

COMMONWEALTH OF PENNSYLVANIA



OFFICE OF CONSUMER ADVOCATE

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September 2, 2016

Rosemary Chiavetta, Secretary  
PA Public Utility Commission  
Commonwealth Keystone Bldg.  
400 North Street  
Harrisburg, PA 17120

Re: Joint Application of Pennsylvania-American Water Company and the Sewer Authority of the City of Scranton for Approval of (1) the transfer, by sale, of substantially all of the Sewer Authority of the City of Scranton's Sewer System and Sewage Treatment Works assets, properties and rights related to its wastewater collection and treatment system to Pennsylvania-American Water Company, and (2) the rights of Pennsylvania-American Water Company to begin to offer or furnish wastewater service to the public in the City of Scranton and the Borough of Dunmore, Lackawanna County, Pennsylvania.

Docket No. A-2016-2537209

Dear Secretary Chiavetta:

Attached for electronic filing please find the Office of Consumer Advocate's Exceptions in the above-referenced proceeding.

Copies have been served as indicated on the enclosed Certificate of Service.

Respectfully submitted,

/s/ Erin L. Gannon

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Enclosures

cc: Honorable David A. Salapa, ALJ  
Honorable Steven K. Haas, ALJ  
Office of Special Assistants (email only - [ra-OSA@pa.gov](mailto:ra-OSA@pa.gov))

Certificate of Service  
225451

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Application of Pennsylvania-American :  
Water Company and the Sewer Authority :  
of the City of Scranton for Approval of :  
(1) the transfer, by sale, of substantially all :  
of the Sewer Authority of the City of Scranton's :  
Sewer System and Sewage Treatment Works :           Docket No.    A-2016-2537209  
assets, properties and rights related to its :  
wastewater collection and treatment system to :  
Pennsylvania-American Water Company, and :  
(2) the rights of Pennsylvania-American Water :  
Company to begin to offer or furnish wastewater :  
service to the public in the City of Scranton and :  
the Borough of Dunmore, Lackawanna County, :  
Pennsylvania.

I hereby certify that I have this day served a true copy of the following document, the Office of Consumer Exceptions to the Recommended Decision, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 2<sup>nd</sup> day of September 2016.

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Application of Pennsylvania-American :  
Water Company and the Sewer Authority :  
of the City of Scranton for Approval of :  
(1) the transfer, by sale, of substantially all :  
of the Sewer Authority of the City of Scranton’s :  
Sewer System and Sewage Treatment Works :           Docket No.    A-2016-2537209  
assets, properties and rights related to its :  
wastewater collection and treatment system to :  
Pennsylvania-American Water Company, and :  
(2) the rights of Pennsylvania-American Water :  
Company to begin to offer or furnish wastewater :  
service to the public in the City of Scranton and :  
the Borough of Dunmore, Lackawanna County, :  
Pennsylvania.

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EXCEPTIONS OF THE  
OFFICE OF CONSUMER ADVOCATE

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Dated: September 2, 2016

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## **I. INTRODUCTION**

On March 30, 2016, Pennsylvania-American Water Company (PAWC) and the Sewer Authority of the City of Scranton (SSA) filed a Joint Application to transfer nearly all of SSA's assets to PAWC and for PAWC to render wastewater service in the areas currently served by SSA. PAWC has agreed to pay \$195 million plus an additional unknown amount due to the variance adjustment provision of the Asset Purchase Agreement (APA). In addition, PAWC proposes that its existing water and wastewater customers will subsidize \$140 million of improvements needed to meet the SSA's commitments under a Consent Order.

The Office of Consumer Advocate (OCA) filed a protest setting forth its position that storm water service was not subject to the Public Utility Commission's (PUC or Commission) jurisdiction and that the Joint Application did not provide affirmative benefits and in fact will only increase costs for PAWC's existing customers in the short and long term. A complete procedural history of the case is in the OCA's Main Brief. OCA M.B. at 3-5.

On August 24, 2016, the Office of Administrative Law Judge issued the Recommended Decision (R.D.) of Administrative Law Judges (ALJs) David A. Salapa and Steven K. Haas. In the R.D., the ALJs recommended that the application be denied because a price adjustment provision in the APA is unreasonable, not in the public interest and violates the Public Utility Code. R.D. at 1, 42-44. While the ALJs' conclusion matches the OCA's recommendation that the Application be denied, the OCA disagrees with the ALJs' conclusion that the PUC has jurisdiction over storm water. In addition, the OCA submits that there are additional reasons why the Joint Application should be denied that were not addressed by the ALJs. Finally, the ALJs' determination that the PUC has jurisdiction, if adopted, would necessitate the additional



step of requiring the allocation of storm water costs. For those reasons, the OCA files these Exceptions.

