 applications.

The crux of the RRR is to determine the ratio of the fair market value to depreciated original cost (DOC) of a barometer group of similarly situated investor-owned water utility companies (IOUs). The barometer group of IOUs would be the same group of water utility companies the Commission utilizes in its Report on the Quarterly Earnings of Jurisdictional Utilities (Quarterly Earnings Report).⁸

To determine the fair market value, the Commission would utilize the enterprise value (EV) of the IOUs as a relevant proxy. The enterprise value is a comprehensive valuation of the IOUs and is readily available to the public for each of these IOUs given their publicly traded status.⁹

To determine the DOC of these IOUs, the Commission would utilize the 'net property, plant, and equipment' metric (Net PP&E) included on each of the companies' balance sheets. Net PP&E is an appropriate proxy for DOC since it represents the total value of the physical assets of the company less depreciation.

⁸ Latest Quarterly Earnings Report issued January 18, 2024 at Docket No. M-2023-3044811.

⁹ Enterprise Value is calculated via the following: Market Capitalization + Debt – Cash.

The RRR would then be the ratio of these two numbers, with EV being in the numerator and Net PP&E being in the denominator: Reasonableness Review Ratio = Enterprise Value / Net Property, Plant, & Equipment.

The RRR would be published by the Commission annually. The published RRR would be comprised of the average of the RRR barometer group information set scraped four times a year. The EV and Net PP&E information would be comprised of values for each indicator at the end of all four quarters.¹⁰

The data set would begin in quarter one of 2017, given that this would be the first full calendar year dating back to the passage of Act 12 in April of 2016. The average would be rolling, so every year the RRR is published you would add four new quarters and remove the four oldest quarters. This would essentially eliminate the oldest year from the subset while adding the newest year. Therefore, the rolling average subset would entail a full seven years. This would instill a certain rigidity to the RRR, while allowing it to move gradually in relation to market circumstances.

The results for the EV, Net PP&E, and RRR are all exhibited in Appendix A to this Tentative Supplemental Implementation Order. If utilizing this information at present, we would see an RRR of 1.68.¹¹

In summary, the RRR would help to foster a more informed judgement by the Commission on the merit of the overall Section 1329 application. This is the case since the relationship between EV and DOC in the IOU industry, *i.e.* the RRR, can help guide

¹⁰ The net PP&E quarterly information will lag one quarter due to the timing of Securities and Exchange Commission reporting.

¹¹ Note, the current data set proposed herein does not include Q4 2023 data for Net PP&E since it has not been published yet. Consequently, the fourth quarter 2023 information for EV, and by result the fourth quarter 2023 RRR has also been omitted. As this Tentative Supplemental Implementation Order proposes, publishing of the RRR in April of any year would instill access to the Net PP&E and EV figures for the previous calendar year.

the Commission in its determination on the reasonableness of the transaction price within a Section 1329 application. Given that the Section 1329 application will include the DOC of the selling utility's assets and the proposed transaction price, the Commission can use this information to see how the ratio of these figures compares with the annually published RRR.

We recognize the novel nature of this proposal and welcome interested parties to submit alternative approaches that could assist the Commission in its efforts to review and determine the reasonableness of Section 1329 application transaction prices.

Timing To Effectuate Proposed Changes

The public hearing, rate impact notice, and default appraisal weight revisions to the Commission's Section 1329 Application Filing Checklist contemplated herein would go into effect 30 days after issuance of any final order. Any applications filed pursuant to Section 1329 after that date would need to be submitted on the revised application materials in order to be considered.

An initial RRR would be published 30 days after the issuance of any final order in this proceeding. Thereafter, the RRR would be published annually by the Commission in the month of April, or as soon as practical after the first quarter of the year recognizing the lag in Net PP&E reporting. The Commission would acknowledge that some transactions may be in the midst of negotiations, and as such, provide due consideration to the timing of the initial RRR release and any initial Section 1329 applications under this proposal. This would particularly be emphasized in the instance where an asset purchase agreement may be completed in close proximity to the issuance of the initial RRR.

CONCLUSION

We believe these four updates to the Commission's presently established Section 1329 implementation and administrative regimes will improve the general public's awareness of applications, establish more consistent and expected weighing of valuation methods, and assist the Commission in its ultimate review and analysis of Section 1329 dockets. **THEREFORE,**

IT IS ORDERED:

1. That a copy of this Tentative Supplemental Implementation Order, including Appendix A, shall be published in the *Pennsylvania Bulletin*.
2. That a copy of this Tentative Supplemental Implementation Order, including Appendix A, shall be served on all jurisdictional water and wastewater companies, the National Association of Water Companies – Pennsylvania Chapter, the Pennsylvania State Association of Township Supervisors, the Pennsylvania State Association of Boroughs, the Pennsylvania Municipal Authorities Association, the Pennsylvania Rural Water Association, the Bureau of Investigation and Enforcement, the Office of Consumer Advocate, and the Office of Small Business Advocate.
3. That comments shall be due within thirty (30) days following publication in the *Pennsylvania Bulletin*, and reply comments shall be due within forty-five (45) days following publication in the *Pennsylvania Bulletin*.

