

**STATE OF MARYLAND
OFFICE OF PEOPLE'S COUNSEL**

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BILL NO.: **Senate Bill 854**
Public Utilities – Water or Sewage Disposal
Companies- Acquisition

COMMITTEE: **Finance**

HEARING DATE: **March 13, 2018**

SPONSORS: **Senator Klausmeier**

POSITION: **Oppose**

Senate Bill 854 proposes a new approach to the Public Service Commission (PSC) review of acquisitions of water or sewage disposal companies in Maryland. While the Office of People's Counsel (OPC) understands the purpose for revising the acquisition process, certain provisions of the Bill as drafted can have adverse impacts on the customers of the acquired company. OPC therefore must oppose Senate Bill 854.

OPC understands that the sponsor may introduce significant amendments to this Bill. The draft of the amendments that OPC has reviewed expands the scope of the Bill to include state, county and municipal water or sewage disposal service providers, which are not subject to the Public Service Commission's jurisdiction. Other amendments that may be introduced resolve some, but not all, of OPC's concerns. For example, OPC understands that the proposed amendments may remove the provisions regarding the distribution system improvement charge (DSIC) discussed below. OPC supports elimination of the DSIC. OPC continues to oppose

inclusion of additional unspecified fees in the amended version, shifting the burden of proof on the validity of the appraisals to parties other than applicants, and the limits on the PSC's ability to scrutinize transactions involving companies under its jurisdiction.

Senate Bill 854 establishes a process for valuation of a water or sewage disposal system which is the subject of a voluntary sale to an "acquiring entity" or "acquiring utility." The Bill also sets out requirements for information the acquiring utility must present to the Public Service Commission (PSC) for its review of the transaction. The PSC must review and issue a final order on the acquisition within 180 days of the filing. If the PSC approves the transaction, it must include in its order a decision on the rate base of the selling utility, a new tariff instituting rates and charges, and any conditions it requires. As drafted, the Bill would permit the acquiring company to add a new rate base to its existing rate base that consists of the lesser of the purchase price or fair market value (rather than the selling company's actual rate base) plus any transaction and closing costs incurred by the acquiring utility.

OPC understands that these types of proposals for the acquisition of water and sewage disposal companies are under consideration or have been adopted in other states. They are driven by several concerns, including infrastructure replacement needs and federal clean water regulations. In the case of regulated utilities, another factor is the very small size of many of these companies, which can impede capital investment. The Bill aims to address these concerns by allowing a very different valuation method of the property, called "fair market value."

Senate Bill 854 (Without Amendments)

The Office of People's Counsel opposes Senate Bill 854 as drafted because of its apparent adverse impact on the rates that the customers of the acquired company will pay. First, the fair

market valuation not only determines the payment to the “selling utility,” it ultimately will result in a different and more expensive rate base used for setting future rates by the acquiring utility. This is because rate base will be based on the lesser of the negotiated purchase price or fair market value and not the utilities’ actual rate base built into its existing rates. This is significant because the size of the rate base drives the revenues collected from ratepayers. It is unlikely that either a purchase price or fair market value will be less than existing rate base. Second, the Bill permits collection of a distribution system improvement charge (DSIC), with an open-ended period of time in which the acquiring company is permitted to collect certain charges without Commission rate review.

OPC represents residential utility customers in cases before the PSC, including mergers/acquisitions and rate cases of private water companies.¹ Except for two water utilities, the remaining private water utilities are small, with relatively few customers. There are significant clean water and infrastructure requirements for the systems, necessary for public health and safety. There are sometimes limits on access to capital and no economies of scale for these systems, limiting the ability to make necessary capital investments.

OPC’s initial understanding of this Bill is that it is an attempt to incent smaller companies to consider selling themselves to larger, better-capitalized concerns because the acquiring company would pay “fair market value” rather than a lower price based upon the cost of a depreciated rate base. If the only purpose of the Bill were to clear a path to allow a fair selling price for a small water system in danger of failing, the trade-off between use of this approach and the expected rate impacts might be reasonable, to ensure access to the water or sewage supply.

¹ Most water and sewer disposal customers are served by municipalities or WSSC, which are exempt from Commission regulation.

