

**Middletown Water
Annual Recovery Report**

February 10, 2025

Final

The 2024 Annual Recovery Report is being presented to the Borough of Middletown in accordance with the Concession and Lease Agreement between the Borough of Middletown and Middletown Water Joint Venture LLC (“Joint Venture”) signed on September 30, 2014 (“Concession and Lease Agreement” or “Concession Agreement”).

Under the Concession and Lease Agreement *the Concessionaire shall not revise the Schedule of Service Charges from the Initial Schedule of Rates in effect on the Closing Date, without the prior approval of such revisions by the Borough, which approval shall be at the sole discretion of the Borough; **provided that no Borough approval shall be required for any revision of the Schedule of Service Charges established by the Concessionaire to fund or finance Major Capital Improvements as permitted by Section 7.1(f), Changes of Law as permitted by Section 7.1(g), Leasehold Tax Adjustments as permitted by Section 7.1(h), Major Force Majeure Events as permitted by Section 7.1(j), SRBC Charges as permitted by Section 7.1(k), or Demand Shortfall Recoveries as permitted by Section 7.1(l) (emphasis added).***

This report is presented to the Borough of Middletown by Middletown Water Joint Venture LLC as demonstration of the need to revise the Schedule of Service Charges in 2025. Note that the first year in which a tariff change was to be effected through a Capital Cost Recovery Charge as contemplated in the event *Major Capital Improvements (Section 7.1(f))* was **2017** and the first year in which a tariff change was to be effected through *Demand Shortfall Recovery (Section 7.1(l))* was **2018** whereas, the first year in which a tariff change was effected through an Annual Rate Adjustment (Section 7.1 (e)) was **2019**.

The only anticipated changes to the Schedule of Service Charges in 2025 are those contemplated under Section 7.1 (e), Annual Rate Adjustment and Section 7.1(f) Major Capital Improvements.

Annual Rate Adjustment

The Annual Rate Adjustment will equal the Annual Percentage Change as defined below:

“Annual Percentage Change” means, with respect to the 2019 calendar year and each calendar year thereafter, the percentage determined by adding the Index Change for that calendar year (which may be positive or negative) and the Margin Change for that calendar year provided that whenever the sum of the Index Change and the Margin Change is zero or a negative percentage, there shall be no Annual Percentage Change for that calendar year.

where

“Margin Change” means (i) for each calendar year commencing with the 2019 calendar year to and including the 2033 calendar year, two and one-half percent (2.50%) and (ii) for the 2034 calendar year and each calendar year thereafter, two percent (2.00%).

and

“Index Change” means, for the 2019 calendar year and each calendar year thereafter, the percentage change in the Index for the annual period ending on June 30 of the prior calendar year.

and

“Index” means the “Consumer Price Index –for all Urban Consumers (CPI-U), Northeast Region” – (not seasonally adjusted) as published by the U.S. Department of Labor, Bureau of Labor Statistics (the “CPI-U Index”).

Which, as shown in Table A below, the CPI-U Index was **3.8%** for the 12 months ending June 30, 2024.

Table A. Northeast region CPI-U 1-month and 12-month percent changes, all items index, not seasonally adjusted

Month	2020		2021		2022		2023		2024	
	1-month	12-month	1-month	12-month	1-month	12-month	1-month	12-month	1-month	12-month
January	0.7	2.3	0.4	1.1	0.8	6.3	0.7	6.0	0.6	2.5
February	0.3	2.4	0.4	1.2	0.7	6.6	0.5	5.9	0.5	2.4
March	-0.2	1.7	0.6	2.1	1.3	7.3	-0.2	4.3	0.7	3.4
April	-0.4	0.8	0.7	3.3	0.6	7.2	0.2	3.8	0.4	3.6
May	0.0	0.6	0.6	3.9	0.9	7.5	0.1	3.1	0.4	3.9
June	0.3	0.8	1.0	4.6	1.2	7.6	0.3	2.2	0.3	3.8
July	0.4	1.1	0.2	4.3	-0.2	7.3	0.2	2.6	0.0	3.6
August	0.1	1.1	0.1	4.4	0.3	7.4	0.5	2.8	0.2	3.4
September	0.1	1.2	0.3	4.6	0.1	7.2	0.3	3.0	0.3	3.4
October	-0.2	1.1	0.6	5.4	0.3	6.9	0.0	2.7	0.1	3.5
November	0.1	1.1	0.6	6.0	0.1	6.4	0.0	2.5	0.0	3.5
December	0.2	1.4	0.2	5.9	-0.1	6.1	0.0	2.6		

Accordingly, the Annual Rate Adjustment for 2024 is 6.3% - effective January 1, 2025.

Annual Rate Adjustment
Calculation:

Index Change = 3.8%

Margin Change = 2.5%

Annual Percentage Change =
Index Change + Margin Change
= 3.8% + 2.5% = 6.3%

Major Capital Improvements – Capital Cost Recovery

In consultation with the Borough through regularly scheduled Operating Committee meetings and in accordance with Section 6.18.2 of the Operating Standards as well as relevant portions of the Final Award of the Arbitrators dated July 10, 2019 as follows,

XII. FINAL AWARD

Upon careful consideration of the entire evidentiary record, and all the legal arguments made by the parties' counsel in their post-hearing briefs, the Panel enters its Final Award in this arbitration as follows:

1. The Panel finds in favor of Claimant, Middletown Water Joint Venture, LLC, on its claim for the imposition of Capital Cost Recovery Charges and declares that (a) Water Main Replacement Work constitutes a Major Capital Improvement when such work otherwise meets the requirements of clause (c) of the definition of Major Capital Improvement in the Concession Agreement; (b) Claimant is entitled to impose a Capital Cost Recovery Charge for all Water Main Replacement Work that meets the requirements of clause (c) of the definition of Major Capital Improvement in the Concession Agreement; (c) Claimant is entitled to perform, on average, 2,500 linear feet of Water Main Replacement Work and to recover a Capital Cost Recovery Charge whenever the Water Main Replacement Work meets the requirements of clause (c) of the definition of Major Capital Improvement in the Concession Agreement, for all such work performed for the duration of the Concession Agreement, including for the years 2016, 2017 and 2018 and for all subsequent years until the Concession Agreement terminates by its terms; (d) Respondent, the Borough of Middletown, Dauphin County, Pennsylvania, shall assist and cooperate with Claimant in connection with the performance of all such Water Main Replacement Work and in the collection of any resulting Capital Cost Recovery Charges; and (e) Respondent is enjoined from taking any action to oppose, frustrate, dispute, object to or interfere with Claimant's recovery of any Capital Cost Recovery Charges due for the Water Main Replacement Work it has performed or will perform in the future when such work otherwise meets the requirements of clause (c) of the definition of Major Capital Improvement in the Concession Agreement.

the Concessionaire, following a competitive bidding process among qualified contractors, has been trying to catch up by replacing approximately 2,500 linear feet of water main for each of two of the years [i.e. missed during litigation/ arbitration] 2016 and 2019 at a total cost of approximately \$2.55 million (summary in Appendix B).

The Capital Cost Recovery Charge is defined in the Concession Agreement as follows:

“Capital Cost Recovery Charge” means, for a particular Reporting Year, the annual amount that the Concessionaire may charge during the Cost Recovery Period with respect to the cost of a Major Capital Improvement consisting of: (i) the amounts required to pay the principal of and interest on debt issued or incurred to finance such Major Capital Improvement at the Concessionaire's then current interest cost assessed by the lender on such borrowed funds and (ii) a return on equity contributed to pay the capital costs of such Major Capital Improvement equal to the rate of return on equity at the time the equity is contributed for such Major Capital Improvement at the average of the return on equity as most recently calculated by the PUC Technical Utility Services Staff (and referred to as the Return on Equity in the most recent Quarterly Earnings Report – Water Utilities DSIC ROE) for [name multiple – at least 3 - major Pennsylvania public utilities], where such companies were seeking to implement a new DSIC charge.

Accordingly, the most recent **Distribution System Improvement Charge (DSIC) Eligible Utilities** found at <https://www.puc.pa.gov/filing-resources/reports/quarterly-earnings-summary-reports/> is shown below:

Attachment D

Distribution System Improvement Charge (DSIC) Eligible Utilities
Return on Equity (ROE) Summary

	Utility Adjusted ROE ² (%)	Commission Approved ROE ³ (%)
WATER		
PA American Water Company	8.56	9.45
PA American – Wastewater	8.56	9.45
AQUA Pennsylvania*		9.65
AQUA Pennsylvania – Wastewater*		9.65
York Water Company	8.00	9.65
Veolia Water Pennsylvania, Inc.	5.70	9.65
Columbia Water Company	3.19	9.75
Newtown Artesian Water	-1.11	9.65

The commission approved return on equity for PA American, AQUA Pennsylvania, York Water Company, Veolia Water Pennsylvania Inc., Columbia Water Company and Newtown Artesian Water are shown in this report as 9.45%, 9.65%, 9.65%, 9.65%, 9.75 and 9.65% respectively. The average utility adjusted return on equity for the water utilities shown is 5.09%. The annual Capital Cost Recovery Charge calculated for the remaining 40 years of contract term at a return of 5.09% (with a total of \$2,550,000 in Major Capital Improvements including the 15% management fee which is in dispute) is \$150,445 p.a. This amount comprises **1.6%** of the year-end 2024 revenues - excluding amounts related to the surcharge.

Accordingly, the Annual Rate Adjustment for 2024 of 6.3% together with Capital Cost Recovery Charge of 1.6% sums to a total increase of 7.9% - effective January 1, 2025. However, Middletown Water Joint Venture only raised rates by 7.7% until such time as the 15% management fee dispute is resolved (see note under Appendix B).

Demand Shortfall Recoveries

Aa an update note that the recovery charge (“surcharge”) was put into effect in March 2024 and is impacting customer bills (the surcharge on customers’ bills was calculated as ~ 5.6%) during the three-year period ending in March 2027 in respect of the \$1,424,852 *Shortfall Recovery Amount*¹ from the *third* 3-year Test Period.

The surcharge associated with the *first* 3-year Test Period was initially calculated to equate to an Annual Shortfall Recovery Amount² of **\$616,380**. However, the Borough filed an action seeking reformation of the *Water Sales Shortfall*³ provisions in the Concession Agreement, along with a motion for a preliminary injunction in Pennsylvania state court on April 16, 2018. The Borough’s motion for a preliminary injunction sought an order barring Middletown Water Joint Venture LLC from implementing any rate increases pending resolution of the reformation claim, by the Pennsylvania court (and an arbitration process which largely proceeded in parallel). Later in April 2018 the case was removed from Pennsylvania state court to federal court and assigned a federal docket number (1:18-cv-00861-CCC). The Chief Judge of the Middle District of Pennsylvania – Judge Christopher C. Conner – was assigned to the case and presided over a hearing on May 22nd 2018.

