

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

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BILL NO.: **House Bill 1566**
Public Utilities – Water or Sewage Disposal
Companies- Acquisition

COMMITTEE: **Economic Matters**

HEARING DATE: **March 8, 2018**

SPONSORS: **Delegates Miller *et al.***

POSITION: **Oppose**

House Bill 1566 proposes a new approach to the Public Service Commission review of acquisitions of water or sewage disposal companies in Maryland. While the Office of People's Counsel (OPC) understands the underlying purpose for revising the acquisition process, certain provisions of the Bill can have adverse impacts on the customers of the acquired company. OPC therefore must oppose House Bill 1566.

House Bill 1566 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," as determined by the average of two utility valuation expert appraisals.

The Office of People's Counsel opposes House Bill 1566 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 understands this Bill to be an attempt to incent smaller companies to think of 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. 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

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

² Proposed sections 6-302 through 6-305.

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

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 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.

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

⁴ See generally, PUA §4-210.