

Testimony of Martin A. Kropelnicki
President and CEO – California Water Service Group
President – National Association of Water Companies

**Reinvestment and Rehabilitation of our Nation's Safe Drinking
Water Delivery Systems**

**Presented on behalf of the National Association of Water
Companies**

House Energy and Commerce Committee
Environment and the Economy Subcommittee

March 16, 2017

Good morning, Chairman Shimkus, Ranking Member Tonko, and Members of the Subcommittee. Thank you for the opportunity to discuss the water infrastructure challenges facing the country and the actions the federal government can take to unleash innovative and sustainable solutions to those challenges.

I am Marty Kropelnicki, President and CEO of California Water Service Group (Cal Water), the third largest publicly traded water and wastewater utility company in the United States. I am also the President of the National Association of Water Companies (NAWC) – the association that represents the regulated private water utility service industry and professional water management companies. NAWC’s core belief is that by embracing the powerful combination of public service and private enterprise, we can not only improve our nation’s water infrastructure, but also ensure that future generations have access to safe, reliable, and high-quality water utility service.

NAWC applauds you, Mr. Chairman, and this Subcommittee, for highlighting America’s water infrastructure needs and the solutions that will best address them. Safe, reliable, and high-quality drinking water is critical to every person, community, and business in this country, and NAWC’s members are proud to provide these services to our customers.

NAWC members are located throughout the nation and range in size from large companies that own, operate or partner with hundreds of systems in multiple states to individual utilities serving a few hundred customers. Through NAWC’s various innovative business models, private water and wastewater professionals serve more than 73 million Americans, nearly a quarter of our country’s population.

Cal Water, for one, provides water and wastewater service to approximately two million people in California, Hawaii, New Mexico, and Washington. Every day, Cal Water treats and delivers more than 320 million gallons of water to our customers. For us, there is nothing more important than enhancing the quality of life for our customers by working each and every day to ensure they have safe, high-quality water each time they turn on the tap.

Private Utility Role in Meeting the Nation’s Drinking Water Needs

Private water systems have existed in the United States for well over 100 years. Today, the private water utility sector is highly regulated by state public utility commissions (PUCs), which set water rates, the U.S. Environmental Protection Agency, which sets federal drinking water quality standards, and state agencies, which are also responsible for setting water quality standards. The private water utility sector focuses on long-term planning by making appropriate and necessary investments in our nation’s communities. As a result, private water companies have a proven track record of consistently meeting the drinking water needs of consumers in many areas of the country.

The private sector is already helping overcome water infrastructure challenges facing the country. Ensuring the high standard of quality that private water companies deliver requires extraordinary amounts of capital investment. NAWC estimates that its six largest members alone are collectively investing nearly \$2.7 billion each year in their water systems – and these six companies provide service to about six percent of the U.S. population. In Cal Water’s case, we are budgeting to invest about \$1 billion in our water systems over the next five years.

It is significant that six of NAWC’s members are collectively investing more than \$2 billion in their water systems when one considers that the current total federal appropriation for the Clean Water and Drinking Water State Revolving Fund (SRF) programs is approximately \$2 billion annually.

One of the factors that enable the private water sector to undertake such significant levels of investment is outstanding credit ratings. In fact, the corporate credit ratings of some of NAWC’s members are amongst the highest in the U.S. For example, Cal Water’s first mortgage bonds are currently rated AA-, and Cal Water has the highest credit rating of any utility in the U.S., as rated by Standard & Poor’s.

In addition to helping to ensure our customers have safe, reliable, and high-quality water utility service, NAWC members provide significant economic benefits to the communities they serve. We pay federal and state income taxes, local property taxes, local pump taxes, and permit fees for projects, all of which provide much needed revenue to all levels of government in the county. We hire local employees, and provide them with good-paying jobs and competitive benefits. We procure local goods and services. And to help ensure our medium- and long-term financial stability, our employees’ retirement benefits are fully funded. All of these things contribute to the economic multiplier effect that benefits the communities that we serve.

Perhaps most importantly, NAWC’s members work diligently with our state regulators to ensure that we meet federal and state water quality and customer service standards every day. For example, analysis of EPA data conducted by American Water Intelligence found that the “compliance record of major companies in the private water utility sector has remained nearly spotless.”¹ NAWC’s members are at the forefront of efforts to ensure the water we provide to our customers is safe. For example, Cal Water’s Director of Water Quality was part of the national group of experts who developed the Lead Service Line Replacement Collaborative, which seeks to accelerate voluntary replacement of lead water service lines. Similarly, in 2016, J.D. Power ranked California Water Service, a subsidiary of Cal Water, and Illinois American Water, a subsidiary of American Water, “highest in water utility customer satisfaction in their respective

¹ American Water Intelligence, “Data Show IOUs a Cut Above in SDWA Compliance,” October 2012, p. 10.

regions.”²

In summary, the private water utility sector stands able, ready, and willing to partner with local and state governments, as well as the federal government, to help meet the challenges our nation’s water infrastructure will face in the coming years and decades. In addition to supplying necessary capital, private water companies can leverage decades of experience solving complex water challenges to help bring new water infrastructure projects online faster and cheaper. Two examples highlight the value private water companies bring to the table.