On July 19th 2018, Judge Conner issued an order denying the Borough’s motion for preliminary injunction. The Defendant, Middletown Water Joint Venture LLC, filed a motion to dismiss the Borough’s amended complaint on August 1st and, following the Borough’s submittal of opposition to that motion on August 15th and also a surreply on September 7th, Judge Conner issued a memorandum and an order in favor of the Defendant on March 27th, 2019 (attached in Appendix A). Upon completion of the concurrent arbitration proceeding, an arbitration panel issued a

¹ Shortfall Recovery Amount means, with respect to a particular Water Sales Test Period, the amount of money that would have been collected from Retail Water customers and Retail Sewer Customers from the imposition of Service Charges during the Water Sales Test Period if an amount of water equal to the Water Sales Shortfall had been sold to Retail Water Customers, calculated based upon the assumptions that the Water Sales Shortfall expressed in gallons per day would have been purchased by Retail Water Customers during each day of the Water Sales Test Period at the rate per gallon in effect for that day under the applicable Schedule of Service Charges and with a collection rate equal to the average collection rate of Retail Water Customers during the Water Sales Test Period.

² Annual Shortfall Recovery Amount means, with respect to any Shortfall Recovery Amount, one-third of the Shortfall Recovery Amount.

³ Water Sales Shortfall means, for any Water Sales Test Period, the amount (if any) expressed in gallons per day by which the sum of (A) the actual average daily volume of metered water sales to all Retail Water Customers over the entire Water Sales Test Period and (B) the Bulk Sales Surplus (if any) over the entire Water Sales Test Period was less than 639,340 gallons per day.

decision on July 10th, 2019 effectively reducing the *Shortfall Recovery Amount* for the aggregate first 3-year recovery period (2018 – 2020) from \$1,849,139 to \$1,772,770 – a reduction of \$76,369.

In accordance with Section 3.22 of the Concession and Lease Agreement *on or prior to the 10th day of February next following the end of a Water Sales Test Period, the Concessionaire shall file with the Authority [Borough] a written report with respect to the Water Sales Test Period ended on the prior December 31st setting forth either (i) that no Water Sales Shortfall occurred with respect to such Water Sales Test Period or (ii) that a Water Sales Shortfall have occurred with respect to such Water Sales Test Period and, in such event, also setting forth the Annual Shortfall Recovery Amounts that will apply for the then current and next two Reporting Years as a result of such Water Sales Shortfall.*

Accordingly, the next (i.e. 4th) Water Sales Test Period will end on December 31st, 2026 and the Joint Venture will present a *draft 2027 Water Sales Test Period Report* to the Middletown Borough as a courtesy for the Borough's review and will file it in final form with the Borough in accordance with Section 3.22 of the Concession and Lease Agreement. All *Shortfall Recovery Amounts* for the last recovery period (2021, 2022 and 2023) Concession Years were presented in the monthly Operations Reports in a table similar to that shown in Table B below which, for the purposes of this report, captures the first year related to the fourth water sales test period and runs through December 2024.

Table B *Water Sales Test Period*

MIDDLETOWN WATER & WASTEWATER OPERATIONS REPORT

December 2024

Water Sales Test Period

Water Sales Test Period No. 4 1/1/2024 to 12/31/2026	Calendar Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD	
														Total	Avg
Total consumption for the month (gallons)	2024	20,610,500	22,016,900	18,229,900	20,271,100	18,323,200	19,844,100	19,538,500	21,325,800	20,035,300	20,548,000	18,853,300	21,750,200	241,346,800	20,112,233
	2025													0	0
	2026													0	0
Billing Period (days)	2024	31	29	31	30	31	30	31	31	30	31	30	31	366	31
	2025	31	28	31	30	31	30	31	31	30	31	30	31	365	30
	2026	31	28	31	30	31	30	31	31	30	31	30	31	365	30
Retail Sales - Total month (gallons)	2024	18,849,700	20,234,400	16,655,500	18,480,100	16,592,500	17,810,100	17,582,900	19,295,500	18,132,400	18,501,900	16,985,000	19,567,500	218,687,500	18,223,958
	2025													0	0
	2026													0	0
Retail Sales - Average Daily (gallons per day)	2024	608,055	697,738	537,274	616,003	535,242	593,670	567,190	622,435	604,413	596,835	566,167	631,210	7,176,234	598,019
	2025													0	0
	2026													0	0
Avg retail water sales (gal)		608,055	697,738	537,274	616,003	535,242	593,670	567,190	622,435	604,413	596,835	566,167	631,210	2,392,078	199,340
Bulk Municipal Sales - Total month (gallons)	2024	1,760,800	1,782,500	1,574,400	1,791,000	1,730,700	2,034,000	1,955,600	2,030,300	1,902,900	2,046,100	1,868,300	2,182,700	22,659,300	1,888,275
	2025													0	0
	2026													0	0
Bulk Municipal - Average Daily (gallons per day)	2024	56,800	61,466	50,787	59,700	55,829	67,800	63,084	65,494	63,430	66,003	62,277	70,410	743,079	61,923
	2025													0	0
	2026													0	0
Avg Bulk Customer sales (gal)		56,800	61,466	50,787	59,700	55,829	67,800	63,084	65,494	63,430	66,003	62,277	70,410	247,693	20,641

Contract Daily Bulk Water Sales Upper Limit (gal/day) = 62,970

Bulk Sales Surplus (gal/day) = No Surplus

Sum of Actual Average daily volume of Metered water sales to Retail Water Customers over Test period + Bulk Sales Surplus (gal/day) = 199,340

Contract Daily Water Sales Upper Limit (gal/day) = 639,340

APPENDIX A

Order and Memorandum

in favor of the Defendant (Middletown Water Joint Venture LLC)

issued by Judge Conner on March 27th, 2019

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**IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA**

MIDDLETOWN BOROUGH,	:	CIVIL ACTION NO. 1:18-CV-861
	:	
Plaintiff	:	(Chief Judge Conner)
	:	
v.	:	
	:	
MIDDLETOWN WATER JOINT	:	
VENTURE LLC,	:	
	:	
Defendant	:	

ORDER

AND NOW, this 27th day of March, 2019, upon consideration of defendant's motion (Doc. 56) to dismiss plaintiff's amended complaint, and the parties' respective briefs in support of and opposition to said motion, and for the reasons set forth in the accompanying memorandum, it is hereby ORDERED that:

1. Defendant's motion (Doc. 56) to dismiss is GRANTED.
2. Plaintiff's amended complaint (Doc. 45) is DISMISSED.
3. The Clerk of Court is directed to CLOSE this case.

