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Regulating Troubled or Failing Monopolies: Ordering One Public Utility to Acquire Another

One of the traditional reasons for government intervention in the marketplace is market failure. A classic example of a market failure is a natural monopoly such as a public utility. Most economists agree that government should regulate such monopolies rather than allowing competition for such services as public water and sewer.

The Pennsylvania Public Utility Code (Code) gives the Pennsylvania Public Utility Commission (PUC) extensive powers to regulate public utilities, but what can it do when the monopoly becomes troubled and starts to fail; when the public utility is no longer financially and technically capable of providing reasonable and adequate service to the public? For example, how does the PUC deal with a water utility that is not providing customers with potable water and lacks the financial resources to address the deficiencies in service?

The public utility cannot be ordered — or even permitted — to liquidate its assets and go out of business because that would leave customers without vital public utility service. Additionally, some public utilities may be unable to find a willing buyer because the system requires extensive capital improvements to address service deficiencies or to comply with increasingly strict environmental or other standards.

In Pennsylvania, the problem of troubled or failing monopolies is particularly acute in the water and wastewater industries because there are many small privately owned water and wastewater systems that struggle to remain viable. To address this problem, the Code includes a provision that gives the PUC authority to order a proximate capable public utility¹ to acquire a small water or sewer utility.² 66 Pa. C.S. § 529. The PUC must make six findings about the buyer and the seller before it can issue such an order. These findings are:

1. the small water or sewer utility is in violation of statutory or regulatory standards that affect the safety, adequacy, efficiency, or reasonableness of the service provided;
2. the small water or sewer utility failed to comply, within a reasonable period of time, with any order of the Pennsylvania Department of Environmental Protection (DEP) or the PUC concerning the safety, adequacy, efficiency, or reasonableness of service;
3. the small water or sewer utility cannot reasonably be expected to furnish and maintain adequate, efficient, safe, and reasonable service and facilities in the future;
4. alternatives to a forced acquisition (such as the reorganization of the utility under new management or a voluntary sale of the system to a public utility, municipality or municipal authority³) have been considered and the PUC has determined them to be impractical or not economically feasible;
5. the acquiring capable public utility is financially, managerially, and technically capable of acquiring and operating the small water or sewer utility in compliance with applicable statutory and regulatory standards; and
6. the rates charged by the acquiring capable public utility to its pre-acquisition customers will not increase unreasonably because of the acquisition.

If the PUC orders the small water or sewer utility to be sold to a capable public utility, the purchase price is determined by agreement between the parties (subject to a PUC determination that the purchase price is reasonable). If the parties cannot reach an agreement, or if the PUC disapproves their agreement, the acquisition price is determined through an eminent domain proceeding. 66 Pa. C.S. § 529(e).

For many years, the “typical” Section 529 proceeding began with a complaint initiated by customers, the PUC’s prosecutorial staff,⁴ or other public advocates⁵ alleging that the small utility was not providing reasonable and adequate service as required by the Code. Upon finding that the small utility was not providing reasonable and adequate service, the PUC would open an investigation to determine whether the utility should be ordered to be sold to a capable public utility pursuant to Section 529. In two relatively recent cases, however, the PUC held that a small water or sewer utility can ask the PUC to institute an investigation to determine whether that utility should be ordered to be sold to a capable public utility.⁶

Section 529 provides the PUC with a mechanism to deal with a troubled or failing monopoly in a limited number of situations. It gives the PUC a tool to address failing small water or sewer utilities, but does not permit the PUC to address other troubled or failing public utilities (such as small natural gas distribution companies).

These limits do not mean that the General Assembly should rush to extend Section 529 to other situations. Section 529, and its implementation, raise important legal and public policy questions. Virtually all Section 529 proceedings to date have been resolved through settlements. As a result, the appellate courts have yet to construe the provisions of Section 529 and the PUC’s application of them. Additionally, in some Section 529 cases, a receiver is appointed to operate the system pending the outcome of the Section 529 investigation. In many of these cases, the receiver is ultimately ordered to purchase the small water or sewer system. How are receivers selected, what are their duties, and how are they compensated?⁷ Moreover, it appears that every Section 529 case to date has resulted in the sale of a small, troubled water or sewer company to one or the other of Pennsylvania’s two largest investor-owned water and sewer utilities. Should the costs of these acquisitions (and the accompanying system remediation) be borne solely by the ratepayers of the utility that was forced to make the acquisition, or should the costs be spread more broadly? Should proximate municipalities and municipal authorities also be targeted for the forced acquisition of troubled or failing privately owned utilities? Before the General Assembly extends Section 529 to other situations, it may wish to review existing procedures and consider other approaches for addressing the problem of regulating troubled or failing monopolies.

1 A “capable public utility” is generally defined as a public utility that is not affiliated with the small water or sewer utility, provides reasonable and adequate service, and regularly provides the same type of service as the small water or sewer utility to 4,000 or more customer connections. However, a public utility that does not regularly serve 4,000 or more customer connections, and is not proximate to the small water or sewer utility, can elect to be a capable public utility. 66 Pa. C.S. § 529(m).

2 A small water utility is defined as a public utility that regularly provides water service to 1,200 or fewer customer connections. Similarly, a small wastewater utility is defined as a public utility that regularly provides wastewater service to 1,200 or fewer customer connections. 66 Pa. C.S. § 529(m).

3 The PUC generally has no authority over a utility system owned by a municipal authority. Similarly, the PUC has no authority over a utility system owned by a municipality, if the system only

serves customers within the municipality's boundaries.

4 The PUC's Bureau of Investigation or Enforcement.

5 The Office of Consumer Advocate in the Office of Attorney General or the Office of Small Business Advocate in the Department of Community and Economic Development.

6 Petition of Delaware Sewer Company for the Opening of an Investigation into Whether the Public Utility Commission Should Order a Capable Public Utility to Acquire the Company Pursuant to 66 Pa. C.S. § 529, Docket No. P-2014-2404341 (opinion and order entered Jan. 28, 2016) and Petition of Twin Lakes Utilities, Inc. for a Commission Order Authorizing the Acquisition of Twin Lakes Utilities, Inc. by a Capable Public Utility Pursuant to 66 Pa. C.S. § 529, Docket No. P-2020-3020914 (opinion and order entered Sept. 17, 2020).

7 For a discussion of these issues, see our previous Alert Receivers of Public Utilities in Pennsylvania: The Need for Legislation or Regulations.

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