- The wastewater system in Fairview Township, Pennsylvania serves approximately 4,000 customers. In late 2015, the Township sold its wastewater system to Pennsylvania American Water for \$16.8 million. In order to help ensure residents have a wastewater system they can depend on, Pennsylvania American Water will be investing \$13 million in capital improvements. In addition, the revenue from the sale has enabled the Township to pay off \$21 million in existing sewer debt, avoid addition debt of approximately \$14 million, and reduce residents’ property taxes by 50 percent.
- West Basin Municipal Water District (West Basin) is a wholesale water supplier in Southern California. West Basin’s Edward C. Little Water Recycling Facility is the largest water recycling facility of its kind in the U.S.; it produces approximately 40 million gallons of useable water every day. Cal Water manages and operates the recycled water distribution system, which includes approximately 100 miles of pipeline that crosses multiple political subdivisions in Los Angeles County. Cal Water was able to utilize our experience working with West Basin to help form a partnership in northern California with the City of Sunnyvale, the Santa Clara Valley Water District, and Apple that will bring more than 150,000 gallons of recycled water per day to the new Apple 2 Campus in Cupertino.

Water Infrastructure Today

Our water infrastructure systems are the backbone upon which communities survive and thrive. Water service is a critical part of the physical platform of the U.S. economy. Not a single business in any community can survive, nor be established, without a sustainable water supply. Communities must have reliable and resilient water infrastructure systems to attract and retain industry, business, and qualified workers. Simply put, capital investment in water infrastructure means job creation across the country.

² J.D. Power, “Robust Water Infrastructure Is Essential to Customer Satisfaction; Water Quality and Reliability Are Critical, Says Inaugural J.D. Power Water Study,” May 18, 2016, available at: <http://www.jdpower.com/press-releases/2016-water-utility-residential-customer-satisfaction-study>.

Unfortunately, aging and deteriorating water systems threaten economic vitality and public health, and communities nationwide are faced with massive fiscal challenges to replace critical water and wastewater infrastructure and effectively manage their systems. The network of pipes that every American relies on for drinking water spans 700,000 miles and is more than four times the length of the National Highway System. Some of these pipes originally intended to survive 50 to 75 years, have been in service for more than 100 years – well beyond their useful life. On average, there are 650 water main breaks every day across the country and two trillion gallons of treated water is lost every year due to leaking pipes at an estimated cost of \$2.6 billion.

As will be discussed by my counterparts today, the estimates for maintaining, replacing, upgrading, and operating the nation’s water infrastructure are staggering. Water related services require miles of underground systems and extensive treatment plants. The complex nature of the water industry makes it twice as capital-intensive as electricity and three times as capital-intensive as natural gas. The continued deterioration of the nation’s water systems could lead to increased water service disruptions, more barriers to emergency response, impacts to other public infrastructure, as well as threats to public health for many Americans.

Water systems are the most expensive asset for a community to maintain, and many municipally owned utilities simply cannot afford to improve their systems. They have a limited revenue base which must service all the needs of the community, not just water and wastewater services. In this context, the importance of bringing in private capital cannot be underestimated.

On the other end of the spectrum, there are many instances where needed water system improvements are indefinitely deferred as a result of short-term political expediency. For example, during a recent trial in southern California, it was brought to light that one local water supplier is currently on a water pipeline replacement cycle of 148,000 years.³ In other words, it will take the water utility 148,000 years to replace all of the water pipes in its system. Too frequently, these decisions are made in order to keep the cost of water service as low as possible. Yet, having low water rates is not, in and of itself, virtuous, especially considering how critical the nation’s drinking water systems are to economic vitality and public health.

Addressing these dramatic needs will require focused, dedicated and robust participation by both public and private sectors. Thus, it is important that the federal government look to all sources of capital and expertise – both public and private – to invest in water infrastructure. Federal funds alone will not bridge the growing investment gap. As Congress examines future funding for drinking water and

³ Golden State Water Company, “Golden State’s (Proposed) Findings of Fact and Supporting Evidence and Law,” in *City of Claremont v. Golden State Water Company*, Superior Court of the State of California – Los Angeles County, Case Number BC566125, August 5, 2016, p. 35.

wastewater programs as part of any infrastructure initiative, NAWC recommends that all policies be examined to ensure that the private water industry is not disadvantaged, but rather, is incentivized to add additional resources to this effort. And just as important, we must ensure that any future federal funds are utilized to most effectively address the nation's vast water infrastructure needs.

