

BOROUGH OF
MIDDLETOWN
FOUNDED 1755 • DAUPHIN COUNTY'S OLDEST COMMUNITY

STATEMENT FROM BOROUGH OF MIDDLETOWN

On July 10, 2019, a Panel of Arbitrators entered a Final Award in the arbitration proceeding between the Borough of Middletown and Middletown Water Joint Venture, LLC involving disputes under the Concession and Lease Agreement for the water and wastewater systems of the Borough of Middletown. The Panel ruled generally in favor of the Concessionaire on the two areas of dispute. First, the Panel determined that the Concessionaire is entitled to impose capital cost recovery charges for the costs of performing the replacement on an annual basis of water mains, finding that the language of the Agreement required that the water main replacement work be treated as a major capital expense subject to recovery from the ratepayers. The Borough disagrees with this analysis of the language, and this result is contrary to the assurances provided to the Borough by its lawyers, who negotiated and largely drafted the language, that the financial burden of the water main replacement work would remain on the Concessionaire. The Panel also relied on communications between the Borough's lawyers and negotiators on behalf of the Concessionaire that preceded closing on the Agreement to support this result.

The effect of this ruling will be that during each year of the lease (which runs for another 45 years), there will be a capital cost recovery charge imposed on water and sewer rates. Those charges will be designed to cover the Concessionaire's costs, including costs of capital, of performing the annual replacement work, spread over the anticipated useful life of the new piping. The total amount of these charges will increase on an annual basis as more work is performed. At the end of the lease, the right to operate the system (which remains owned by the Borough) will revert to the Borough.

The Panel also ruled on the Borough's challenge to the amount of the surcharge imposed by the Concessionaire on account of a "Water Sales Shortfall." The Agreement effectively guaranteed the Concessionaire that it would make a minimum amount of sales of water to retail customers, or it would be paid the revenue it would have received had the minimum amount of water been sold to retail customers. The Borough's advisors did not explain to the Borough that the minimum was set at an unrealistically high level, which will cause a shortfall recovery charge during every year of the lease.

The Concessionaire announced in early 2018 that it would begin to collect a surcharge on all customer bills to recover \$1,922,754 over the period 2018-2020 based on its calculated shortfall in the initial three-year period of the lease. The Borough disputed this amount, raising a number of issues, including two errors made by the Concessionaire in calculating this amount. Ultimately, the Concessionaire recognized that the Borough's position on these two issues was correct and agreed to a downward adjustment in the amount to be recovered.

The Borough also raised issues concerning the accuracy of the data used by the Concessionaire to determine the shortfall. The Borough pointed out problems with meters at some of the system's largest customers, coupled with the failure of the Concessionaire (1) to develop an appropriate program for testing meters, (2) to take prompt action to repair or replace malfunctioning meters and (3) to use a proper methodology to estimate consumption when meters were found to be registering inaccurately. The Panel largely agreed with the Borough's arguments but did not award relief to the Borough for most of those issues. The Borough is disappointed with the Panel's treatment of this issue, particularly given the Concessionaire's control over the data necessary to demonstrate the impact of the Concessionaire's failures in detail. The Panel reduced the shortfall recovery based on the failure to accurately capture consumption at only one major customer. Coupled with the errors noted above to which the Concessionaire admitted, the overall reduction in the shortfall recovery amount for the initial three-year period as a result of the arbitration was approximately \$150,000.

The Borough intends to exercise its right to review the amount of capital cost recovery charges based on the reasonableness of the costs incurred, and to continue to monitor the Concessionaire's metering activity to ensure that the water sales shortfall recovery amounts are not overstated. In addition, among its efforts to mitigate the harm to the Borough and its residents going forward the Borough is pursuing professional liability claims against its former lawyers and financial advisors.