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BUSINESS

A Pa. law sets off a feeding frenzy for public water systems. Will customers pay the cost?

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government — and who will be left paying the bill.

Limerick Township in July closed the sale of its municipal sewer system to Aqua Pennsylvania Inc., generating a $75.1 million windfall for the Montgomery County town. Limerick will use the proceeds to pay for several high-profile projects, including a new township building and two upgraded fire stations — without raising property taxes.

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But Pennsylvania's Office of Consumer Advocate estimates that Limerick's 5,400 customers will pay dearly for the acquisition, and are facing an 84 percent bill increase, to $70 a month, after a rate freeze is lifted in 2020. Aqua's customers outside Limerick are also expected to subsidize the purchase for more than a decade before realizing a tiny financial benefit from the expansion.

Limerick is not alone.

In Chester County, New Garden and East Bradford Townships are selling their sewer systems to Aqua, which in July also agreed to buy Cheltenham Township's troubled Montgomery County wastewater system for $50.25 million. Pennsylvania American Water, the state's largest private operator, is buying the sewer systems in Sadsbury Township in Chester County, Exeter in Berks County, and two small systems in Northumberland County.

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Contractors rebuild an aging sewer line in Cheltenham Township, which in July agreed to sell its sewer system to Aqua Pennsylvania Inc. because it faces up to $80 million in repairs.

Shifting industry environment

The merger frenzy was set off by a 2016 state law that encourages the consolidation of smaller water and wastewater systems under private ownership. Act 12 allows investor-owned utilities to charge ratepayers for the appraised fair-market value of an acquired system, rather than its lower depreciated cost.

The new law, combined with a 2012 act that allows a utility to spread the acquisition costs to all its ratepayers across the state, creates an industry-friendly environment for private water utilities to expand their reach. Pennsylvania American already has 658,000 water and wastewater customers. Aqua Pennsylvania, which filed for a 15.4 percent water rate increase on Aug. 17, has 450,000 customers.

The high prices being offered for municipal utilities — mostly sewer systems — provide a convenient way for a town to monetize an asset, and redirect the

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$23 million more than the next closest bid.

But some Act 12 privatizations have aroused opposition. The Office of Consumer Advocate, an arm of the attorney general, has sued the Pennsylvania Public Utility Commission to block Aqua's $29.5 million acquisition of the New Garden Township sewer system in southern Chester County, saying that for this generation of customers, the sale will bring only higher rates.

At least nine other states have adopted fair-value laws, which the industry strongly supports. Illinois was the latest.

"Since the fair-market legislation has begun to pass in various states, we've just not seen this level of interest and activity for many, many years," said Christopher Franklin, CEO of Aqua America, the Bryn Mawr utility with operations in eight states, including five with fair-value laws.

Aqua last year launched what would be Pennsylvania's largest Act 12 transaction when it made an unsolicited $350 million offer to buy the Chester Water Authority, a regional water system that supplies 43 municipalities in Delaware, Chester, and Lancaster Counties.

Aqua's bid was presented as a bankruptcy rescue for Chester city, which created the authority nearly 80 years ago. But the authority, now controlled by suburban interests that represent nearly three-quarters of the system's customers, rejected the offer because it says customer costs would soar, in perpetuity, after a 10-year rate freeze expired.

For ratepayers, "Act 12 just made what's going on in the water industry scarier," said Francis J. Catania, the CWA's solicitor. The proposal still remains alive, however, because Chester's state-appointed receiver argues that the city, as the utility's founder, has the legal authority to sell it.

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Contractors expand Aqua's wastewater treatment plant in Media, a $28 million project that will be completed in 2022.

What privatization means

Anti-privatization advocacy groups, such as Food and Water Watch, object to the fair-value laws, calling them corporate giveaways that allow profit-making enterprises to pass through potentially inflated acquisition prices to customers through rate hikes.

"Public water systems overall can provide service at a lower cost," said Mary Grant, the director of Food and Water Watch's campaign against water privatizations. "It's about local control of the water system."

Investor-owned utilities say they buy systems only from willing sellers, often from towns in financial distress. They portray themselves as "solutions providers," not predators.

Fair-value laws such as Pennsylvania's include consumer protections that cap the cost an acquiring utility can pass on to ratepayers at no more than the system's

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Robert F. Powelson, a former PUC member who recently became head of the National Association of Water Companies, an industry lobby.

Private operators say they have the expertise and resources to run complex water treatment systems, and also the incentive to invest in expensive infrastructure that was often neglected by government managers. Under public-utility law, regulators typically set rates to allow utilities to recover their investments, plus a return on equity of up to 10 percent — the profit inducement to attract private capital.