Effective Utility Management and Accountability

NAWC and its members support EPA's ten attributes of effective utility management endorsed by all major water and wastewater associations, including the American Water Works Association (AWWA), National Association of Clean Water Agencies (NACWA), Water Environment Federation (WEF), Association of Metropolitan Water Agencies (AMWA), Association of Drinking Water Agencies (ASDWA), and the Association of Clean Water Administrators (ACWA). The attributes include things such as financial viability, infrastructure stability and operational resiliency, which reflect the basics of financial, technical and operational capacity of sustainable utility management.

Failing and noncompliant water systems not only create a growing financial burden, but they pose significant risks to public health and the environment. According to EPA's compliance database, in 2016, there were over 1,500 community water systems in significant noncompliance.⁴ These rates of noncompliance are unacceptable and unsustainable. If we are to change the status quo, we must offer more "carrots and sticks" in the regulatory toolbox.

As a good first step, and as a general rule, applicants for public dollars should demonstrate that they have fully accounted for the long-term costs of their projects, including any risks inherent in construction, operations, or maintenance, and have selected the delivery model that provides the best value. For a community to maintain and enhance the condition of its infrastructure long-term, water utilities should be expected, at a minimum, to manage their assets based on a process where adequate repair, rehabilitation, and replacement are fully reflected in management decisions, including water pricing.

On this latter point, it is important to note one of the core differences between regulated private water utilities, like Cal Water, and some of our public counterparts. The water rates charged by regulated private water utilities are set by state public utilities commissions to ensure they reflect the actual cost of service, including the costs of operating, maintaining, and upgrading their water systems. We do not rely on other sources of revenue that are not related to the water system, such as sales or property tax revenue. Not only does this approach send an efficient price signal to customers, but it also helps to ensure that the utility remains financially stable.

⁴ Brent Fewell, "Encouraging Greater Compliance Requires a Change in the Status Quo," Journal AWWA, September 2016.

As well, we would be wise to assess impediments to effective utility management resulting from local procurement processes. Public procurement today tends to overvalue low initial costs and undervalue future obligations, rewarding bidders who can build cheaply, rather than those who offer the best value over a project's lifecycle. This often increases the costs down the road – both higher operations and maintenance costs – and as repairs go unaddressed, infrastructure fails prematurely, requiring expensive rebuilds, etc. This is fiscally irresponsible.

Partnerships and Consolidation

Drinking water systems must be expected to maintain their assets and operations in compliance with health-based laws. If a system is unable to attain compliance and is plagued with a history of serious noncompliance, it should be given an option to pursue a partnership that will lead to a return to compliance or be compelled by the State to consolidate or transfer assets to an able owner/operator. In this regard, NAWC has been working closely with other water groups to promote legislation that would encourage partnerships, ranging from peer-to-peer support and public-private partnerships (P3s) to transfer and consolidation. We simply cannot continue to expect failing systems to change unless good decision-making is incentivized and, conversely, bad decision-making is discouraged.

While NAWC and its members are mindful of the socioeconomic and financial complexities associated with our nation's growing water crisis, communities must be held accountable for failing systems. We should expect communities to proactively seek assistance and support or they should get out of the business of water provision. Year after year there is talk of the growing water crisis, yet little is done to actually stem this crisis.

One option to help struggling systems that is currently under discussion is to encourage these systems to pursue partnerships *in lieu* of traditional enforcement or, alternatively, the State should compel the transfer of assets and/or operational control where a return to compliance is unlikely to occur. While traditional enforcement tools are not always appropriate or practicable where, for example, communities simply do not have adequate resources, these communities must be expected to do things differently.

Cal Water's experience with the unincorporated community of West Goshen in Tulare County, California highlights the efficacy of an approach that focuses on partnerships and consolidation. For years, the 400 residents of the community dealt with ongoing water quality issues, including nitrate and bacteria contamination of their two water wells. To make matters worse, in 2012, West Goshen's wells began failing. The community received emergency funding from the State to replace the failing wells. Unfortunately, a short while after receiving this funding, a portion of the water system's pipes collapsed; instead of water, residents had sand flowing through their taps. Residents were forced to travel to nearby towns to shower, brush their teeth, and cook.

Fortunately for the residents of West Goshen, one of Cal Water's service areas was only a little over a mile away. Cal Water worked with several non-profits, Tulare County, and the state to secure \$3 million from the Safe Drinking Water State Revolving Fund to connect the community's water system to Cal Water's. As part of the project, Cal Water installed more than 8,500 feet of new water pipe from its existing system to West Goshen, and installed a number of new fire hydrants to improve fire protection in the area. Today, the residents of West Goshen are able to enjoy something they did not have for years: safe, reliable, and high-quality water service.

