

**Pennsylvania House of Representatives
Consumer Protection, Technology & Utilities Committee
Room G-50, Irvis Office Building, December 12, 2023**

Public Hearing on Act 12 Reform

Testimony of Justin Ladner, President, Pennsylvania American Water

Good morning, and thank you to Chairman Matzie, Chairman Marshall and distinguished members of the House Consumer Protection, Technology and Utilities Committee for holding this important hearing today. My name is Justin Ladner, and I am the President of Pennsylvania American Water. For more than 135 years, we have provided water services across Pennsylvania and currently serve 2.3 million Pennsylvanians in more than 400 communities in 37 counties. We are proud to serve as the Commonwealth's largest water and wastewater utility, and we value our relationship with the General Assembly and are thankful we have been invited to provide our perspective on the package of bills before us.

Let me start by saying we are openminded to modifications to Act 12 of 2016 that will truly improve the fair valuation of systems, promote public input and transparency, and allow for sufficient and timely regulatory review, while continuing to promote the Commonwealth's policy of water and wastewater regionalization and consolidation. We are committed to participating in this discourse and continuing to be part of solutions that bring necessary investment to water and wastewater systems in Pennsylvania.

Before I get into the substance of the legislation, I think it's important that I express our fundamental disagreement with the premise that the "vast majority of Act 12 acquisitions have been of well-run and well-maintained systems, not failing or stressed" systems, and these were "healthy systems" that sold at prices "much greater than their current value." In fact, I'd say the opposite is true. The vast majority of the systems we have acquired suffered from chronic underinvestment, deferred maintenance, and regulatory non-compliance, placing customers and the environment at risk. I say this because it's important to agree what the problem is in order to work together to solve it.

Opponents of Act 12 claim the acquisition prices are responsible for higher rates. We need to make this abundantly clear, and as we have outlined to the Commission in our recent general rate case filing, our significant capital investments to upgrade and replace aging infrastructure, bring systems into compliance, and meet increasingly stringent regulations are the primary drivers of upward pressure on rates – not acquisition purchase prices. Acquisition purchases only account for approximately one-eighth of our current rate filing, so while they are a component, they are not the main driver historically nor going forward.

Furthermore, with regard to acquisition purchase prices, our company is not interested in overpaying for systems, and under the current law all purchase prices are grounded in (1) a detailed review of assets comprising a system and (2) professional valuations conducted by PUC-approved appraisers using standards established by Uniform Standards of Professional Appraisal Practice (USPAP)¹. These valuation standards are used across a number of sectors including, for example, the real estate sector, should a municipal owner choose to sell underutilized buildings. Accordingly, we could support reforms that potentially reduce purchase prices as long as they continue applying a market-based approach and allow for a timely recovery of investments.

As part of these policy discussions, we also cannot solely look at post-acquisition rate impacts in a vacuum. Rather, we must consider the full picture. Estimates provided on post-acquisition rate impacts often ignore the fact that rates would be rising for these customers due to investment needs and more stringent regulations, regardless of ownership, and would have continued to rise absent a sale, perhaps at an even greater rate. The issue of rising water and sewer rates is also not just a private sector issue; rather, municipalities across the Commonwealth are raising customer rates to address infrastructure replacement, system resiliency, and regulatory compliance needs along with higher operating costs due to inflation and the rising price of labor, supplies and commodities.

The current price control proposal in HB 1865 to cap purchase prices at 125 percent of Depreciated Original Cost (DOC) is not an appropriate valuation method, would drastically disincentivize municipal acquisitions and hamstring critically needed investment in water and wastewater systems. Determining

¹ The *Uniform Standards of Professional Appraisal Practice* (USPAP) is the generally recognized ethical and performance standards for the appraisal profession in the United States. USPAP was adopted by Congress in 1989, and contains standards for all types of appraisal services, including real estate, personal property, business and mass appraisal. Compliance is required for state-licensed and state-certified appraisers involved in federally related real estate transactions.

an asset's original cost is important if you were calculating the asset's income tax basis but is not and was never meant to be a basis for valuing assets for a present-day sale. DOC, also referred to as Net Book Value, is based on the accounting value of the system when it went into operation in many cases 75 years ago, less decades of depreciation. It is not an actual reflection of a system's value.

On many occasions, we have encountered municipalities that have depreciated assets of their water or wastewater system to zero, even though the asset is still in use. These assets, while depreciated for accounting purposes, still have real value and the seller should be compensated for that asset. That value is best determined by conducting professional appraisals by valuation experts using USPAP standards. Act 12 requires two appraisals, one commissioned by the seller and one by the buyer. The lesser of the purchase price or the average of these two appraisals is used to determine what value the utility is able to recover.