4. That the Law Bureau, with assistance from the Bureau of Technical Utility Services, shall review the comments, and all the information provided therein, and shall present a Final Supplemental Implementation Order to the Commission for consideration.

BY THE COMMISSION

A handwritten signature in black ink, appearing to read "Rosemary Chiavetta". The signature is written in a cursive style with a large initial "R".

Rosemary Chiavetta
Secretary

(SEAL)

ORDER ADOPTED: February 1, 2024

ORDER ENTERED: February 7, 2024

Appendix A

Investor Owned Utility Ticker Key

- American States Water Company (ticker: AWR)
- American Water Works Co., Inc. (ticker: AWK)
- California Water Service Group (ticker: CWT)
- Essential Utilities, Inc. (ticker: WTRG)
- Middlesex Water Company (ticker: MSEX)
- SJW Group (ticker: SJW)

Reasonableness Review Ratio

AWK AWR CWT WTRG MSEX SJW

RRR Result	1.68
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	AWK	AWR	CWT	WTRG	MSEX	SJW
9/30/2023	1.44	1.97	1.19	1.34	1.59	1.29
6/30/2023	1.60	2.15	1.29	1.49	1.86	1.44
3/31/2023	1.72	2.20	1.39	1.62	1.84	1.54
12/31/2022	1.70	2.29	1.44	1.71	1.88	1.57
9/30/2022	1.55	2.02	1.32	1.57	1.88	1.32
6/30/2022	1.70	2.11	1.38	1.70	2.12	1.38
3/31/2022	1.91	2.30	1.46	1.82	2.52	1.49
12/31/2021	2.14	2.64	1.74	1.88	2.79	1.52
9/30/2021	2.02	2.29	1.52	1.75	2.47	1.45
6/30/2021	1.91	2.17	1.46	1.74	2.05	1.43
3/31/2021	1.88	2.10	1.48	1.74	2.03	1.47
12/31/2020	1.92	2.23	1.44	1.78	1.93	1.51
9/30/2020	1.88	2.17	1.25	1.63	1.77	1.42
6/30/2020	1.74	2.29	1.32	1.71	1.92	1.46
3/31/2020	1.67	2.39	1.39	1.25	1.79	1.39
12/31/2019	1.71	2.52	1.44	1.80	1.98	1.00
9/30/2019	1.73	2.67	1.48	1.72	1.93	1.52
6/30/2019	1.65	2.30	1.44	1.89	1.81	1.37
3/31/2019	1.54	2.23	1.52	1.50	1.78	1.41
12/31/2018	1.42	2.16	1.41	1.43	1.73	1.58
9/30/2018	1.42	2.05	1.31	1.53	1.64	1.35
6/30/2018	1.39	1.97	1.24	1.52	1.49	1.45
3/31/2018	1.35	1.87	1.20	1.50	1.37	1.24
12/31/2017	1.46	2.02	1.43	1.67	1.47	1.43
9/30/2017	1.39	1.80	1.29	1.50	1.47	1.32
6/30/2017	1.37	1.83	1.27	1.52	1.50	1.23
3/31/2017	1.38	1.76	1.25	1.50	1.44	1.25

Enterprise Value (all numbers in thousands)