The Public Utility Code does not authorize the provision of storm water service by a regulated public utility. 66 Pa. C.S. §§ 102, 1102. The fact that storm water service and wastewater service are provided in a combined system does not make them a single service subject to Commission regulation; they are fundamentally and functionally distinct. Storm water is rain and snow or ice melt that is collected and drained to prevent flooding of streets and property. OCA St. 1 at 5-6; OCA St. 2 at 8-9. Wastewater is “used” water from homes and businesses that is collected so that it can be treated before it is returned to streams and creeks. In Pennsylvania, only municipalities and municipal authorities own and operate storm water systems and combined storm water/wastewater systems. This reflects that storm water management is tied inextricably to land use and other municipal functions like street cleaning, solid waste collection and green infrastructure initiatives. OCA St. 1 at 12-13; OCA Exh. TLF-5; OCA St. 2 at 9-10. For these legal and policy reasons, the Joint Applicants’ request that the Commission expand its jurisdiction to include storm water service must be denied.

In addition, as discussed below, the Joint Applicants have not shown the proposed acquisition of SSA’s combined storm water/wastewater system will provide affirmative public benefits. The ALJs correctly concluded that the variance adjustment is not in the public interest. There are other parts of the proposed transaction which similarly are not in the public interest. Either individually or taken together, the adverse impacts of the proposed transaction outweigh any claimed benefits and, as a result, the transaction should not be approved.

All told, the Joint Applicants are proposing that PAWC’s existing wastewater and water customers subsidize as much as \$700 million in costs over the next thirty years in order to

acquire 31,000 wastewater customers who are already PAWC water customers. OCA St. 2 at 27, 33. This reflects the projected costs of required capital improvements, the proposed purchase price and cost shifting from the SSA customers – it does not account for the variance adjustment that would increase costs by another \$104 million. Even the SSA customers could face severe increases after the first 10 years post-transaction, if they are moved to PAWC system rates, because the APA caps their rate increases during the first 10 years. The OCA submits that these are additional reasons why the Commission should deny the Joint Application because it is not in the public interest.

If the Commission disagrees with the ALJs recommendation and determines that it will regulate storm water service in combined systems, the OCA submits that it must condition its approval by requiring PAWC to develop separate rates and charges for the storm water service to responsible parties. In addition, the Commission must condition its approval to prevent PAWC's existing customers from subsidizing the purchase price and mandated storm water-related capital improvement costs. Unless the transaction is conditioned on measures that prevent PAWC's existing wastewater and water customers from paying the storm water-related costs of the City of Scranton and the Borough of Dunmore, the record cannot support a finding that the transaction is in the public interest.

## II. EXCEPTIONS

OCA Exception No. 1: The ALJs Erred By Finding that the Commission Has Jurisdiction over Storm Water Service. R.D. at 17-23; OCA M.B. at 9-28; OCA R.B. at 3-12.

A. Cases regarding the Wayne System Are Not Dispositive.

The SSA system is a “combined sewer system,” which provides wastewater service and storm water service. PAWC Exh. BCG-1 at 304; OCA St. 1 at 2-3; OCA Exh. TLF-10. PAWC seeks approval to recover all costs associated with the combined system through rates charged to its existing wastewater and water customers. PAWC Exh. BJG-1, Att. F (APA); OCA St. 2 at 26, 33-35. The Public Utility Code defines a “public utility” as “[a]ny person or corporations now or hereafter owning or operating in this Commonwealth equipment or facilities for . . . sewage collection, treatment, or disposal for the public for compensation.” 66 Pa. C.S. § 102(1)(vii). The Public Utility Code does not address storm water and, therefore, the Commission does not have jurisdiction over the provision of storm water service and cannot authorize PAWC to acquire the SSA system and provide storm water service for compensation.

