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The tangled tale of a troubled town's water authority

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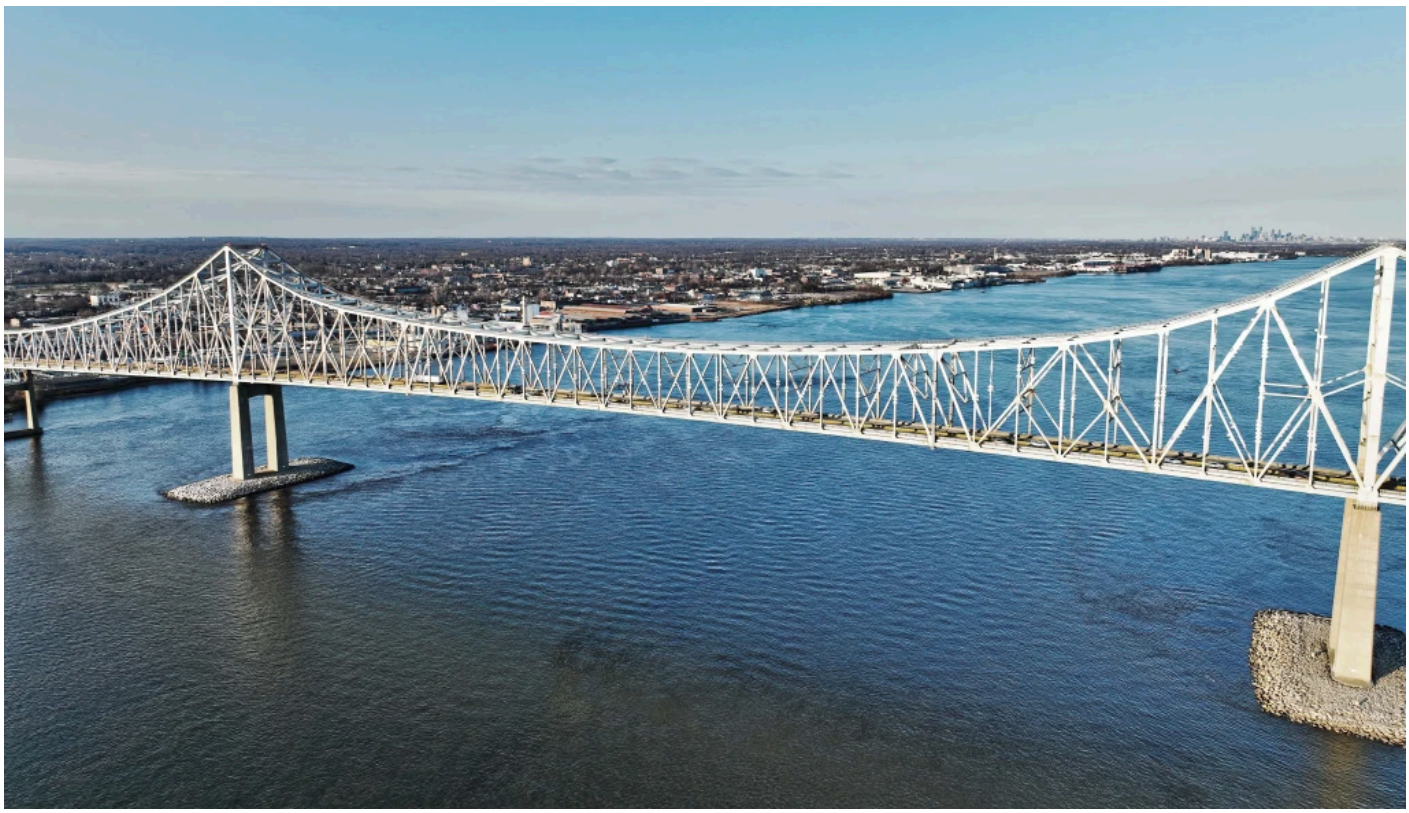

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The Chester Water Authority traces its origins back to 1868, when it was created as a private entity to provide water to Chester, Pennsylvania's residents.

