

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17120

**Pennsylvania American Water
Company - Wastewater**

Public Meeting held November 9, 2023
3037047-OSA
Docket No. A-2022-3037047

STATEMENT OF VICE CHAIR KIMBERLY BARROW

This matter concerns the Application filed with the Commission by Pennsylvania-American Water Company (PAWC or Company) on February 14, 2023, pursuant to Sections 507, 1102, and 1329 of the Public Utility Code (Code), 66 Pa. C.S. §§ 507, 1102, and 1329 (as amended, the Application). In its Application, PAWC requested Commission approval of the acquisition of substantially all of the assets, properties and rights related to the wastewater collection and treatment system (the System) owned by the Butler Area Sewer Authority (BASA), and the right of the Company to provide wastewater service in the areas served by BASA. Also before the Commission is the Joint Petition for Approval of Unanimous Settlement of All Issues (Joint Petition or Settlement) filed by PAWC, the Commission’s Bureau of Investigation and Enforcement (I&E), the Office of Consumer Advocate (OCA), the Office of Small Business Advocate (OSBA), BASA, the Township of Butler, and the City of Butler (collectively, Joint Petitioners) on August 14, 2023.

Mergers and acquisitions of public utilities are especially complicated transactions and are governed by Sections 1102 and 1103 of the Code, 66 Pa. C.S. §§ 1102 and 1103, which provide that acquisitions must provide a substantial affirmative public benefit. However, because the targeted system is municipally owned, we must also apply the valuation criteria found in Section 1329 of the Code, 66 Pa. C.S. § 1329. It is the intersection of the long-established Sections 1102 and 1103, with Section 1329, that I wish to discuss.

Section 1329 of the Code establishes a process to assign a dollar value to municipal water and wastewater systems to be acquired by certificated public utilities. Under Section 1329, the value of water and wastewater system assets to be included in the acquiring utility’s rate base for ratemaking purposes will be the lesser of the purchase price negotiated by the acquiring utility and seller or the “fair market value” of the selling utility’s system. 66 Pa. C.S. § 1329(c)(2).

Section 1102(a)(3) of the Code requires a utility to first obtain a Certificate of Public Convenience (Certificate) from the Commission prior to a utility or an affiliated interest of a utility to acquire or transfer, to any person or corporation by any method, property used or useful in the public service. 66 Pa. C.S. § 1102(a)(3). Section 1103(a) of the Code establishes the standard for granting a Certificate required under Section 1102:

A certificate of public convenience shall be granted . . . only if the
commission shall find or determine that the granting of such

certificate is necessary or proper for the service, accommodation, convenience or safety of the public. The commission, in granting such certificate, may impose such conditions as it may deem to be just and reasonable.

66 Pa. C.S. § 1103(a) (emphasis added); *see also, Seaboard Tank Lines v. Pa. PUC*, 502 A.2d 763, 764-65 (Pa. Cmwlth. 1985).

According to the Pennsylvania Supreme Court, satisfying the standard of Section 1103(a) requires the Commission to find that the proposed transaction will “affirmatively promote the service, accommodation, convenience, or safety of the public in some substantial way.” *City of York v. Pa. PUC*, 449 Pa. 136, 141, 295 A.2d 825, 828 (1972) (*City of York*). In establishing this precedent, the Court held that the statute’s clear command is that the Commission must find that the granting of a certificate “will affirmatively benefit the public.” *Id.* (overruling in part, *Northern Pennsylvania Power Co. v. Pa. PUC*, 333 Pa. 265, 267, 5 A.2d 133, 134).

Factors that the Supreme Court identified in *City of York* for the Commission to consider in determining whether there is an affirmative public benefit are the likely effects of the proposed merger on future rates to consumers along with the likely effect upon service to consumers. *City of York*, 295 A.2d at 829.

The Pennsylvania Commonwealth Court recently held that the Commission must perform “the balancing test required by Section 1102 of the Code to weigh all the factors for and against the transaction, including the impact on rates, to determine if there is a substantial public benefit.” *McCloskey v. Pa. PUC*, 195 A.3d 1055, 1066-1067 (Pa. Cmwlth. 2018), *appeal denied*, 207 A.3d 290 (Pa. 2019) (*McCloskey*) (emphasis added). While *McCloskey* held that rate impact must be addressed, it recognized that “the Commission is charged with deciding whether the impact of rates...is outweighed by ... other positive factors that...served [as] a substantial public benefit.” 195 A.3d at 1067. Even more recently, in *Cicero v. Pa. PUC*, 910 C.D. 2022 (Pa. Cmwlth. 2023) (*Cicero*), the Commonwealth Court, upheld prior precedent that the substantial affirmative benefits of a proposed acquisition must outweigh the acknowledged harms resulting from the acquisition.

Here, the ALJ recommended rejection of the Application due to the Company’s failure to show that its ownership of BASA’s System would affirmatively promote the service, accommodation, convenience, or safety of the public. The ALJ concluded that no benefits to be realized from the proposed transaction would outweigh the harms to current PAWC water and wastewater customers or existing BASA wastewater customers that result from the acquisition. R.D. at 66.

I find it difficult to fault the ALJ’s analysis when considering this Application under Sections 1102, 1103, and 1329. Clearly, there are benefits that will accrue from this transaction:

- PAWC is a world class water and wastewater utility operator and BASA’s customers will likely see an improvement in operations and customer service.

