



MAY 2016 ■ NO. 1

## Environmental and Public Utilities

### New PA Law Gives Boost to Investor-Owned Acquisitions of Municipal Water and Wastewater Systems

**Action Item: A new Pennsylvania law makes the Commonwealth a much friendlier place for investor-owned water utilities to acquire municipally-owned water and wastewater facilities. Act 12 of 2016 mitigates the risk that the investor-owned utilities would be unable to recover their investments when assets acquired are in need of physical upgrade by allowing enhanced rate base adjustments for needed upgrades. The new law also mitigates post-acquisition “rate shock” to consumers.**

Recognizing that municipalities often struggle to finance necessary maintenance and upgrades of municipal infrastructure, Pennsylvania recently enacted Act 12 of 2016, 66 Pa. C.S. § 1329 (“Act 12”), to help municipalities sell their aging water and wastewater systems to private sector investor-owned entities. The new law takes effect on June 13, 2016, and allows utilities to value the acquired assets for rate-making purposes at the lesser of fair market value or the negotiated purchase price, instead of the depreciated original cost dictated by 66 Pa. C.S. § 1311(b). The new valuation option means that utilities can now offer municipalities higher prices for the assets, unlocking the value that had been trapped by the lower rate base.

Today, many municipally-owned water and wastewater utilities in the Commonwealth have infrastructure that is urgently in need of repair or replacement and would require those utilities to make extraordinary investments that would ultimately be borne by their customers. Many of these utilities welcome the prospect of selling their systems to a larger investor-owned utility which would facilitate necessary system improvements and promote the continued provision of safe, reliable service at reasonable rates. Prior to the enactment of Act 12, however, larger utilities have been reluctant to pursue these acquisitions due to the risk that the utility would be unable to recover its investment. Act 12 is intended to address that concern.

Act 12 is voluntary, and both the buyer and seller must agree to use it. Under Act 12, the buyer and seller each select a valuation expert from a list maintained by the Public Utility Commission (“PUC”). The experts each prepare an appraisal of the assets, and the average of those appraisals is used as the fair market value of the assets. Act 12 then allows for the seller’s rate base to be incorporated into the buyer’s rate base during the buyer’s next rate base case or initial tariff filing. The seller’s rate base will equate to the lesser of the fair market value or the negotiated

purchase price. The seller's rates are frozen until new rates are approved for the buyer during its next rate base case. The buyer and seller can also seek PUC approval of a rate stabilization plan to hold rates constant or phase rates in over time to help mitigate the impact of future rate increases and avoid rate shock to consumers.

Any of the buyer's post-acquisition improvements that are not recovered through a distribution system improvement charge will be eligible for inclusion in allowance of funds used during construction. The buyer may collect allowance of funds used during construction through rates until the asset has been in service for four years or until the asset is included in the buyer's next rate base case, whichever is earlier. Further, depreciation on the buyer's post-acquisition improvements that have not been included in the calculation of a distribution system improvement charge will be deferred for book and ratemaking purposes. © 2016 BLANK ROME LLP

**For additional information, please contact:**

**Christopher A. Lewis**  
215.569.5793 | [Lewis@BlankRome.com](mailto:Lewis@BlankRome.com)

**Michael L. Krancer**  
215.569.5535 | 412.515.1522 | [MKrancer@BlankRome.com](mailto:MKrancer@BlankRome.com)

**Thomas M. Duncan**  
215.569.5642 | [TDuncan@BlankRome.com](mailto:TDuncan@BlankRome.com)