The Chester Water Service Company, as it was then known, continued to operate privately until, in 1939, when residents complained of "foul tasting, odiferous water." Chester purchased the water system for $1,050,000.

A "cabal" associated with the town's Republican leadership purchased the Chester Water Service Company first, for $750,000, then sold it to the city immediately after, turning a profit, adjusted for inflation, of $5.6 million. The city attempted to prosecute, but was unsuccessful.

Chester never escaped the corruption and mismanagement. The city has been bankrupt for two years, and its state-appointed receiver says its utilities are its only assets. When the receiver proposed monetizing the water authority, tensions reached a boiling point.

The Chester Water Authority, until recently, was rated Aa2 by Moody's Ratings. It touts several awards for best-tasting water and serves Chester City, Delaware County and Chester County.

Chester's economic decline started in the mid-20th century, when the city lost manufacturing jobs and residents who could afford to flee. The city owes $40 million to its pension funds and its tax base is insufficient to cover its expenses, Receiver Michael Doweary said.

Vijay Kapoor, the Chester receiver's chief of staff, consulted for many distressed municipalities through PFM Asset Management and his own company. Chester's condition was unlike any he'd ever seen.

The city has a "history of seeing residents, unfortunately, I think, taken advantage of in different ways," Kapoor said.

One of the receiver's ongoing legal battles stems from an example of government exploitation, Kapoor argued at a public meeting.

The seeds of Chester's problems

For years, Chester's politics were dominated by a Republican political "machine," Kapoor said. In the 2012 election, Democrats won the mayor's seat and a majority on the city council for the first time since 1904.

At the time, there was a bill in the U.S. House of Representatives to regulate utilities. Lawmakers had been spending money intended for utilities on unrelated political projects. Dominic Pileggi, a Republican from Chester and then-Senate Majority Leader, had just lost reelection.

Pileggi added an amendment that changed the board appointment structure for any municipal authority incorporated by a single municipality that serves two or more counties, with assets in three or more counties, and with more than 80% of the served population outside of the incorporating municipality. This amendment, as far as anyone knows, only ever applied to the Chester Water Authority.

The amendment passed unanimously, without any hearings. Now, instead of a five-member board appointed solely by the Chester City Council, the board has nine members, with Chester, Delaware County and Chester County each appointing three members.

As a result, Chester may have lost the ability to sell the CWA. According to a valuation, this might have cost the city more than $400 million.

The law may have violated Pennsylvania's constitution, which has a provision against legislation that applies to only one municipality. Kapoor said Chester reserves the right to challenge the law's constitutionality.

Beyond ownership, it doesn't appear the change to the board had any implications for the CWA.

The CWA's solicitor, Francis Catania, said current operations are normal and the atmosphere between board members is collegial.

Dan Seymour, an analyst for Moody's Ratings, said that until this legal battle broke out, Moody's considered the CWA separate from Chester, precisely because the city didn't have control of the board — which insulated the CWA's ratings from the dysfunction in Chester's government.

In 2016, the Pennsylvania legislature passed another law about utilities which, in Catania's eyes, poses a bigger threat to the CWA.

Act 12, as it's commonly known, was supposed to make utility privatization fairer.

Public utilities are consistently undervalued, according to Matt Fabian, partner and lead analyst at Municipal Market Analytics. Traditionally, the price of a public utility is determined by its original book value, adjusted for inflation, and subtracting the depreciation of assets.

Control of a public utility means a virtual monopoly, in which customers need your product to survive, Fabian said.

In Pennsylvania, a "distressed" system could be sold for its "fair market value," a calculation which accounts for the profit the purchaser will reap. The purchaser — the state has two main ones, Aqua Pennsylvania and Pennsylvania American Water — would then recoup the money it spent in the sale by raising rates.

Act 12 opened up this avenue to all utility providers, not just distressed ones. Private companies could now purchase any water system they liked, and municipalities had much higher incentives to sell.

Theoretically, the Pennsylvania Public Utilities Commission should prevent exorbitant increases in rates. But the PUC is ineffective at this task, according to James Cawley, a former commissioner, because the regulations were heavily influenced by Aqua and American Water.