/S/ CHRISTOPHER C. CONNER
Christopher C. Conner, Chief Judge
United States District Court
Middle District of Pennsylvania

**IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF PENNSYLVANIA**

MIDDLETOWN BOROUGH,	:	CIVIL ACTION NO. 1:18-CV-861
	:	
Plaintiff	:	(Chief Judge Conner)
	:	
v.	:	
	:	
MIDDLETOWN WATER JOINT VENTURE LLC,	:	
	:	
Defendant	:	

MEMORANDUM

Plaintiff Middletown Borough (“the Borough”) commenced this action seeking reformation of its water and sewer services contract with defendant Middletown Water Joint Venture LLC (“Middletown Water”). Middletown Water moves to dismiss the Borough’s amended complaint pursuant to Federal Rule of Civil Procedure 12(b)(6). (Doc. 56).

I. Factual Background & Procedural History

The Borough and Middletown Water are parties to a Municipal Water and Wastewater Utility System Concession and Lease Agreement (“lease agreement”).¹ (Doc. 45 ¶¶ 3-4; Doc. 45-1 at 2, 155-56). Under the lease agreement, Middletown Water provided financial consideration (both at signing and throughout the term of

¹ The Borough is a successor-in-interest to the Middletown Borough Authority, a signatory to the lease agreement. (Doc. 45 ¶ 4; Doc. 45-1 at 2). In 2014, a private equity firm and United Water formed the joint venture Middletown Water for the purpose of entering into the lease agreement. (Doc. 45 ¶¶ 3, 8). United Water is now known as Suez North America. (*Id.* ¶ 3). For clarity, the court will reference Middletown Water when discussing any actions taken by United Water or Suez North America during the contracting process.

the agreement) in exchange for the right to operate the Borough's water and sewer system and to revenues generated therefrom. (Doc. 45 ¶ 11). The term of the lease agreement is 50 years. (*Id.*)

Article 7 of the lease agreement governs imposition of service charges for water and sewer services. (*Id.* ¶ 14). Middletown Water could not increase water and sewer rates prior to January 2019 without Borough approval. (*Id.* ¶ 15; Doc. 45-1 at 83)). The lease agreement regulates the "Permitted Annual Rate Adjustment" post-January 2019 by tying rate increases to the "Margin Change" as defined in the lease agreement, as well as the Consumer Price Index. (Doc. 45 ¶ 16; *see* Doc. 45-1 at 11, 21-22, 26, 28, 83-84). Section 7.1 enumerates several exceptions to the above-described strictures on rate increases, including the following:

(l) *Demand Shortfall Recovery*. [Middletown Water] may also impose upon all Retail Water Customers and Retail Sewer Customers a Service Charge in any Demand Shortfall Recovery Year to recover the Annual Shortfall Recovery Amount that may be recovered in that Demand Shortfall Recovery Year, which Service Charge shall be in addition to the Service Charges otherwise imposed under Section 7.1.

(Doc. 45-1 at 85; Doc. 45 ¶¶ 19-20). A demand shortfall recovery year is any of the three years following the final year of a three-year rolling test period in which there is a water sales shortfall. (Doc. 45-1 at 18, 36). "Reporting Years" 2015-2017 comprised the first three-year rolling test period under the lease agreement. (*Id.* at 36).

A water sales shortfall is measured by calculating the sum in gallons of
(1) "the actual average daily volume of metered water sales to all Retail Water

Customers” over a three-year test period, and (2) the bulk sales surplus over the three-year test period; a shortfall occurs if the sum of these figures is less than 639,340 gallons per day. (*Id.* at 36; Doc. 45 ¶¶ 19, 23). A bulk sales surplus is the amount in gallons per day that the “actual average daily volume of metered water sales to all [Middletown bulk customers]” over a three-year test period exceeds 62,970 gallons.² (Doc. 45-1 at 13; Doc. 45 at 6 n.3). Middletown Water may impose a service charge when a water sales shortfall occurs to recover the annual shortfall recovery amount (one-third of the shortfall recovery amount for a three-year test period). (Doc. 45-1 at 11, 32, 85; Doc. 45 ¶ 21). The water sales shortfall, expressed in gallons per day, is used to calculate the three-year shortfall recovery amount. (Doc. 45-1 at 32). In a three-year test period, the shortfall recovery amount is the amount of money that Middletown Water would have collected from retail water and sewer customers “if an amount of water equal to the Water Sales Shortfall had been sold to Retail Water Customers.” (*Id.*; Doc. 45 ¶ 22).

A. Negotiation of the Lease Agreement

In 2014, the Borough initiated a competitive procurement process to lease its water and sewer system. (Doc. 45 ¶ 5). The Borough engaged a financial advisor and legal counsel to facilitate the procurement process. (*Id.* ¶ 6). After issuing a request for qualifications, three qualified prospective bidders expressed interest, including Middletown Water. (*Id.*; *see id.* ¶ 8). A preliminary draft of the lease

² The threshold volume of 62,970 gallon per day includes bulk water sales to customers in the neighboring Borough of Royalton. (Doc. 45 at 6 n.4).

agreement was circulated to the prospective bidders, each of whom had the opportunity to comment and request changes to the draft. (Id. ¶¶ 6-7).