- PAWC will likely complete the Department of Environmental Protection's 2019 Corrective Action Plan (CAP) on a quicker timeline than BASA. Record evidence states that the BASA system is compliant with the CAP and in good to fair condition, so I cannot quantify this benefit.¹
- PAWC will offer an assistance program to both residential and commercial and industrial BASA customers experiencing payment difficulties.
- PAWC will retain BASA utility employees and a Butler Area office.
- The municipality will receive \$228 million for a plant with a book value of \$91 million, allowing it to clear debt and utilize the proceeds for other municipal priorities.

I weigh these benefits against harms:

- Rates for BASA customers will increase from \$43/month to \$45.50/month per EDU prior to Closing.² And one year after Closing will increase to \$63.70/month per EDU (an approximately 48 percent increase one year after Closing) for BASA customers. The rate increases will not stop there as the goal will be to bring BASA customer rates level with the PAWC zoned rates, currently at \$106/month.
- Due to the considerable revenue shortfall inherent in this acquisition, \$12,815,800, spawned by the initial rate cap in this transaction,³ existing PAWC customers will subsidize the \$228M acquisition with **no** corresponding benefit to existing PAWC customers.⁴
- The revenue shortfall included in this acquisition will be subsidized by existing PAWC ratepayers when the shortfall and \$228M purchase price are factored into PAWC's next rate case. Depending on timing, it is possible that other recent PAWC acquisitions will be added to that rate case as well, compounding the burden to existing PAWC ratepayers.

¹ As part of the acquisition, Herbert, Rowland & Grubic (HRG) was contracted by PAWC and BASA to prepare an Engineer's Assessment of all wastewater infrastructure for the purchase of BASA's Wastewater Treatment Plant (WWTP), collection and conveyance systems by PAWC. According to the Engineer's Assessment, since acquiring the WWTP, BASA has completed numerous improvements to the original WWTP and collection system. The Engineer's Assessment further indicated that although portions of the WWTP are aging, BASA has maintained the plant in good working order and condition. The Engineer's Assessment categorized the assets of BASA's WWTP to be in good to fair condition. Appendix A-15-a at 5-6.

² The current rate for PAWC residential Rate Zone 1 wastewater customers with an average usage of 3,212 gallons per month is approximately \$106.00. Joint Petition at 8.

³ This amount does not include the impact of any planned post-acquisition improvements of \$75.8 million, which will only further exacerbate the revenue shortfall that must be recovered through rates.

⁴ It is important to note that the acquisition cost of \$228M for the 14,792 customers served by the BASA System results in a rate base per customer of \$15,413. This amount is one of the highest for similar 1329 acquisitions approved by the Commission.

The Court explained that where there are known harms, the transaction must have benefits that differ substantially from the benefits already being provided by the existing system operator to support approving the transaction. *Cicero* at 21. The Court clarified that:

Where...there are **no benefits that differ substantially** from the benefits already being provided by the existing system operator, those alleged benefits arise as a result of the acquiring utility's fitness, rather than from the actual transaction, and where there are acknowledged or known harms that will result from the transaction, there are insufficient net benefits to support approving the transaction and granting the [Certificate] under Section 1103(a).

Id. at 20 (emphasis in original). The Court further explained that providing the same services as are already being provided, or providing for upgrades that the existing system operator is capable of providing, are not substantial affirmative benefits consistent with *City of York*, especially if the existing system is already operating safely and reliably. *Id.* at 19. Moreover, the public benefits arising from aspirational statements or benefits that cannot be quantified at the time of the transaction may not always constitute affirmative public benefits that will be substantial enough to outweigh known harms. *Id.* at 21. Many of the benefits I listed above are aspirational, unquantified, or simply arise because PAWC is a without question, a fit operator.


The stated benefits to this transaction outnumber the harms; however, those benefits do not **outweigh** the harms. *Id.* The vast majority of the benefits of this transaction accrue to the municipality, with some benefit to BASA's customers. All of the harms resulting from the transaction accrue to acquired customers and existing PAWC customers in the form of substantial rate increases. BASA customers may get better service, but this record suggests that the municipality has the ability to improve that service and infrastructure itself without impacting rates to the degree that this transaction will.⁵

Earlier I said that it is the intersection of Sections 1102, 1103, and 1329 that concerns me. I have no quarrel with Section 1329, the Legislature enacted it as a tool to be utilized to encourage the consolidation of the water and wastewater companies in this state. Properly implemented Section 1329 has the potential to improve water and wastewater service to millions of Pennsylvania's citizens. My quarrel is with the runaway valuations carried out under the cover of Section 1329 and industry consolidation. The benefits analysis required by 1102 and 1103 in this case would be fairly straightforward if the financial value assigned to this system was anywhere in the neighborhood of what I consider realistic. Book value of this system is \$91M, yet PAWC's ratepayers are being told by evaluators that it is worth \$230M. The Parties discounted that \$230M to \$228M, and offered universal service programs to both residential and commercial customers to alleviate the rate increases that this sizeable transaction will have on rates. Granted, Act 11 of the Code allows the cost of these transactions to be spread across a

⁵ The record reflects that while BASA would very likely have to raise rates to complete the DEP CAP expeditiously, BASA's rates might be lower than an investor-owned utility's because municipal borrowing rates tend to be lower, municipal utility rates do not include returns on equity, nor do municipalities have to design rates that satisfy a cost of service standard that typically applies to jurisdictional utilities.

larger customer base to diminish the impact of the rate increases arising from the transactions. Yet, we cannot deny the fact that the rate increases from these transactions are still substantial. The problem here is not with the statutes that we are tasked with implementing, it is that it is incumbent upon the Commission to implement the provisions of 1102, 1103, and 1329 in concert, to effectuate a reasonable outcome that provides a public benefit. That will require robust development of the evidentiary record in a manner that I have not seen in this case.

November 9, 2023
DATE


Kimberly Barrow, Vice Chair