

# Recognizing and Preserving a Municipality's Equity in Local Utility Systems

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# The Value Of Municipal Utility Systems Has Never Been Higher

For Most Municipalities, The Local Water and Sewer Systems Are Their Most Valuable Assets.

In addition to public parking, the revenue generating potential of the local water and sewer systems (especially water) typically make them the most valuable assets of a municipality. The monopoly powers granted to municipalities, in the form of mandatory connection ordinances, were essential to the original creation of such value. Once customers are connected, and on-lot systems abandoned, that value remains even if sold to another entity.

## The Value Of Municipal Utility Systems Has Never Been Higher

### Act 12 of 2016 Has Enabled Private Utilities To Offer Municipalities Much More Money To Purchase their Systems

The value of municipal water and sewer systems has increased considerably since the enactment of Pennsylvania Act 12 of 2016. This law created new valuation and cost recovery options through the state Public Utility Commission, and enables investor-owned utilities (“IOUs”) to offer higher purchase prices for existing municipal utility systems. Basically, if proper value, rate and impact studies are undertaken under Act 12, an IOU can obtain a rate hike through the PUC allowing the purchase price to be spread over the IOU’s much larger customer base.

# The Value Of Municipal Utility Systems Has Never Been Higher

## Regional Municipal Authorities Are Also Purchasing Neighboring Systems.

Municipal Authorities seeking to grow and spread costs over additional customers (just like the private utilities), are competing with IOUs to purchase neighboring utility systems. The possibility of a private sale, or a competitive bidding scenario, could draw the interest of large Authorities seeking to expand their territory. Public perception might view an Authority buyer as a “white knight” to thwart a private company takeover. The Authority’s ability to issue tax-exempt debt to finance a purchase can also result in a higher price.

## Who Owns these Valuable Assets?

### Many Municipalities Gave Away Valuable Assets Long Ago.

Until the 1970s, the Pennsylvania Constitution severely limited how much money municipalities could borrow to construct or improve local water and sewer systems. Before then, the work-around was to create a Municipal Authority to borrow on behalf of the municipality. Later, as systems expanded into neighboring municipalities, Authorities were used to avoid PUC jurisdiction over local rate setting. The concept of an “operating authority” gained popularity so municipalities could delegate utility operations to an appointed Authority board. Title to the system assets was typically transferred to the Authority, even if it was then leased back to the municipality to operate.

## Whose Interests do Authorities Serve?

Authorities' Allegiance has Focused on its Utility Customers Rather than the Municipality Incorporator.

Despite many years of financial support provided by the original customers in the incorporating municipality, and the monopoly powers it granted to the Authority, many Authorities view their allegiance to their customers above the incorporator. The clash of these interests becomes particularly acute when a municipality seeks to “monetize” an Authority-run utility system, through a sale or annual payments. The Authority views monetization as against customer interests and, therefore, to be opposed. Neighboring municipalities served, but not legal “members” of the Authority (having Board appointments and system equity), are typically hostile to sales or payments.

# Monetizing a Utility System Typically Requires Ownership

Without First Getting Title to the Assets, Monetizing is Difficult if Not Impossible.

The Municipal Authorities Act prohibits the authority from just giving or loaning money to its incorporator. There has to be commensurate value given by the municipality to the Authority. If the municipality owns the system and then leases it to the Authority, compensation to the owner/lessor (municipality) in the form of annual lease payments, is arguably “reasonable”.

# Is a Fight Inevitable?

## The Battle Lines are Drawn.

If a municipality wishes to sell its local system, it would have to overcome resistance from the Authority's Board, and its customers, before transferring the assets. Neighboring municipalities consider it unfair for the original incorporator to reap such a financial "windfall". Political tensions flare. Also, the Authority Manager and employees are not overjoyed by the idea of their employer being sold. Litigation is common in these situations.



# What are the Municipality's Legal Rights?

## The Municipality has Legal Rights to Control Assets and Actions of Its Authority.

If the Municipality owns the system in question, one obstacle to monetization is the lender, or bondholders, holding a lien on the system revenues. Debt would have to be paid off, or obtain prior lender consent. A municipal guaranty can help.