Middletown Water's first markup of the draft lease agreement in July 2014 did not include changes to the water sales shortfall definition. (Id. ¶ 30). The second draft of the lease agreement defined the bulk sales surplus at 62,970 gallons per day (the actual 2013 bulk sales) and the water sales shortfall threshold at 480,000 gallons per day (75% of the 2013 average daily sales to all customers). (Id. ¶ 31). On August 27, 2014, Middletown Water requested that the Borough increase the water sales shortfall threshold to 608,000 gallons per day, or approximately 95% of the 2013 average daily bulk and retail sales. (Id. ¶ 33). The following day, another prospective bidder sought to increase the water sales shortfall to 577,225 gallons per day. (Id. ¶ 34).

On September 3, 2014, Middletown Water submitted two "last minute" substantive changes to the supposedly near-final draft. (Id. ¶¶ 35-36). Those changes were as follows: (1) inclusion in the shortfall recovery amount of both water and sewer revenues; and (2) measurement of any water sales shortfall by comparing the three-year average of retail water sales plus any bulk sales surplus against *100% of 2013 retail and bulk water sales by volume*. (Id. ¶ 36; Doc. 45-2 at 6-7). Borough counsel responded that 2013 was not a representative year because bulk water sales were approximately 20% higher than the five-year average that encompassed 2013. (Doc. 45 ¶ 37; see id. ¶ 78; Doc. 45-2 at 3). Middletown Water's representative replied in defense of the proposed changes that Middletown Water could not "accept undue risk on volume." (Doc. 45-2 at 2; Doc. 45 ¶ 38). The representative

stated that Middletown Water “understood the timeframe [counsel was] under” and asked that counsel explain the changes to the Borough. (Doc. 45-2 at 2).

Middletown Water transmitted a redlined version of the lease agreement, including proposed language implementing its requested changes, to the Borough’s counsel by email at 5:16 p.m. on September 3, 2014. (Doc. 45 ¶ 39; Doc. 45-2 at 2, 6-7, 9). Approximately an hour later, counsel for the Borough circulated a redlined version of the lease agreement (including Middletown Water’s changes) titled “Binding Offer” together with an explanatory memorandum to all prospective bidders. (Doc. 45 ¶¶ 41-42). The memorandum identified a list of “substantial changes to the economic terms of the [lease agreement]” including the proposed changes to the shortfall recovery amount and the water sales shortfall provisions. (Id. ¶ 43; Doc. 45-3 at 3-4). On September 18, 2014, Borough counsel disseminated another version of the lease agreement titled “Binding Proposal – Execution Copy,” wherein the “[100% of 2013 Average Daily Volume sales] gallons per day” language was converted to “639,340 gallons per day” using data provided by Middletown Water and confirmed by Borough counsel. (Doc. 45 ¶ 44).

Middletown Water submitted the sole offer on the lease agreement. (Id. ¶¶ 8, 45). Between September 19 and September 29, 2014, the parties engaged in negotiations regarding, *inter alia*, Middletown Water’s upfront payment, subsequent annual payments, and the annual rate caps following the four-year service charge freeze. (See id. ¶¶ 45-49). Middletown Water tendered a final offer of a \$43 million upfront payment and annual payments thereafter of \$750,000. (Id. ¶ 50).

The Borough convened a council meeting on September 29, 2014, to discuss and vote on Middletown Water's offer. (Id. ¶ 58). During the meeting's executive session, a member of the Borough council stated that the lease agreement "safe guard[s] utility rate payers now and in the future" and provides "annual rate caps in the contract." (Doc. 45 ¶ 58 (quoting Doc. 17-2 at 3)). The meeting minutes also reflect that there would be no service charge increases during the first four years of the agreement. (Id. (citing Doc. 17-2 at 6)). Middletown Water representatives attended this meeting, and the Borough alleges that those representatives made no effort to correct the council member's statements. (Id. ¶ 59). The Borough council voted to accept Middletown Water's bid, (Doc. 17-2 at 7), and the parties executed the lease agreement on September 30, 2014, (Doc. 45 ¶¶ 10, 52). The Borough now claims that it was unaware of the potential impact of Middletown Water's proposed changes throughout the lease agreement negotiation process. (Id. ¶¶ 51, 53-54, 64).

B. Shortfall Recovery

Middletown Water assumed control of the Borough's water and sewer system effective January 1, 2015. (Id. ¶ 10). Water sales data for the first three-year test period (2015-2017) resulted in a water sales shortfall. (Id. ¶ 88). The corresponding shortfall recovery amount was \$1.9 million. (Id.) In March and April of 2018, Middletown Water began assessing Borough residents an 11.5% surcharge on their water and sewer bills. (See id. ¶¶ 90, 92-94). The Borough objected to imposition of the surcharge. (Id. ¶ 116). Following mediation, the Borough initiated arbitration proceedings in part because of unaddressed meter deficiencies throughout the

water and sewer system which allegedly impacted calculation of the water sales shortfall. (*Id.* ¶¶ 116-19; *see id.* ¶¶ 102-04).

C. Procedural History

The Borough filed this action in the Court of Common Pleas for Dauphin County, seeking injunctive relief and contract reformation. Middletown Water timely removed the case to this court. Following a May 22, 2018 preliminary injunction hearing, we denied the Borough's request for preliminary injunctive relief, concluding that the Borough had failed to show a likelihood of success on the merits or that it would suffer irreparable harm absent injunctive relief.

