KEYSTONE TAP MAGAZINE

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Privatization

Over the last three decades, municipally-owned drinking water systems were acquired in large numbers by investor-owned utilities, whose rates and operations are regulated by the Pennsylvania Public Utility Commission ("PUC") and Department of Environmental Protection ("DEP"). Now, municipal wastewater collection and treatment systems are increasingly the targets of acquisition by large, privately-owned water utilities. What are some of the forces behind this acquisition trend for the ownership of Pennsylvania's wastewater utilities?

Money is the principal answer. Large, private water systems have offered and paid relatively large sums recently for a number of Pennsylvania's public wastewater systems. Local elected officials sell the municipal system – often for a large, single payment that can be used, only once, to pay down or pay off debt, or for other municipal needs. After that, the municipality loses all control over the utility. For a municipality facing economic pressure and debt, the one-time cash injection is hard to resist. A more difficult question is whether the sale really solves underlying structural deficit in the municipality's finances. And then what happens to rates, service, and the fate of the customers?

Sewer system customers generally enjoy low rates and responsive, locally-based service provided by their municipal systems. They can finance capital projects with low-cost, tax free financing. These benefits arise from and are assured by the power of the ratepayers to appear at local meetings and direct their concerns to their neighbors who oversee and run the systems. Ratepayers can take their concerns to the ballot box as well, pressuring local elected officials to provide good service and value and to make effective appointments to local authorities. Local service needs are addressed locally under this model. The community's common interest in providing its members low-cost, high-quality service drives the arrangement. Elected and appointed local leaders are motivated to keep rates low.

Investor-owned utilities operate in a different world. With rates and service regulated by a relatively friendly PUC, these companies thrive by earning a return on capital invested in the system; they operate for profit. The more money they invest in systems, their rate base, the more a return on investment is earned. These utilities generate profits for their shareholders. Because they are monopolies, the PUC regulates their rates of return and their customer rates, which are set out in tariffs. PUC rate case proceedings are very expensive, and the costs of the proceedings are paid by ratepayers. One might guess that customers would pay more to be served by a company whose cost of providing service includes a statutorily mandated return on investment. According to one recent study, Pennsylvania drinking water rates for 60,000 gallons were $793 for Pa. American Water Co., an investor-owned, for-profit utility, and $382 for the average publicly-owned water system. That is quite a difference, a $400 annual swing in customer rates.

Certainly, a large sum of cash can entice a cash-poor municipality. And some systems face upgrade costs so high their only choice may be to exit the utility business altogether. But look more closely and one can see that ratepayers, who are citizens, constituents, and often voters, may well be asked to pay more for service when a municipality sells its wastewater system. How can a community value the lump sum received in a cash sale compared to the new rates facing its community? Is the sale a true value for the community, or simply a short-sighted tradeoff? Ralph Waldo Emerson once said, “Money costs too much.” The money received by the seller of a municipal system is not free and in a very real sense is paid by future rates.

Rate protection promises are a common feature of these sales. Designed to protect ratepayers from sudden rises in rates upon takeover by an investor-owned utility, they can help reduce or avoid “rate shock.” But look five years beyond the same date, and one can see the cash payment will be long gone, and the customers will look only to the elaborate and arcane rate case litigation proceedings before the PUC to voice concerns over rates. They can choose to litigate before a PUC administrative law judge to press problems about service. Rates are driven by the PUC’s endorsed return on investment across the investor-owned utility’s statewide rate base.

Municipalities at times used their publicly-owned systems as a source of additional revenue to offset taxes. This practice was not sound, and amounted to a violation of the Sewer Rental Act as to municipal systems. Municipal Authorities later were protected when the law prohibited cash transfers to the parent municipality in the absence of some corresponding service. Where this traditional – but illicit – cash flow of utility revenue into the municipal general fund was stopped, some municipalities faced a difficult choice to raise taxes or reduce services. Sale of a sewage treatment or collection system may appear to be a good solution for the municipality to realize the cash value of those lost revenues. After a fashion then, the legislature’s protection of utility revenues for publicly-owned systems may be a contributing factor in the sale of these systems to investor-owned utilities. If the municipality can no longer enjoy rate revenues, it may still receive cash for the sale of the system.

The larger investor-owned utilities are busy staking out territory and paying top dollar for municipal systems. Prices offered for even small treatment and collection systems are high enough to be tempting. Public officials at the helm have difficult decisions, with far-reaching effects. The long-term effect of such sales on the fate of the customers, their cost of service, should be at the top of the list of aspects to review when sale is under consideration.
“If money is your hope for independence, you will never have it,” said Henry Ford. Municipalities considering a sale of their treatment or collection systems should determine whether the sale will lead to true long-term financial independence, or whether the sale offers merely a short-term, one-time slug of cash paid for by future generations of ratepayers. These are difficult and serious considerations. Sometimes the sale of a municipal system is a good thing. Other times, what may initially seem like a great idea may be trading cash now for high rates later.

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