However, that purpose could be achieved by limiting the sections of the Bill dealing with the valuation of the system, and the incremental changes to the rate base valuation, to selling utilities meeting certain criteria.²

Additionally, OPC has concerns with the portion of the Bill that provides for automatic collection of a distribution system improvement charges (DSIC) and associated provisions involving timing of rate cases.³ If the PSC approves an acquisition under this Bill, the tariffed rates included in the application for approval of the transaction must remain in place until new rates are approved for the acquiring utility in a base rate proceeding. The acquiring utility also will be able to collect a DSIC during the time between approval by the PSC of the acquisition and approval of new rates. There is no requirement that the acquiring utility file for a change in base rates by a specified time so the acquiring utility could theoretically collect the DSIC for years with no review.

The DSIC itself is problematic. OPC, as well as most consumer advocates, believes that infrastructure investment is a normal and expected utility cost that should be reviewed for prudence and reasonableness in a rate case before customers are expected to pay. Infrastructure surcharges such as the DSIC constitute single-issue ratemaking divorced from other considerations of a company's revenues and expenses. For that reason, OPC opposes the DSIC provision in this Bill.

OPC recognizes that the General Assembly has passed legislation providing for similar surcharges for gas distribution company infrastructure (STRIDE). However, the STRIDE law provides for the infrastructure repair and investment plans to be submitted to the PSC for prior review and approval in an administrative proceeding. The PSC review includes requirements for timelines for completion of projects, estimated costs, and descriptions of how customers will

² Proposed sections 6-302 through 6-305.

³ See, for example, proposed section 6-306(E) and 6-308.

benefit by the investment. Additionally, for gas infrastructure surcharges, there is a robust public hearing process to ensure that the proposed investments are reasonable, prudent, non-revenue producing and designed to improve public safety or reliability.⁴ This Bill includes no such provisions and there is no cap or limit on how much an acquiring company could collect through a DSIC.

Senate Bill 854 With Proposed Amendments

The Office of People's Counsel has been provided a set of proposed amendments to Senate Bill 854. The proposed amendments would extend the Bill's requirements to state, county and municipal service providers, and limit the size of the customer base of affected providers to less than 400,000 customers.

The proposed amendments include a significant, and favorable, change to the original bill, by striking the permissive inclusion of a Distribution System Improvement Charge (DSIC) (Page 8, lines 9-11) by the acquiring utility. However, the significance of this change may be undercut or offset by several other changes.

First, the Bill as drafted allows the acquiring utility to include transaction and closing costs, including fees paid to valuation experts, in its rate base. While the proposed amendments place a dollar cap of \$50,000 on those expert fees, the amendments also provide that the Commission "may permit **additional fees** to be added to the ratemaking rate base of the selling utility." (Amendments, page 3, emphasis added). The tariff filed with the application would include a schedule of rates, service charges and additional fees incurred at or immediately after closing. The inclusion of "additional fees" may not appear significant, given the usual standards for

⁴ See generally, PUA §4-210.

Commission review and approval of transactions. However, these fees are not limited or defined in any way. (Amendments, page 3). Further, the proposed amendments add a new provision that states that the Commission's review of an application "shall be limited to determining whether the requirements of this subtitle have been followed." (Amendments, p. 4). This is in stark contrast to Public Utilities Article, Section 5-205, that currently requires the Commission to find that transfers of controlling interests in water and sewage disposal companies be "consistent with the public interest and necessity." The proposed amendments also shift the burden of proof regarding the fair market value appraisals, from the applicants to other parties, including OPC and Staff, by stating that the appraisals "are presumed to be valid," unless "substantial evidence" demonstrates a failure to comply with the law (Amendments, p. 4).

The removal of the DSIC provisions by amendment would be a real improvement. However, these other proposed changes would further restrict the ability of Commission Staff or OPC to review the proposed transaction, except in the most limited fashion. Given the likelihood of a very real increase in the new utility's rate base value, and thus an increase in rates paid by the customers as a result of the Bill's authorization of a fair market valuation, these proposed limitations on review of the transaction are problematic.

For all the above reasons, the OPC urges an UNFAVORABLE report.