If an Authority owns the system, but the municipality appoints its members, there are rights under the Authorities Act that the municipality can exercise. If it is a joint Authority, the rights of one of the incorporators, even the one with a majority of the board members, are compromised. Little case law exists for how to liquidate joint Authorities if all incorporators cannot agree.

# Legal Right to Acquire an Authority's Utility System

The incorporating Municipality has the unilateral power to acquire and sell its Authority utility system

## **MAA § 5622. Conveyance by authorities to municipalities or school districts of established projects.**

(a) **Project.**--If a project established under this chapter by a board appointed by a municipality is of a character which the municipality has power to establish, maintain or operate and the municipality desires to acquire the project, it may **by appropriate resolution or ordinance** adopted by the proper authorities signify its desire to do so, and the authorities shall convey by appropriate instrument the project to the municipality upon the assumption by the municipality of all the obligations incurred by the authorities with respect to that project.

# Legal Right to Control an Authority's Utility System

The incorporating Municipality has the power to limit Authority “projects” and related actions

## **MAA § 5607. Purposes and powers.**

(c) **Effect of specificity.**--The municipality or municipalities organizing such an authority may, in the resolution or ordinance signifying their intention so to do or from time to time by subsequent resolution or ordinance, specify the project or projects to be undertaken by the authority, and no other projects shall be undertaken by the authority than those so specified. If the municipal authorities organizing an authority fail to specify the project or projects to be undertaken, then the authority shall be deemed to have all the powers granted by this chapter.

# Legal Updates on Municipal Control of Authority Utility Systems

## □ In Re: Chester Water Authority Trust – Filed September 16, 2021

Since 1995 the City of Chester has been declared financially “distressed”, and the State recovery plan recommended that the City “monetize” (sell or lease) assets. There was concern from customers (and local politicians), that a sale of the Authority’s water system to a private utility would greatly increase rates. Nevertheless, the City entered into negotiations with Aqua Pennsylvania for a sale.

In 2012 the PA legislature, with an eye on the proposed sale, amended the Authorities Act to reduce the City’s Board appointments from 5 to 3, and added 3 appointed by the Delaware County Commissioners, and 3 by the Chester County Commissioners. The new Board of the Authority then took steps to prevent an asset takeover by creating a “trust” containing the water system assets, making them unavailable to sell to Aqua.

In 2020, the Authority asked the Delaware County Court to approve the trust and deny the City’s (and Aqua’s) requests for a declaration that the City maintained its rights to acquire the system despite the legislative reconstruction of the Chester Authority Board.

# Legal Updates on Municipal Control of Authority Utility Systems

## □ In Re: Chester Water Authority Trust – Filed September 16, 2021

The trial court held that the state legislature, by increasing the size of the Chester Authority Board, essentially gave the Counties 2/3 veto power over a sale.

However, the Commonwealth Court reversed, saying “*our General Assembly, in enacting [the 2012 amendment], merely intended to reconfigure the numerical and geographical organization of [the board of the] water authority...We hold that section 5622(a) of the MAA continues to vest a municipality, such as the City in this case, with the power to acquire and dispose of the assets of an authority and an authority itself, such as the Authority in this case, without the advice or consent of...the Authority [Board].*”

The PA Supreme Court has agreed to review this decision.

# Legal Updates on Municipal Control of Authority Utility Systems

## □ County of Delaware v. DELCORA– Decided March 3, 2022

In another Delaware County case, the Board of the Delaware County Regional Water Quality Control Authority (DELCORA), sought to place its assets beyond of the reach of its incorporator, the County of Delaware. By the time there was a change in political control of the Board of Commissioners, DELCORA had already entered into an agreement to sell its water system to Aqua Pennsylvania. The new Commissioners sought to stop the sale by invoking its legal rights to limit the Authority’s actions and dissolve DELCORA.