AWK AWR CWT WTRG MSEX SJW

9/30/2023	35,567,818	3,737,055	3,858,182	15,967,536	1,568,284	3,531,076
6/30/2023	38,857,932	4,001,638	4,112,505	17,280,588	1,802,507	3,838,399
3/31/2023	40,880,319	4,015,253	4,323,438	18,365,246	1,743,409	4,036,106
12/31/2022	39,554,205	4,116,802	4,363,803	19,072,223	1,739,980	4,105,693
9/30/2022	35,295,634	3,551,174	3,956,881	17,095,720	1,702,001	3,370,121
6/30/2022	37,772,198	3,646,680	4,061,940	18,089,622	1,870,809	3,476,742
3/31/2022	41,031,580	3,913,844	4,207,071	18,951,815	2,173,385	3,688,030
12/31/2021	45,391,070	4,427,530	4,904,568	19,325,527	2,429,517	3,763,648
9/30/2021	41,693,794	3,765,227	4,243,815	17,489,661	2,109,615	3,481,548
6/30/2021	38,739,751	3,512,200	3,998,954	16,969,687	1,725,191	3,376,068
3/31/2021	37,679,654	3,341,180	3,977,473	16,713,115	1,666,246	3,410,111
12/31/2020	38,037,880	3,469,600	3,788,272	17,059,520	1,546,448	3,465,833
9/30/2020	36,355,326	3,300,990	3,233,389	15,201,708	1,362,694	3,199,372
6/30/2020	33,155,343	3,426,059	3,359,310	15,609,313	1,440,915	3,213,609
3/31/2020	31,124,906	3,513,473	3,393,809	11,189,966	1,311,974	3,056,454
12/31/2019	31,355,861	3,671,215	3,418,911	11,429,960	1,407,053	2,170,493
9/30/2019	31,554,011	3,787,073	3,471,860	10,690,084	1,318,737	2,087,304
6/30/2019	29,522,554	3,205,990	3,317,490	11,584,697	1,194,721	1,851,208
3/31/2019	27,294,084	3,033,265	3,441,939	9,054,422	1,128,519	1,866,040
12/31/2018	24,711,687	2,853,600	3,118,579	8,480,913	1,070,864	2,073,862
9/30/2018	24,167,899	2,638,674	2,873,189	8,811,976	981,843	1,742,129
6/30/2018	23,344,810	2,484,072	2,634,468	8,442,477	864,849	1,826,988
3/31/2018	22,284,321	2,329,224	2,500,460	8,201,649	771,736	1,533,329
12/31/2017	23,688,565	2,484,712	2,899,961	9,024,830	818,955	1,746,286
9/30/2017	21,813,823	2,167,935	2,548,885	7,922,048	799,924	1,582,374
6/30/2017	21,116,810	2,154,028	2,443,042	7,855,896	800,554	1,434,932
3/31/2017	20,919,023	2,032,972	2,351,139	7,600,345	753,650	1,429,760

**Sourced from Yahoo! Finance Plus.*

Net PP&E (all numbers in thousands)

AWK AWR CWT WTRG MSEX SJW

	AWK	AWR	CWT	WTRG	MSEX	SJW
9/30/2023	24,774,000	1,896,750	3,248,324	11,884,401	988,836	2,729,004
6/30/2023	24,271,000	1,862,425	3,177,730	11,630,000	970,606	2,667,212
3/31/2023	23,715,000	1,827,859	3,103,437	11,335,245	945,655	2,618,204
12/31/2022	23,305,000	1,800,208	3,031,091	11,172,680	924,351	2,613,950
9/30/2022	22,726,000	1,761,437	2,987,612	10,918,773	903,849	2,556,921
6/30/2022	22,193,000	1,728,631	2,934,676	10,637,078	883,089	2,517,561
3/31/2022	21,489,000	1,698,885	2,887,415	10,440,989	862,372	2,480,953
12/31/2021	21,176,000	1,677,289	2,816,907	10,300,796	869,868	2,476,849
9/30/2021	20,680,000	1,642,905	2,796,369	10,012,155	854,588	2,406,475
6/30/2021	20,308,000	1,618,680	2,746,606	9,764,517	840,286	2,361,038
3/31/2021	20,003,000	1,588,952	2,684,936	9,627,848	820,214	2,319,901
12/31/2020	19,805,000	1,558,507	2,622,991	9,573,211	801,807	2,299,745
9/30/2020	19,364,000	1,521,952	2,596,314	9,322,482	771,431	2,246,220
6/30/2020	19,043,000	1,498,604	2,537,816	9,114,457	751,734	2,206,033
3/31/2020	18,689,000	1,472,697	2,446,971	8,954,900	732,308	2,192,170
12/31/2019	18,335,000	1,459,166	2,381,516	6,358,657	711,674	2,173,062
9/30/2019	18,260,000	1,418,962	2,343,254	6,209,835	683,883	1,376,807
6/30/2019	17,910,000	1,394,033	2,302,205	6,128,012	660,567	1,353,804
3/31/2019	17,739,000	1,358,410	2,259,559	6,033,428	635,123	1,327,038
12/31/2018	17,409,000	1,321,666	2,207,980	5,930,326	618,487	1,313,022
9/30/2018	17,063,000	1,289,301	2,185,742	5,740,801	599,104	1,287,513
6/30/2018	16,777,000	1,262,862	2,130,264	5,541,973	580,480	1,262,417
3/31/2018	16,477,000	1,242,574	2,083,038	5,460,219	564,324	1,239,369
12/31/2017	16,246,000	1,229,062	2,025,753	5,399,860	557,240	1,224,851
9/30/2017	15,681,000	1,204,962	1,981,924	5,276,474	545,461	1,201,421
6/30/2017	15,391,000	1,176,616	1,928,612	5,159,151	533,281	1,169,015
3/31/2017	15,128,000	1,158,320	1,888,005	5,057,826	524,532	1,140,249

**Sourced from Yahoo! Finance Plus*