The presiding ALJs recognized that this is a case of first impression and that there are no controlling Commission decisions concerning Commission jurisdiction over combined sewer systems. R.D. at 19. The ALJs then concluded, however, that three Public Service Commission (PSC) decisions regarding a utility in Wayne, Pennsylvania are dispositive because – in the ALJs’ view – they show that the PSC exercised jurisdiction over a combined sewer system. R.D. at 21-22. Specifically, the ALJ’s stated:

The decisions in Fronfield and Dickson describe the Wayne Sewerage Company’s predecessors in 1883 as having constructed the town of Wayne, laying out streets and lots and constructing a gravity drainage or sewage system by laying drains or pipes in the streets. Subsequently, these predecessors constructed houses and connected the houses to the drainage system. From this description in Fronfield and Dickson of the service being provided by the Wayne Sewerage Company, it

appears that the Wayne Sewerage Company's system was initially constructed as a combined system, handling both water from the streets and sewage from the houses.

When the Public Service Commission assumed regulatory authority over the Wayne Sewerage Company, there is no indication in the Public Service Commission's Wayne decision that it determined that it had no jurisdiction over the system because it handled water from the streets. Rather, the Commission referred to the entire system as a sewage system. Therefore the Public Service Commission interpreted the term "sewage" in its enabling statute to include water from the streets and sewage from the houses. In other words, since the time that the Public Service Commission began regulating public service companies, it appears that it regulated combined sewage systems.

R.D. at 21-22 (citing Wayne Title & Trust Co. v. Wayne Sewerage Co., 3 Pa. P.S.C. 1170 (1919) (Wayne), Wayne Sewerage Co. v. Fronefield, 76 Pa. Super. 491 (1921) (Fronefield), Dickson v. Drexel, 285 Pa. 419, 132 A. 284 (1926) (Dickson)). The cited cases do not, however, conclusively show that the Wayne system was a combined system – there may have been a sanitary sewer system and a storm water drainage system. The fact that the sewage system pipes were placed "in the streets" before the lots were sold and the homes were connected thereto does not mean that the "sewage system" handled water from the streets. Fronefield at 494. Further, even if the system was initially constructed as a combined system, there is no information to show that it was still a combined system when the Public Service Commission was created in 1913, a span covering thirty years and two owners. Dickson, 285 Pa. at 422, 132 A. at 284.

It is known with certainty, however, that rates for the sanitary sewer system (only) were at issue in the Wayne cases. As shown in the comparison of the sewage company's initial and proposed rates for service, all of the fees underlying the "sewage" rates are based on rooms or fixtures in the homes – there is no mention of downspout connections or lot size, roof area or paved area that are used to set storm water rates.

## SCHEDULE OF RATES

Schedule of Rates under Ball Agreement of November 29, 1905 as contained in P. S. C. P. No. 1.      Schedule of Rates Effective July 15, 1918, as set forth in P. S. C. Pa. No. 2.

	Annual Rate	FIXTURES <i>For Dwelling Houses</i>	Annual Rate
Dwelling houses of 12 rooms or less, . . . . .	\$10 00	Kitchen sink, . . . . .	\$7 00
For each additional room, . . . . .	1 00	Each additional sink, . . . . .	1 25
For stable, one or three stalls, . . . . .	5 00	Water closet, each, . . . . .	4 00
For stable, four to five stalls, . . . . .	7 50	Urinals each, . . . . .	4 00
For stables used for housekeeping, purposes in addition to ordinary use, . . . . .	10 00	Bath Tubs, each, . . . . .	4 00
For each church building, . . . . .	15 00	Shower Baths, each, . . . . .	4 00
For all buildings not enumerated in schedule, rates are to be agreed upon.		Wash Stands, each, . . . . .	1 25
No building other than a stable shall be allowed to connect with the sewer system for a less rate than \$10.00 per annum.		Laundry Tubs, each, . . . . .	1 25
A room is hereby defined to be any subdivision of a house containing not less than 180 cu. ft. in which subdivision there is at least a window and a door.		<i>For Stores and Offices</i>	
		Sinks or Wash Stands, each, . . . . .	6 00
		Water Closets, each, . . . . .	6 00
		Urinals, each, . . . . .	6 00
		<i>For Halls, Public Buildings and Moving Picture Halls</i>	
		First Sink or Wash Stand, . . . . .	12 00
		Each additional Sink or Wash Stands, . . . . .	6 00
		Per Annum	
		First Water Closet, . . . . .	\$15 00
		Each additional Water Closet, . . . . .	7 50
		First, Urinal . . . . .	15 00
		Each additional Urinal, . . . . .	7 50
		For all fixtures not enumerated in schedule, rates are to be agreed upon.	
		For each school room, . . . . .	10 00
		An annual minimum charge of \$12.00 will be made for each sewer connection in event the annual rate for the fixtures in use do not amount to that sum.	

Wayne at 1174.