Middletown Water moved to dismiss the Borough's complaint, prompting the Borough to file an amended complaint on July 13, 2018. Therein, the Borough seeks reformation of the lease agreement in two ways. First, the Borough suggests removing 2013 bulk water sales from the baseline threshold for calculating a water sales shortfall. (Doc. 45 at 39). Second, the Borough posits that retail sewer customers should be excluded from the shortfall recovery amount formula. (*Id.*) Middletown Water now moves to dismiss the Borough's amended complaint. The motion is fully briefed and ripe for disposition.

II. Legal Standard

Rule 12(b)(6) of the Federal Rules of Civil Procedure provides for the dismissal of complaints that fail to state a claim upon which relief may be granted. FED. R. CIV. P. 12(b)(6). When ruling on a motion to dismiss under Rule 12(b)(6), the court must "accept all factual allegations as true, construe the complaint in the light most favorable to the plaintiff, and determine whether, under any reasonable

reading of the complaint, the plaintiff may be entitled to relief.” Phillips v. County of Allegheny, 515 F.3d 224, 233 (3d Cir. 2008) (quoting Pinker v. Roche Holdings, Ltd., 292 F.3d 361, 374 n.7 (3d Cir. 2002)). In addition to reviewing the facts contained in the complaint, the court may also consider “matters of public record, orders, exhibits attached to the complaint and items appearing in the record of the case.” Mayer v. Belichick, 605 F.3d 223, 230 (3d Cir. 2010) (citing Pension Benefit Guar. Corp. v. White Consol. Indus., Inc., 998 F.2d 1192, 1196 (3d Cir. 1993)).

Federal notice and pleading rules require the complaint to provide “the defendant fair notice of what the . . . claim is and the grounds upon which it rests.” Phillips, 515 F.3d at 232 (alteration in original) (quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555 (2007)). To test the sufficiency of the complaint, the court conducts a three-step inquiry. See Santiago v. Warminster Township, 629 F.3d 121, 130-31 (3d Cir. 2010). In the first step, “the court must ‘tak[e] note of the elements a plaintiff must plead to state a claim.’” Id. at 130 (alteration in original) (quoting Ashcroft v. Iqbal, 556 U.S. 662, 675 (2009)). Next, the factual and legal elements of a claim must be separated; well-pleaded facts are accepted as true, while mere legal conclusions may be disregarded. Id. at 131-32; see Fowler v. UPMC Shadyside, 578 F.3d 203, 210-11 (3d Cir. 2009). Once the court isolates the well-pleaded factual allegations, it must determine whether they are sufficient to show a “plausible claim for relief.” Iqbal, 556 U.S. at 679 (citing Twombly, 550 U.S. at 556); Twombly, 550 U.S. at 556. A claim is facially plausible when the plaintiff pleads facts “that allow[] the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.” Iqbal, 556 U.S. at 678.

III. Discussion

Courts may reform a written instrument so it conforms to the parties' understanding following a showing of fraud, accident, or mistake. Regions Mortg., Inc. v. Muthler, 889 A.2d 39, 41 (Pa. 2005) (citation omitted). Contract reformation "presupposes that a valid contract between the parties was created but, for some reason, was not properly reflected in the instrument that memorializes the agreement." Erie Telecomms., Inc. v. City of Erie, 853 F.2d 1084, 1091 (3d Cir. 1988) (quoting H. Prang Trucking Co. v. Local Union No. 469, 613 F.2d 1235, 1239 (3d Cir. 1980)). Reformation is an equitable remedy that is "sparingly granted." H. Prang Trucking Co., 613 F.2d at 1239. The Borough premises its contract reformation claim on theories of mutual and unilateral mistake.

A. Contract Reformation: Mutual Mistake

In Pennsylvania, mutual mistake "will afford a basis for reforming a contract." Zurich Am. Ins. Co. v. O'Hanlon, 968 A.2d 765, 770 (Pa. Super. Ct. 2009) (quoting Holmes v. Lankenau Hosp., 627 A.2d 763, 767 (Pa. Super. Ct. 1993)); see Consol. Rail Corp. v. Portlight, Inc., 188 F.3d 93, 96 (3d Cir. 1999); Bugen v. New York Life Ins. Co., 184 A.2d 499, 500-01 (Pa. 1962). Both parties to a contract must be "mistaken as to existing facts at the time of execution" of the contract for mutual mistake to exist. O'Hanlon, 968 A.2d at 770 (quoting Holmes, 627 A.2d at 767); Consol. Rail Corp., 188 F.3d at 96 (quoting Holt v. Dep't of Pub. Welfare, 678 A.2d 421, 423 (Pa. Commw. Ct. 1996)). The doctrine of mutual mistake will only apply where the mistake "(i) relates to the basis of the bargain; (ii) materially affects the parties' performance; and (iii) is not one as to which the injured party bears the

risk.” Consol. Rail Corp., 188 F.3d at 96 (citing Lanci v. Metro. Ins. Co., 564 A.2d 972, 974 (Pa. Super. Ct. 1989); RESTATEMENT (SECOND) OF CONTRACTS § 154 (AM. LAW. INST. 1981)).

Middletown Water insists that the Borough cannot maintain a claim for contract reformation premised on mutual mistake. We are constrained to agree. According to the Borough, the shortfall recovery amount and water sales shortfall provisions as currently written guarantee Middletown Water yearly windfall profits, rather than merely providing downside protection in the event that water sales drop so low as to threaten profitability of the lease agreement in a particular year. (Doc. 58 at 2). The Borough seeks to reform the lease agreement to (1) eliminate the 2013 bulk water sales from the baseline threshold for determining when a water sales shortfall occurs and (2) eliminate retail sewer customers from the shortfall recovery amount calculation. (Doc. 45 at 39).