The new Commissioners enacted an “*Ordinance, directing and ordering DELCORA to terminate its operation, wind up its affairs, satisfy outstanding debts, and take all actions necessary to remove any impediments to its termination, and refrain from taking any action or expending any funds inconsistent with DELCORA’s termination of its affairs*”.

# Legal Updates on Municipal Control of Authority Utility Systems

## □ County of Delaware v. DELCORA– Decided March 3, 2022

The County asked the trial court to compel the Authority to comply with its Ordinance. In response, the Authority raised several potential obstacles to the County’s demands, including that the Aqua agreement was not, by its terms, assignable to the County. The County Court agreed with the Commissioners, but the Commonwealth Court reversed.

**“[W]e conclude that the Ordinance is valid and enforceable to the extent it directs the termination/dissolution of DELCORA and dictates that, after termination/dissolution is underway, DELCORA must engage in conduct necessary to effectuate the transfer of its assets and the assumption of its liabilities/obligations by the County...”**

# Legal Updates on Municipal Control of Authority Utility Systems

- County of Delaware v. DELCORA– Decided March 3, 2022

The Court also held that DELCORA’s could not shield its assets by entering into an unassignable Asset Purchase Agreement with a third party (Aqua).

***“We conclude that an authority may utilize its power to contract and sell its assets to another entity; however, a municipality may invoke its power under section 5622(a) to demand that the authority terminate and/or convey its assets to the municipality at any time prior to the complete performance of that contract.”***



# Legal Updates on Municipal Control of Authority Utility Systems

## □ County of Delaware v. DELCORA– Decided March 3, 2022

One problem remained, however. Delaware County could not simply ignore the Aqua agreement entered into before the takeover Ordinance was enacted. **“The County ... *will have no choice but to abide by and fully perform its obligations or else be potentially subjected to a breach of contract suit by Aqua.*”**

Although the Authority’s plan to block the sale was defeated, the County faces a potential lawsuit from Aqua. This highlights the importance of the timing of actions taken by a municipality to limit actions by the Authority. If the County Ordinance had preceded the Aqua agreement, it might have been nullified.

# Legal Updates on Municipal Control of Authority Utility Systems

## □ Municipal Authority of the Borough of Lewistown v. Borough of Lewistown

In December, 2019, the Borough of Lewistown adopted a Resolution signifying its intent to acquire the water system of the Municipal Authority of the Borough of Lewistown and prohibiting actions that would interfere with the acquisition, such as issuing debt that could not be promptly repaid. The Borough originally incorporated the Authority, and appointed all of its members, but over several decades the water system had expanded into surrounding municipalities. The Authority sued the Borough and, after receiving an injunction from the local trial court, the Commonwealth Court reversed and reinstated the effectiveness of the Borough's takeover ordinance pending trial.

After months of political acrimony, the Borough sold its rights to acquire the Authority assets to a newly-created Mifflin County Municipal Authority, with members nominated from nearly all of the served municipalities. Lewistown received an initial payment of \$1,000,000 and \$300,000 per year thereafter, plus inflation, for 30 years.

# Legal Updates on Municipal Control of Authority Utility Systems

## What do these cases mean for other Municipalities?

- a. Since 2016, the value of municipal utility systems has increased dramatically.
- b. A municipality has the power to acquire the assets of an Authority it created, and to compel the Authority to cooperate in that process.
- c. Actions taken by an Authority Board to block a takeover, are likely illegal.
- d. Contracts entered into by an Authority Board before a municipality signifies its intention to acquire its assets, can bind the municipality afterwards.

## Legal Updates on Municipal Control of Authority Utility Systems

- e. “Monetizing” assets is a common strategy in Act 47 recovery plans to alleviate municipal distress.
- f. Ultimate control (and avoiding costly litigation) comes from the annual appointment of Authority Board members sympathetic to the municipality’s circumstances.
- g. Council and municipal employees are eligible to serve as Authority Board members (subject to agreements requiring resignation at end of the elected term or employment termination).

# Questions?

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