The OCA submits that the Wayne, Fronefield and Drexel cases do not provide the guidance sought by the ALJs regarding whether the General Assembly intended for the term “sewer” in the Public Utility Code to include combined systems that provide storm water service. That guidance can be found, however, in other statutes promulgated by the General Assembly, which address storm water and sewer service.

**B. The General Assembly Has Distinguished Storm Water.**

Where the General Assembly has intended to include storm water in the types of service an entity can provide, it has amended the statute to add “storm water” where the existing statute already authorized the provision of “sewer” service. Specifically, in 2013, the General Assembly amended the Municipal Authorities Act to allow municipal authorities to operate “storm water

planning, management and implementation” projects. 53 Pa. C.S. § 5607(a)(18). The statute already provided for municipal authorities to finance, construct and maintain projects relating to “sewers, sewer systems or parts thereof” as well as “sewage treatment works.” 53 Pa. C.S. § 5607(a)(5), (a)(6). If “storm water” were commonly understood to be included in the term “wastewater,” then adding a provision for storm water would be redundant. Because a statute should be interpreted so as to “give effect to all its provisions,” 1 Pa. C.S. § 1921(a), it is presumed that the legislature does not intend for any provisions of a statute to be “mere surplusage,” see, e.g., Holland v. Marcy, 584 Pa. 195, 206 (2005); Burdick v. Erie Ins. Group, 946 A.2d 1106, 1108 (Pa. Super. Ct. 2008).

The Pennsylvania Storm Water Management Act also supports a statutory distinction between “storm water” and “sewage.” 32 P.S. § 680.4. The Act defines “public utility service” to include “sewage collection, treatment or disposal.” Id. Storm water is separately defined as “drainage runoff from the surface of the land resulting from precipitation or snow or ice melt.” 32 P.S. § 680.4.

In addition, the Pennsylvania Sewage Facilities Act explicitly defines “sewage” as “any substance that contains any of the waste products or excrement or other discharge from the bodies of human beings or animals and any noxious or deleterious substances being harmful or inimical to the public health, or to animal or aquatic life, or to the use of water for domestic water supply or for recreation, or which constitutes pollution . . . .” 35 P.S. § 750.2. This definition excludes storm water.

Thus, where the General Assembly has intended to include storm water in the types of service an entity can provide, it has amended the statute to add “storm water” where the existing statute already authorized the provision of “sewer” service.

C. Lancaster is Persuasive.

The ALJs determined that the City of Lancaster cases are not persuasive on the question whether combined sewer systems are properly regulated by the Commission. R.D. at 19; Pa. P.U.C. v. City of Lancaster Sewer Fund, Docket No. R-0004986, Remand Order at 3 (Sept. 15, 2008) (Lancaster 2004); Pa. P.U.C. v. City of Lancaster Sewer Fund, Docket No. R-2012-2310366, Order (Apr. 18, 2013) (Lancaster 2012). The ALJs ignore that Lancaster is the only combined storm water/wastewater system over which the Commission exercises jurisdiction.<sup>1</sup> The ALJs distinguished these cases because no storm water facilities serve the jurisdictional customers. R.D. at 19. The Commission's decisions in Lancaster, however, depended on two findings that are applicable to the transaction under review: (1) the costs of providing storm water service are distinct from the costs of providing wastewater service, even where one system is providing two services and (2) PUC-regulated customers should not pay the costs associated with storm water service when they do not contribute to the storm water costs. Lancaster 2004; Lancaster 2012; OCA St. 1 at 9; OCA St. 1S at 5-7; OCA St. 2 at 19.

OCA Exception No. 2: The ALJs Erred by Not Addressing the Need for Separate Allocation. OCA M.B. at 41-43; OCA R.B. at 23-35.

If the Commission concludes that it does have jurisdiction, the sewage and storm water rates must be separately allocated because they are different services and if the costs are allowed to be put on the existing water and wastewater customers, then there will not be any affirmative

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<sup>1</sup> With regard to Commission jurisdiction, the OCA provides one correction to a statement made on page 40 of the Recommended Decision. The ALJs stated:

The Commission only has authority to regulate a municipal authority if it provides utility service outside its service territory. Such is not the case here.

Instead, the Commission has no authority to regulate a municipal authority but does have the authority to regulate a municipality or municipal corporation if it provides utility service outside its municipal boundaries and only for service to those customers outside of the municipality. 66 Pa. C.S. § 1102(a)(5).

benefits as a result of the transaction but rather there will be harm, as discussed below. This was not reached by the ALJs because of their position on jurisdiction but is necessary.