The Borough’s own allegations belie any finding of mutual mistake. The Borough alleges that Middletown Water was “well aware” that the proposed change to the water sales shortfall provision was “virtually certain to produce significant additional revenue and profit beginning in 2018” because it utilized bulk retail sales in a record high year as part of the measuring threshold. (Doc. 45 ¶ 61). The Borough specifically alleges that Middletown Water was “never mistaken or confused as to the meaning” of the water sales shortfall provision, (id. ¶ 62), and an employee of Middletown Water testified that it knew its proposed changes would “produce a shortfall absent an unprecedented growth in sales volume,” (id. ¶ 63). The amended complaint ascribes misunderstanding to the Borough alone. (Id.

¶ 64). Hence, the Borough has not alleged that the parties entered into the lease agreement based on a mutual mistake as to the shortfall provisions.

The amended complaint also sets forth facts indicating that the Borough bore the risk of any mutual mistake. An injured party bears the risk of a mistake if either: (1) the parties agree that the injured party shall bear the risk; (2) the injured party treats its limited knowledge of facts to which the mistake relates as sufficient; or (3) the court reasonably allocates the risk to the injured party. Step Plan Servs., Inc. v. Koresko, 12 A.3d 401, 411 (Pa. Super. Ct. 2010) (quoting RESTATEMENT (SECOND) OF CONTRACTS § 154 (AM. LAW. INST. 1981)).

Middletown Water requested on September 3, 2014, that the shortfall recovery amount provision be amended to include both water and wastewater revenues and that the water sales shortfall be measured against a baseline of 2013 total retail and bulk water sales. (Doc. 45 ¶¶ 35-36). Borough counsel initially pushed back by noting that 2013 was an “abnormal” year, (Doc. 45-2 at 3; Doc. 45 ¶ 37), but nonetheless circulated a redlined version of the lease agreement incorporating the requested changes less than an hour and a half after Middletown Water emailed the changes to counsel, (see Doc. 45 ¶¶ 39, 41). The Borough acknowledges that it was unaware of the effects of the proposed changes. (Id. ¶¶ 40, 64).

The Borough chose to adopt Middletown Water’s edits based on cursory review and limited understanding of their impact. Approximately two weeks later, the changes were memorialized in a draft of the lease agreement marked “Binding Proposal – Execution Copy.” (Id. ¶ 44). The parties spent an additional week and a

half negotiating other aspects of the lease agreement, (see id. ¶¶ 45-48, 50, 52), but at no point between September 3 and the date the lease agreement was executed (September 30) did the Borough further investigate Middletown Water's proposed changes to the shortfall provisions, (see id. ¶¶ 35-36, 51-55). The Borough's conduct clearly establishes that it regarded its knowledge of the facts underlying the water sales shortfall changes as sufficient to sign the lease agreement. Moreover, because this candid acknowledgement stems from the Borough's own *allegata*, it is proper to allocate any risk of mistake to the Borough. For all of these reasons, the Borough has not adequately pled a claim for contract reformation based on mutual mistake.

B. Contract Reformation: Unilateral Mistake

Unilateral mistake arises due to the negligence of the party acting under the mistake. See Roth v. Old Guard Ins. Co., 850 A.2d 651, 653 (Pa. Super. Ct. 2004); Kramer v. Schaeffer, 751 A.2d 241, 246 (Pa. Super. Ct. 2000) (citation omitted). In Pennsylvania, a unilateral mistake generally will not permit relief from a contract. Kramer, 751 A.2d at 246 (citation omitted). A party seeking reformation based on unilateral mistake must show that the party against whom reformation is sought "had 'such knowledge of the mistake as to justify an inference of fraud or bad faith.'" Regions Mortg., 889 A.2d at 42 (quoting Dudash v. Dudash, 460 A.2d 323, 327 (Pa. Super. Ct. 1983)); see Kramer, 751 A.2d at 246 (citation omitted). To obtain relief, the party seeking reformation must allege unilateral mistake and the actual intent of the parties. See Kramer, 751 A.2d at 246 (quoting Dudash, 460 A.2d at 327).

The Borough avers that it was "mistaken as to the impact that Middletown Water's revisions to the [water sales shortfall] provisions had on Borough

residents.” (Doc. 58 at 11; see Doc. 45 ¶¶ 51, 53-54, 64). Notably, the Borough does not allege that it was mistaken as to the precise changes requested by Middletown Water or that it intended to exclude those changes from the lease agreement. (See Docs. 45, 58, 64). Taking the factual allegations in the amended complaint as true, counsel for the Borough failed to fully investigate Middletown Water’s requested edits before incorporating them into the lease agreement even after initially expressing reservations. (See Doc. 45 ¶¶ 37, 39, 41-43; Doc. 45-3 at 3-4). The Borough claims that its counsel failed to comprehend “the economic significance of these changes” or explain their significance to the Borough. (Doc. 45 ¶ 43). And in signing the lease agreement, the Borough acknowledged that it had “substantial business experience and [was] fully acquainted with the provisions of th[e] Agreement.” (Doc. 45-1 at 151). Any unilateral mistake in this case is the clear product of the Borough’s negligence.

The Borough also fails to allege fraud or bad faith by Middletown Water. Federal Rule of Civil Procedure 9(b) requires a party alleging fraud or mistake “must state with particularity the circumstances constituting fraud or mistake.” FED. R. CIV. P. 9(b). The Third Circuit has described this heightened pleading standard as requiring “the who, what, when, where[,] and how of the events at issue.” See In re Suprema Specialties, Inc. Sec. Litig., 438 F.3d 256, 276 (3d Cir. 2006) (citations and internal quotation marks omitted). The strictures of Rule 9(b) “insure adequate notice so that defendants can intelligently respond,” Ill. Nat’l Ins. Co. v. Wyndham Worldwide Operations, Inc., 653 F.3d 225, 233 (3d Cir. 2011) (citation omitted), and are not designed to “test the factual allegations of the claim,”

id. (quoting Morganroth & Morganroth v. Norris, McLaughlin & Marcus, P.C., 331 F.3d 406, 414 n.2 (3d Cir. 2003)). Conditions of a person's mind, including malice, intent, and knowledge, may be alleged generally. FED. R. CIV. P. 9(b).