Unlike electric and gas utilities, which long ago consolidated mostly under private ownership, water and wastewater systems have largely remained in government ownership.

About 84 percent of the nation's population is served by water systems owned by local government, and only 12 percent by private systems, according to the U.S. Environmental Protection Agency. (The remainder are served by state or federal systems or public-private partnerships.)

In the Philadelphia region, privatized water systems are fairly common: About 30 percent of Pennsylvanians and 37 percent of New Jersey's population are served by private water companies. Two local companies, Aqua America and American Water, which is headquartered in Voorhees, are among the nation's largest private operators.

Untapped wastewater market

Private owners say wastewater systems represent the new frontier because the market is more fragmented — 97 percent of sewage is treated by government-operated systems — and because the need for new investment is huge.

Cheltenham Township, on Philadelphia's northern border, is one municipality in desperate need of sewer repairs. The township can't take on new customers because its leaky system exceeds capacity, and estimates it needs $50 million to

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New pipe awaits installation in Cheltenham Township, which is undergoing a $9 million sewer upgrade. The township, citing the high costs of sewer repairs, agreed in July to sell the system to Aqua Pennsylvania for $50.25 million.

"It's in our best interests to look at divesting," said commissioner Drew Sharkey, who oversees public works. The cost for Cheltenham residents would increase about the same under public or private ownership, Sharkey said.

Aqua, which already provides water service in the township, presented a plan for restoring the township's standing with state environmental regulators and the Philadelphia Water Department, which treats the township's sewage. Aqua says it can use its purchasing power to upgrade the system more economically than the township.

"We come in and are able to focus exclusively on water and wastewater, bring our leverage, our expertise, so these systems come into compliance," said Marc Lucca, Aqua Pennsylvania's president.

Cheltenham is only too happy to exit. "We have a proven track record of not being able to manage the situation, and believe Aqua will do a far better job," Sharkey said. The deal, signed in July, awaits PUC approval.

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Private buyers of municipal systems often agree to freeze current rates for several years and to hire the public utility employees, addressing two potential sources of opposition to a sale.

Investor-owned utilities say their rates and customer service are closely regulated by the PUC, which can penalize bad actors. They also point to a 2018 University of California-Irvine study finding that privately owned utilities are less vulnerable to health violations than government systems.

"There are pretty significant protections for customers that exist in a regulated environment vs. a municipal nonregulated environment," said Bernard J. Grundusky, Pennsylvania American's director of business development, who organized the company's $159 million purchase last year of the McKeesport sewer system near Pittsburgh, the first Act 12 deal to close.

Public acquisitions

The Pennsylvania Municipal Authorities Association is mobilizing its members to oppose the "threat of privatization," providing them with fill-in-the-blank news releases, letters to the editor, and op-ed columns extolling public ownership's virtues.

But some larger government-owned utilities have also become targets of the same criticisms of inflicting rate shock on customers of smaller systems they've acquired, sometimes after outbidding private rivals.

The Bucks County Water and Sewer Authority in 2015 outbid private operators to acquire the sewer system in Springfield Township, Montgomery County, for $16.5 million. Springfield used the proceeds to pay for parks and a new municipal campus.

But the invoice came due this year when residential sewer bills jumped by 115 percent, matching the rates paid by other BCWSA customers. The authority says its rates are still better than those charged by private companies.

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Aqua, a losing bidder in the Springfield sale, alleged in a lawsuit it filed last year against BCWSA that the township's system was valued at no more than $12 million, not the $16.5 million that the authority paid. The lawsuit alleges the BCWSA is illegally using its nonprofit status to expand beyond its core territory.

The Springfield acquisition was BCWSA's last major transaction before Act 12 went into effect, said authority CEO Benjamin W. Jones. Since private operators can now pay a higher price, BCWSA has only acquired the tiny West Vincent Township sewer system in Chester County.

"We're a nonprofit, and we don't acquire something that doesn't pay for itself," said Jones.

Cost to the consumer

The benefits of Act 12 may not be realized by current customers.

PUC Vice Chairman Andrew G. Place, the lone dissenter in Aqua's acquisition of the Limerick and New Garden systems, was unconvinced that Aqua's current customers would realize much benefit from the "substantial cost" they would bear. And the consumer advocate said Aqua's existing customers might see a tiny savings in their bills from the Limerick acquisition — 3 cents a months — but only after subsidizing the purchase for 15 years.

A majority on the PUC says the acquisitions are consistent with its policy that consolidation of water and wastewater systems "will allow the water industry to institute better management practices and achieve greater economies of scale."

The industry is thinking not only about the current generation of customers, but what form water systems will take a century from now.

"The company is definitely in it for the long game," said Grundusky, Pennsylvania American's business development director.

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