A. Storm Water Costs Must Be Separately Allocated.

If a PUC-regulated utility is to be permitted to provide storm water service to the public, then the utility would need to develop separate rates and charges that are proportional to a customer's contribution of storm water to the system. OCA St. 2 at 19-20. Mr. Rubin also concluded that it would be necessary to levy storm water charges on the entities that contribute to the storm water but are not wastewater customers. For example, building owners, but not tenants in a multi-unit building would need to be charged for the storm water contribution of the building. The tenants would not have any control over the storm water management for the building and thus would not be charged a storm water fee from PAWC. Id. at 19-20. Regarding the development of separate charges, Mr. Rubin stated:

[I]n my opinion such separate proportional charges would be necessary to pass muster as "just and reasonable" rates under Pennsylvania law and as being "based on some fair approximation of the [customer's] proportionate contribution" to stormwater under federal law.

OCA St. 2 at 20.

The estimated costs of the LTCP are \$169 million in August 2012 dollars. OCA St. 1 at 3; Exh. TLF-1. Approximately \$144 million plus a significant portion of the \$25 million for the wastewater treatment plant upgrade for BNR and CSO control is related to storm water control. OCA St. 1 at 4. These amounts are in addition to the \$195 million that is the initial acquisition price under the proposed transaction.<sup>2</sup>

Storm water costs are the majority of the costs that need to be expended under the consent decree. Thus, if PAWC is permitted to provide storm water service to the public, it

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<sup>2</sup> The impact of the variance adjustment on the final purchase price will not be known until 10 years after the transaction closes. OCA St. 2 at 23.



would need to develop separate rates and charges that were proportional to a customer's contribution of storm water to the system. OCA St. 2 at 19. As Mr. Fought explained, PAWC proposes that all of its water and sewer customers will pay a portion of the costs based on each customer's water usage. OCA St. 1 at 11. PAWC's proposal should be rejected.

First, there is no correlation between the volume of water used by a customer and storm water runoff. Id. The storm water runoff is based on the lot size, ground cover, soil type, ground slope, roof area, paved area, etc. Id. Mr. Fought recommended that the original cost, operation and maintenance costs of the SSA combined system be allocated between storm water and wastewater, with the allocated wastewater costs from the combined system being added to the wastewater costs from the customers located in the MS4 system. OCA St. 1 at 11-12. This procedure has been used in the City of Lancaster Sewer Fund's 2004 and 2012 rate cases. Id. at 12. The allocated storm water costs could then be billed to either the City and the Borough or an Authority that could bill residents for storm water costs. OCA St. 1 at 12.

Second, separately allocating the storm water costs addresses the issues raised with the additional duties that PAWC has agreed to undertake, namely street sweeping and catch basin cleaning in the areas serviced by the combined system. OCA St. 1 at 12. Based on the relative areas of the MS4 system and the combined system as shown on Exhibit TLF-9, it is clear that the majority of the street sweeping and catch basin cleaning in the City of Scranton and the Borough of Dunmore will be the responsibility of PAWC, an investor-owned utility, rather than the municipalities. Id. Mr. Fought noted that PAWC does not provide those services in any other of its wastewater systems. Mr. Fought was unaware of any other PUC regulated utility, other than Lancaster, that is responsible for sweeping the streets and cleaning the catch basins of the municipalities it serves. Id.

Further, it is important to recognize that present PAWC water and wastewater customers reside in municipalities that are providing for and paying the costs of their storm water handling. Id. Thus it would not be appropriate to allocate those costs, normally borne by municipalities, to PAWC's existing water and sewer customers outside of the Scranton and Dunmore areas. OCA St. 1 at 13. Mr. Fought noted that storm water costs could be billed to the City of Scranton and the Borough of Dunmore or an Authority because it is the municipalities' responsibility to provide for the handling of storm water within its borders.

1. Setting Storm Water Rates and Identifying the Customers

As explained by Mr. Rubin, the way in which storm water rates are set vary by municipality but regardless of which methods are used, storm water rates are set in a very different manner than the way water and wastewater rates are set the PUC. OCA St. 2 at 11-18.

In addition, storm water customers are not the same as wastewater customers. A commercial parking lot owner, with no water connection or wastewater connection would currently not pay anything under the SSA system (see Tr. 180) or under PAWC's proposed transaction. However, that entity's contribution to storm water is undeniable and under a system that separately bills for storm water, that entity would pay its fair share towards the total costs of storm water.