Act 12 unleashed a wave of utility privatization. In May 2017, Aqua Pennsylvania made an unsolicited $320 million bid to the CWA, which the board rejected. But that wasn't the end of the story.

In July 2019, as Chester's finances were in free fall, the City Council issued a request for proposals to sell the CWA. Meanwhile, the CWA filed a petition before the Court of Common Pleas to put its assets in a trust; Chester and Aqua both filed motions challenging the CWA's ability to do so.

Pennsylvania law treats a municipality's authorities as separate legal entities, but the municipality retains the right to sell the assets of an authority it created. The CWA argued that Chester lost that right in 2012.

In February 2020, the city once again put out an RFP to gauge the value of the CWA. Aqua and Pennsylvania American Water put in bids of $410 million and $425 million, respectively. The authority itself bid $60 million to leave the CWA alone.

In April 2020, then-Gov. Tom Wolf declared an economic state of emergency and appointed Doweary as receiver.

In September 2021, the Commonwealth Court ruled Chester had the right to sell the CWA, and CWA appealed to the state Supreme Court, which accepted the case.

Immediately after the Commonwealth Court's ruling, the City Council formally asked Doweary to approve Aqua's bid, revised to $410 million plus $12 million up front. But the receiver refused to approve the asset purchase agreement.

In Doweary's letter to the City Council, he appears agnostic about privatization.

"Since the city does not have any other asset that would come close to generating the level of proceeds the city needs, it must monetize the water system. However, that does not necessarily mean that the water system needs to be privatized," Doweary wrote. "I have no issue with the water system remaining in public hands if the city can receive a fair price for the system."

Oral arguments before the Supreme Court were set to start in November 2022. But days before, Doweary filed for bankruptcy and the case was frozen.

Spats continued. In April, the receiver's office returned to bankruptcy court with a plan of adjustment and a new vision for its utilities.

The receiver will issue RFPs to monetize the water authority, stormwater authority and reversionary interests in the sewer authority — without privatization.

The new plan

"The simplest course for the receiver to follow would be to sell the city's interests in the water assets to the highest bidder, declare victory and walk away," the receiver wrote in a legal filing. "However, selling off the city's interest in the water assets would be yet another large scale 'quick fix' that would ultimately find the city right back where it has been since 1995 — in financial distress — because doing so does not address the city's ongoing structural deficits."

"Moreover," the filing continued, "privatization of the water assets would not be in the best interests of the city's residents. Privatization of water and wastewater assets in Pennsylvania has led to extraordinary rate increases of between 44.9% and 166.6%, which Chester's already financially burdened residents can ill-afford."

The receiver's office is leaving the details of the monetization vague, as long as the system remains in public hands. Kapoor said an ideal proposal would consolidate the water, sewer and stormwater assets into one authority, and the bankruptcy filing said the receiver would prefer proposals with a "regional approach" which could manage the assets of nearby municipalities that may wish to sell.

Beyond that, the receiver's office is "trying to be creative," Kapoor said. They want to see what proposals come in. They would be open, he said, to selling to another municipality, entering a public-private partnership or lease agreement, or creating a new authority.

The bankruptcy filing also said that upon approving a monetization proposal Chester will dissolve the boards of the water and stormwater authorities and the ownership will revert back to the city.

Kapoor said they may not dissolve the CWA, depending on the proposals they receive and whether they can reach an agreement with the authority.

Kapoor said there is no target price and no floor for an acceptable offer. The CWA is worth more than $400 million; the receiver does not have a valuation for the stormwater or sewer assets.

The plan of adjustment led Moody's to put the CWA's rating under review for possible downgrade.

The plan of adjustment said each utility's debt "shall be paid, repaid, prepaid, redeemed, defeased or assumed." The suggestion, Seymour said, is unusual and it introduced a new credit risk.

Moody's assumed if CWA were to be privatized, the debt would be paid off, Seymour said. This suggests the debt can be "assumed by someone else, and we don't know who that someone else would be."

Kapoor said the Municipal Authorities Act allows the purchaser to assume the debt.