The amended complaint does not support an inference of fraud. The Borough contends that Middletown Water misrepresented the nature of its proposed changes to the lease agreement by stating that such revisions were to protect against "undue risk on volume." (See Doc. 58 at 17; Doc. 45 ¶ 38; Doc. 45-2 at 2). But the Borough does not allege that Middletown Water's proffered reason for the changes was untrue, nor does it point to any blatantly false statements of fact by Middletown Water.³ (See Docs. 45, 58, 64). *Per contra*, Middletown Water explicitly outlined the proposed changes to the Borough in a redlined version of the agreement, (Doc. 45 ¶ 39, Doc. 45-2 at 4-9), and identified a number in gallons of the 2013 average daily volume of retail and bulk water sales reflecting the proposed changes, (Doc. 45 ¶ 44). This information was also publicly available. (See id. ¶ 78). Middletown Water expressly asked the Borough's counsel to explain the proposed changes to the Borough. (Doc. 45-2 at 2). Borough counsel understood that 2013 was "an abnormal year," (id. at 3; Doc. 45 ¶ 37), and possessed all the information

³ The Borough points to the testimony of a Middletown Water consultant as evidence of fraud. (See Doc. 45 ¶ 63). This consultant allegedly testified that Middletown Water "understood that the threshold that had been inserted into the Agreement would produce a shortfall absent an unprecedented growth in sales volume." (Id.) Assuming this is an accurate representation of the consultant's testimony, the statement at most supports that Middletown Water understood the possible implications of the proposed changes. It in no way suggests that Middletown Water withheld information from the Borough that prevented the Borough from reaching its own conclusion regarding the proposed changes.

necessary to determine the impact of Middletown Water's proposed changes. Contrary to the Borough's assertions, the amended complaint suggests that Middletown Water dealt at all times in an open and straightforward manner. The Borough has failed to plead with particularity facts constituting fraud.

The Borough asseverates that Middletown Water acted in bad faith by failing to correct the Borough's mistaken understanding of the lease agreement. (Doc. 58 at 18). At the September 29, 2014 meeting, a member of the Borough council stated that the lease agreement "safe guard[s] utility rate payers now and in the future" and provides "annual rate caps in the contract." (Doc. 45 ¶ 58 (quoting Doc. 17-2 at 3)). The meeting minutes also reflect the Borough's belief that under the lease agreement, there would be no rate increases during the first four years of the agreement. (*Id.* (citing Doc. 17-2 at 6)). The Borough alleges that Middletown Water representatives in attendance at that meeting failed to "contradict[] the Borough's public characterization of the intent of the Agreement." (*Id.* ¶ 59).

These statements were accurate representations of the lease agreement's terms. Section 7.1(d) of the lease agreement provides that, "[p]rior to January 2019 [Middletown Water] shall not revise the Schedule of Service Charges from the Initial Schedule of Rates in effect on the Closing Date" without Borough approval. (Doc. 45-1 at 83; Doc. 45 ¶ 15). After January 2019, yearly rate increases could not exceed the "Permitted Annual Rate Adjustment," defined by the lease agreement using the Consumer Price Index. (Doc. 45 ¶ 16; *see* Doc. 45-1 at 11, 21-22, 26, 28, 83-84). The council member's representations were in accord with these lease provisions. Middletown Water representatives were under no affirmative obligation

to qualify the Borough's assertions by noting that Section 7.1 sets forth multiple circumstances under which Middletown Water could impose surcharges including, *inter alia*, to recover the annual shortfall recovery amount in the event of a water sales shortfall. (Doc. 45-1 at 83-85; Doc. 45 ¶¶ 18-19). For all of these reasons, the Borough has failed to state a claim for contract reformation premised on unilateral mistake.

IV. Conclusion

The court will grant Middletown Water's motion (Doc. 56) to dismiss the Borough's amended complaint. An appropriate order shall issue.

/S/ CHRISTOPHER C. CONNER
Christopher C. Conner, Chief Judge
United States District Court
Middle District of Pennsylvania

Dated: March 27, 2019

APPENDIX B

Major Capital Expenditure Summary

(Invoice detail to follow once Veolia has closed its books for 2024.)

Middletown Water Joint Venture - CCRC Calculation 2024

			1	2	3	4	5	6	7	8	9	10
			2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
A	For YE 2024 (12 mos actual):											
	Annual Payment	\$150,445										
	Remaining Term	40										
	WACC	5.09%										
	Projected YE Major Capex	2,550,000										
B	2023 Revenues*	9,472,000										
	2023 Revenues**	9,146,000										
	* Including surcharge											
	** excluding surcharge											
A/B			1.6% Capital Cost Recovery Charge									

Note: The management fee is a standard industry practice where Veolia is paid for engineering, project management, accounting and administrative services to deliver capital programs. As explained in the past, Section 8.4 of the Operating Agreement specifies the 15% fee components. In addition, we have referenced an email from the Borough's former legal counsel, Adam Santucci, who agreed - after discussion with the town engineer - that a management fee of 15 to 17% is typical. It should also be noted that this fee was also included on the "first tranche" of main replacements installed in 2015 in the context of the Fifth Amendment to the Concession Agreement.