Suffice it to say that there are numerous opportunities for similar partnerships to be employed across the country. What is truly needed is the will to make them a reality. While many communities continue to clamor for more federal funding, more funding is not going to solve this growing crisis. In many cases, water system failures – be they related to water quality, reliability, or both – are not due to the absence of funding, but rather are directly attributable to the failure of proper governance and poor decision-making.

This point notwithstanding, we recognize there are many small and rural communities where few, if any, viable partnership options exist due to the fact they are simply too small or too remote to would-be partners. In those cases, the federal government should increase and reprioritize federal funding and technical assistance to help support those communities.

While public-private partnerships are in many cases an efficient and cost-effective solution, there are numerous impediments to more P3s, including the legal and financial liabilities of distressed systems. Such liabilities for past noncompliance, which can range in the hundreds of thousands and millions of dollars, can be a “poison pill” to a prospective new operator or owner. To solve this problem, Congress should consider providing a legal “safe harbor” to encourage more private sector participation, including investment. Without such liability relief, significant amounts of private capital and investment remains on the sideline.

Specific Tax Issues

While we recognize that tax issues are the jurisdiction of the Ways and Means Committee, NAWC has two priority tax issues that we want to highlight for you today.

Private Activity Bonds (PABs) for Water Projects

One of the most effective financing tools of the federal government for long-term, capital-intensive infrastructure projects is the private activity bond (PAB)—tax exempt financing granted to the private sector for public-purpose projects, like water. The PAB is a critical tool for drinking water and wastewater projects. PABs make infrastructure repair and construction more affordable for municipalities and ultimately for users or

customers. The use of PABs spurs capital investment in public projects during a time when governmental budgets are tight; and investors prefer PABs because interest accrues tax-free.

While legislation has yet to be reintroduced this Congress, in past Congresses bills in the House and Senate have been introduced that would remove water projects from state volume caps for private activity bonds and thus spur increased private investment in systems throughout the country. A removal on volume caps for water projects will bring financing of this piece of the nation's critical infrastructure in line with airports, high-speed rail and solid waste disposal, all of which are currently exempt from existing caps. This legislation has received extraordinary bipartisan support in the past, garnering 101 bipartisan co-sponsors spanning the full political ideological spectrum, and was supported by dozens of business and other groups from the Clean Water Council to the U.S. Chamber of Commerce to Operating Engineers and Laborers' Unions and the U.S. Conference of Mayors because of the measure's undeniable merit. We are hopeful that this legislation will be reintroduced in the near future.

Clarify Internal Revenue Code for Public-Private Partnerships (P3)

Most municipal infrastructure projects are financed by tax-exempt municipal bonds. As a general rule, the tax exemption on such bonds is lost if a private-sector business acquires a long-term interest in the project. However, the Internal Revenue Service has issued rules meant to give state and local governments a reasonable path for preserving the tax-exempt status of these bonds in such an event. Unfortunately, as currently drafted, these remedies are not practicable for water utility projects and, thereby, deter beneficial water P3 projects. We look forward to working with Congress and the U.S. Treasury Department to find a reasonable and narrowly tailored solution.

Recommendations

Our current water infrastructure crisis has been in the making for several decades, and it may take several decades to change the direction and right the ship. Today's dwindling resources and increasing demand for safe, sustainable water resources requires a fundamentally different approach than what we have taken over the last several decades.

First, Congress should require as condition to eligibility for public funding, that water systems develop a plan based on life-cycle cost and sustainable materials. Recognizing that not every water system project is of sufficient size to make this level of screening cost-effective, Congress could establish a size or cost threshold below which these requirements would not apply. However, such a threshold should be set at a level, or otherwise be constructed, to encourage opportunities for partnerships or consolidation.

Second, failing systems that are seriously noncompliant with state and federal health-based requirements must be held accountable with a return-to-compliance plan, which could include an option for partnership *in lieu* of a traditional enforcement approach.

Third, Congress should provide more incentives for private-sector participation in the form of public private partnerships, remove barriers such as the PAB volume cap and resolve defeasance issues, and provide “safe harbor” to shield would-be partners from the legal and financial liabilities associated with seriously noncompliant systems.

Conclusion

I sincerely appreciate your invitation to appear before the Subcommittee today and, along with my many colleagues in the National Association of Water Companies, look forward to continuing our work with you to ensure that all Americans benefit from innovations in financing which improve the water infrastructure so essential to their quality of life. Thank you and I would be happy to respond to any questions you may have.