The authorities remain the biggest opponents of the plan to monetize them.

Backlash from the utilities

The plan of adjustment was opposed by the sewer and stormwater authorities, as well as many of Chester's state legislators.

But the plan's fiercest opponent has always been the CWA.

"The municipality is raising money by letting someone else come in and charge their residents more money," Catania said. "If you're a local elected official and you've run your town into the ground financially, it's a great scheme to bail yourself out and not get blamed for it."

Catania believes the receiver and the Pennsylvania Department of Community and Economic Development, which oversees the state's distressed municipalities program, always intended to sell the CWA to Aqua.

"The real strategy is to make the situation in the city so bad that they [can] go to a judge somewhere and say, 'We have to [sell to] Aqua,'" Catania said.

The receiver has been having closed-door meetings with Aqua, Catania alleged. The Chester Water Authority also obtained emails from DCED staff via records requests, with Doweary copied, that appear to discuss a "pilot program" for the monetization of water authorities.

The receiver's office denies the CWA's allegations.

"The city and CWA have been in court-ordered mediation at the request of the receiver since the bankruptcy filing in 2022, and the receiver still hopes to reach a settlement with CWA. In the meantime, the receiver has been very clear of his intention to keep the water assets in public hands," the receiver's office said in a statement.

The receiver did meet with Aqua and American Water to discuss their bids prior to declaring bankruptcy, Kapoor said, but denies doing the bidding of the DCED.

"This argument that somehow the receiver came in to privatize the system," Kapoor said, "if that were the case, why would the receiver say to the city, 'No, you don't have the authority to sign the asset purchase agreement?'"

Kapoor said the receiver has taken heat from the city's creditors for not accepting Aqua's bid.

"We have the Chester Water Authority criticizing the receiver for wanting to monetize the system at all," Kapoor said. "And then, on the other hand, you've got the retirees and the unions [criticizing] the receiver, saying, 'Wait a minute, why are you taking privatization off the table?'"

Indeed, the city's creditors had harsh words for the receiver in response to the plan of adjustment.

"By limiting the potential acquirers of the water assets and excluding private-sector entities, the receiver is almost assuredly — and drastically — reducing the value to the city of any monetization transaction," the Retirees' Committee wrote in its filing.

But the main complaint in the filing was a lack of communication from the receiver.

"The only meeting that the Retiree Committee professionals had with the receiver in this entire bankruptcy case regarding a disposition of the water assets was in June 2023 — over one year ago," a footnote in the filing read. In that meeting, a consulting firm discussed water management issues at a general level, and "did not provide any analysis or recommendations whatsoever regarding the water assets."

"It is transparent that the real purpose of the plan is merely to prod the CWA and DELCORA in their months-long mediation negotiations that have apparently reached an impasse," the filing said.

But the CWA also received no warning before the receiver filed the plan of adjustment, Catania said.

Negotiation tactics aside, there is a chance that eschewing privatization will mean missing out on a lot of revenue.

Monetizing a water authority

The receiver's office released a Request for Qualifications on Nov. 20. That RFQ says that "maintaining the assets in public ownership" and "affordable rates for all rate payers" are "paramount" in the city's consideration of any offer. Submissions to the RFQ are due January 15, and the receiver will respond to submissions in February.

The rest of the details are vague, in line with the receiver's strategy; "there's a variety of different kind of possibilities that we would entertain, with the key aspect that it remains publicly owned," Kapoor said.

But it's possible to consider more detail into what the results could look like.

For an outright sale to another municipality, there are a few red flags. For one, when municipal utilities expand, they usually expand within their region, said Mary Grant, campaign director for Food and Water Watch.

The CWA is big enough that it already handles all the water in its region, Grant said. And the neighboring counties' utilities have mostly already been privatized.

Kapoor declined to say whether any municipalities have expressed interest in acquiring Chester's utilities. "I'm not going to necessarily get into anyone we've talked to or didn't talk to," he said.

