

Pennsylvania's New Law for Valuing Acquired Municipal/Authority Water and Wastewater Systems

On Thursday, April 14, 2016, Pennsylvania Governor Tom Wolf signed Act 12 of 2016 (Act 12) into law.¹ Among other things, Act 12 revises Chapter 13 of the Pennsylvania Public Utility Code (the Code) to provide a framework for valuing, for ratemaking purposes, water and wastewater systems that are owned by a municipal corporation or authority (seller) and that are to be acquired by another entity that is or will be regulated by the Pennsylvania Public Utility Commission (Commission) as a public utility (buyer). The Act's provisions will be codified in new Section 1329 of the Code.

Valuation Framework

Act 12 is applicable only where the seller is a "water or wastewater company located in this Commonwealth, owned by a municipal corporation or authority that is being purchased ... as the result of a voluntary arm's-length transaction." As such, the provisions of the Act do not apply to the acquisition of an investor-owned water or wastewater utility. Moreover, the valuation framework is voluntary in nature; that is, both the seller and buyer must agree to the valuation procedure before it can be utilized.

If both parties to the transaction agree, then the seller and the buyer will each select a "utility valuation expert" from a list to be selected and maintained by the Commission. The utility valuation experts will each perform an independent appraisal of the seller for the purpose of establishing its fair market value. The appraisals will employ cost, market and income approaches. Additionally, the seller and the buyer will select one licensed engineer to conduct an assessment of the tangible assets of the seller.² The engineer's assessment will be incorporated into the appraisals.

The utility valuation experts have 90 days from their date of hire to complete and provide a copy of their valuation. Act 12 provides that the "fair market value of the selling utility is the average of the two utility valuation expert appraisals."

Of note, the source of funding for any part of the water or sewer assets of the seller shall not be considered when determining the value of the assets. Accordingly, contributed assets may be valued at their market value.

Use of Fair Market Value

Act 12 allows for the rate base of the seller to be incorporated into the rate base of the buyer during the buyer's next base rate case or its initial tariff filing. The rate base to be incorporated will be the lesser of the purchase price or the fair market value of the seller. If the seller and buyer do not both agree to use the Act 12 valuation process, the buyer must continue to use the traditional depreciated original cost valuation process for ratemaking purposes.

Acquisition Approval

Act 12 requires that, if the seller and buyer agree to use the Act 12 valuation framework, then the buyer's application for a Certificate of Public Convenience from the Commission under Section 1102 of the Code, 66 Pa. C.S. § 1102, must include: (i) copies of the two appraisals; (ii) the purchase price; (iii) the ratemaking rate base; (iv) the transaction and closing costs incurred by the acquiring public utility that will be included in its rate base; and, (v) a tariff containing a rate equal to the existing rates of the selling utility at the time of the acquisition and a rate stabilization plan, if applicable. The Act defines a rate stabilization plan as a "plan that will hold rates constant or phase rates in over a period of time after the next base rate case." Under Act 12, the Commission "shall"



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issue a final order on such an application within six months of the application filing date. The Commission order approving an acquisition must set forth the ratemaking rate base of the seller and any additional conditions of approval that the Commission may require.

Post-Acquisition Projects

Act 12 also addresses certain aspects of post-acquisition project accounting. The buyer's post-acquisition improvements that "are not included in a distribution improvement charge shall accrue allowance for funds used during construction after the date the cost was incurred until the asset has been in service for a period of four years or until the asset is included in the acquiring public utility's next base rate case, whichever is earlier."³ Act 12 further provides that "depreciation on an acquiring public utility's post-acquisition improvements that have not been included in the calculation of a distribution system improvement charge shall be deferred for book and ratemaking purposes."

If you would like to learn more about the impact of Act 12, please contact the Energy, Environmental and Utility Practice Group at Cozen O'Connor.

¹ Act 12 will become effective on June 13, 2016.

² Act 12 is silent regarding the method for selecting the licensed engineer to conduct the asset assessment. The Commission will likely develop a process for the selection.

³ Act 12's reference to a "distribution improvement charge" is presumed to be a reference to a "distribution system improvement charge" as defined by Section 1351 of the Code, 66 Pa. C.S. § 1351.