When you sell a major asset like your home, naturally, you would want the current market to determine its value and selling price. Imagine if state law limited the price you could receive for your home because an archaic accounting rule only allowed it to be sold for the original building cost, plus some improvements, minus depreciation. And when you subtract depreciation, the accounting value of your house using this model may be zero. Even though your property could receive a fair market price through bids from buyers, you may only receive a price that is far below its real market value – or even nothing at all. Using perhaps a starker example further highlighting the time value of money, the original cost to construct the Brooklyn Bridge was \$15 million in 1883; however, it is unreasonable to believe that today it is worth \$15 million less depreciation.

Prior to the passage of Act 12 when a municipal system could only be valued at DOC less contributed property for purposes of a sale, the monetary value of systems was artificially low, disadvantaging local municipalities, stifling regionalization, and delaying much-needed investments in many Pennsylvania communities. With the passage of Act 12, municipalities now receive a purchase price reflective of all assets in service within a system and their system's actual value – not an unfair windfall, as some would have you believe. Pennsylvania American Water is open to discussing market-based valuation reforms that could improve the fair valuation of systems.

Similarly, the current proposal in HB 1865 to limit Section 1329 to troubled and distressed systems would result in even more egregious and chronic under-investment in water and wastewater infrastructure than the Commonwealth is seeing today. This drastic policy change would incentivize

municipalities to drive their systems to failure before they could receive a reasonable price for selling the system to a professional company. The General Assembly should reject any proposals that incentivize such behavior, as it will even further exacerbate the epidemic of under-investment, as we've recently seen in Greene County where chronic underinvestment led to a treatment plant failure at the East Dunkard Water Authority, leaving a community without clean, reliable water. Waiting until these systems meet the legal definition of "troubled" is the most expensive way to solve a community's, and this Commonwealth's, water and wastewater challenges.

Even when systems have not met the onerous criteria of a distressed utility (See 66 PA.C.S. § 1327), I assure you that Pennsylvania American Water has acquired a number of systems where chronic municipal under-investment had resulted in sewer overflows, unreliable service and crumbling infrastructure. In McKeesport, the city and its taxpayers were facing Act 47 municipal bankruptcy, the sewer system faced significant investment needs to support regulatory compliance, and the system was illegally discharging raw sewage from dozens of homes directly into abandoned mines. In Exeter Township, the municipal wastewater plant spilled four million gallons of untreated sewage into the Schuylkill River. Whether or not to technically label these municipalities as "troubled" or "distressed" is secondary; significant private investment following decades of government under-investment is paramount. Since acquiring these systems, Pennsylvania American Water has invested \$57 million and \$19 million respectively in these two systems to upgrade aging sewer infrastructure and achieve environmental compliance.

With regard to HB 1862, we support public notification and transparency around potential acquisitions and welcome opportunities to enhance transparency throughout the acquisition process. Upon reviewing the legislation, there are some opportunities to improve the legislation to ensure the most effective outcome and to eliminate redundancy.

With regard to HB 1863, we are not in favor of eliminating the requirement that the PUC issue an order on an acquisition application within six months. Providing no required timeframe leaves both the buyer and seller with no certainty about the timing of PUC action and runs counter to PUC norms. Acquisition applications are certainly no more complex than a general utility rate case, and PUC orders are required in nine months for those cases.

With regard to HB 1864, we understand the intent of this legislation is to phase in rate increases to acquired systems over multiple rate cases. We do not disagree with this goal, and in fact, our company

frequently requests that the PUC permit rates of acquired systems to be moved toward our statewide rates over several rate cases. However, the bill would prevent acquiring utilities from recovering the full PUC-approved rate base for potentially years. We believe that this prohibition is a violation of the regulatory compact.

In closing, the Pennsylvania General Assembly passed Act 12 of 2016 in response to statewide infrastructure challenges and restrictive valuation rules to update unfair and obsolete laws that prevented municipal governments from getting a fair price for their water and wastewater assets. Without these commonsense utility valuation reforms, communities would continue to have limited options to repair and rebuild water and wastewater systems that are, in most cases, aging and in need of infrastructure improvements.

Through local democracy, many elected municipal leaders in your communities are determining that it is in the best interest of their constituents to redeploy municipal assets to more pressing needs and allow professional water companies with scale and experience to address the challenges of rebuilding and managing aging infrastructure under significant regulatory oversight. Act 12 encourages such investment by providing a tool for municipalities and their taxpayers to receive the fair market value of their assets — and in turn unlock funding to reinvest in infrastructure, retire debt, fund pensions, and address other critical local priorities.

Following a sale, these communities received professional, reliable water and/or wastewater service from a PUC-regulated utility with robust low-income customer assistance programs and a record of excellence in environmental stewardship. And, rather than diminishing oversight, the sale of municipal water and wastewater systems actually increases the regulatory scrutiny of investments in physical infrastructure, rates charged to customers, and the financial health of the utility. We look forward to continuing the conversation surrounding Act 12 reform and I certainly welcome the opportunity to answer any questions you may have.