Public-to-public transactions also tend to yield less revenue. Aqua and American can afford to pay $410 million because they have large rate bases and aren't afraid to raise rates, said Cawley, the former PUC commissioner. Public water authorities are smaller, he said, so that even if they could afford it, it's prohibitively risky. They generally just pay the book value of the assets.

The most common method of monetizing without privatizing is leasing a utility. The lessee in these situations is usually a private company — it's often Aqua or American Water. In those cases, Grant said, ratepayers encounter the same problems as outright privatization.

But municipal entities can lease utilities. In 2013, Allentown, Pennsylvania, was facing $158 million of unfunded pension liabilities. The city created a 50-year concession for its water and sewer assets with the Lehigh County Authority.

The LCA outbid a dozen other entities for that deal, including Aqua and American Water. To back its $220 million final bid, the LCA, a quasi-public authority, had to issue $308 million of debt.

Lehigh County commissioners tried to block the lease, concerned about the debt burden.

The deal also included caps on rate hikes for the duration of the lease. LCA created a rate scheme with an annual increase for Allentown customers, but without increases for the rest of its ratepayers. Even with the rate increases, the LCA's rates stayed far below Aqua's and American Water's.

Litigation and efforts to keep up with regulations still pressured the agency's finances, and Allentown **attempted to sue** the LCA in 2018 over rate increases. But S&P upgraded the bonds related to the Allentown concession in February.

Notably, PFM advised the Allentown mayor during that deal, and Kapoor was involved in the city's negotiations with pensioners.

When asked for an example of a successful monetization of a Pennsylvania water authority, Kapoor pointed to Harrisburg.

As Harrisburg recovered from its disastrous incinerator deal, it rebranded its utilities as Capital Region Water. That move didn't generate much revenue for the city — CRW was considered a success because it was formally insulated from the troubled city's finances and governance.

Chester's utilities are already insulated from its government, so there's not many cues they can take from CRW's creation. The move to emulate is creating a new, consolidated authority.

Grant found this suggestion troubling. The only way to generate revenue from an authority like this would be through debt, she said.

"They transfer all the debt from these systems to that authority, and then they make this new authority take out a lot of debt, new debt, not for system improvement, but to pay the city of Chester to fund other unrelated obligations," Grant said. "It's setting this new authority up for failure."

When the authority fails because of financial pressures, Grant said, Chester would have to sell it. She views the suggestion of a new authority as a "trojan horse for privatization."

Kapoor said the receiver is waiting to see the responses to the RFPs before considering specifics. The receiver also reserves the right to reject all proposals if none of them are adequate. Opponents of water privatization worry that the RFP process will end with the city rejecting all public bids and selling to Aqua. It wouldn't be unprecedented.

Scranton escaped Pennsylvania's distressed municipalities program in part through privatizing its utilities. The city's leaders initially celebrated the deal, but in the years since, residents have faced billing problems, fees and exorbitant rate hikes, Grant said.

When Scranton's leaders and municipal advisors first suggested monetizing its utilities, they suggested leases and "public-to-public" transactions. Incidentally, Kapoor worked on Scranton's recovery in the same role he's serving in Chester.

Aqua's initial asset purchase agreement — the one Doweary refused to approve — is still outstanding. The company remains involved in the litigation and indicated it hopes to purchase the authority, although it did not respond to requests for comment on this story. If no acceptable bids come in, would the receiver consider accepting Aqua's?

"It's a good question. It's just that we're not at that point yet," Kapoor said. "Now, we're really focused on the RFP, RFQ, seeing if we can keep it in public hands. We really want to make a good, safe effort to do that."

All of these questions may be moot. The Pennsylvania Supreme Court has yet to decide whether Chester can sell the CWA. And the bankruptcy judge may side with the creditors and rule that Chester must sell its utilities to the highest bidder.

Meanwhile, Chester is racing against time. Their budget is highly dependent on funds from the American Rescue Plan Act, Doweary said, and they're hoping to get some revenue before the funds run out in 2026.

The revenue should come from state support, Catania argued, rather than the water authority's ratepayers.

"The problem that the city of Chester has," Catania said, "is that no one in Harrisburg is doing anything for them."

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