The Joint Applicants, by ignoring these fundamental differences and proposing that the PUC not only expand its jurisdiction, but then require water and wastewater customers to bear all of the costs of storm water service, gut the principles of cost based rates. As discussed below, how a municipality or municipal authority structures wastewater and storm water service, sets rates, and runs its business, is not under the purview of the PUC, but rather is subject to different statutory framework. However, under the Public Utility Code, rates are set based on costs and

cost causation. The Joint Applicants' proposed ratemaking cannot be reconciled with the principles of cost based ratemaking and cost causation.

Under PAWC's proposal, wastewater customers and water customers will pay for the existing storm water costs for the City of Scranton and the Borough of Dunmore as well as the storm water-related improvements required under the Consent Decree. Storm water costs represent more than 85% of the costs of the capital improvements that are necessary under the Consent Decree. See OCA St. 1 at 3-4. That equates to approximately \$144 million in 2012 dollars. Id.

Therefore, if PAWC is permitted to provide storm water and wastewater service, it is appropriate to separately allocate storm water costs so that the appropriate customers can be charged appropriate storm water rates and the wastewater customers can be charged for wastewater costs.

## 2. Separate Storm Water Fees Are Not an Anomaly.

Mr. Rubin noted in his direct testimony, "It is difficult to say whether a separate fee for stormwater is required, but such charges are becoming more common and there are strong public policy reasons for having a separate charge for stormwater service." OCA St. 2 at 13. He went on to note that failure to have a separate storm water fee may result in the charge for storm water service not being reasonable. Id. Although Joint Applicants argue that there are no legal requirements, they acknowledge that there is legal authority for certain municipalities, such as Scranton, and for municipal authorities, such as SSA, to establish separate storm water charges based on property characteristics. JA Brief at 64. As discussed by Mr. Rubin, there are strong policy reasons why separate charges should be established given the very different services that are provided.

There are an increasing number of entities establishing storm water fees nationwide. The Water Environment Foundation reported that only a few local government agencies had separate fees for storm water in 1994. OCA St. 2 at 11. By 2014, however, there were approximately 1,500 storm water utilities in the United States and Canada. Id. Among those storm water utilities is the City of Philadelphia. OCA St. 2 at 12. Two-thirds of the City of Philadelphia is served by a combined sewer system. Id. at 12-13. Notably, the storm water fees do not vary depending on whether the property is served by Philadelphia's separate storm water system or by the combined system. Id.

Consistent with the national trend, Mr. Rubin stated that he expected to see the number of storm water utilities rise in Pennsylvania. OCA St. 2 at 14. In 2013 and 2014, the Pennsylvania General Assembly amended the Municipal Authorities Act to provide specific authority to municipal authorities to establish a separate storm water fee. OCA St. 2 at 14; 53 Pa. C.S. § 5607(a)(18), (d)(34).

B. Charging Municipalities or a Municipal Authority for Storm Water Service Is a Viable Option As Is a Storm Water Authority.

If the Commission does not accept the OCA's primary position that storm water is not part of the PUC's jurisdiction, the OCA has proposed that the storm water costs should be allocated separately from wastewater costs. The OCA provided the only examples of how the PUC has handled this issue, namely the storm water allocations that were used in the 2004 and 2012 Lancaster Sewer rate cases.

Seven Pennsylvania communities have existing storm water fees including the City of Lancaster. Moreover, 1,500 systems in the United States and Canada have established storm water fees. OCA St. 2 at 11. The OCA's suggestions regarding a storm water authority are

consistent with what other municipalities have done which is consistent with the existing legal framework.

For all of the legal and policy reasons explained supra, investor-owned utility provision of storm water service is not good public policy. There are many solutions that do not involve an unsupported expansion of the PUC's jurisdiction and do not raise all of the other issues that would be involved with an investor-owned utility providing storm water service.

OCA Exception No. 3: The ALJs Erred By Concluding that Customer Growth Would Affect the Calculation of the Variance Adjustment. R.D. at 29.

The Asset Purchase Agreement imposes a potential obligation on PAWC to pay an additional amount to purchase the SSA system. APA §§ 7.07(d), (e); OCA St. 2 at 23-28. This “variance adjustment” is intended to incentivize PAWC to limit rate increases to the SSA customers over the 10 year-period following closing. If actual revenues exceed the limit established in the APA, the agreement provides that PAWC will seek to recover those amounts from existing water customers. Id.; OCA St. 2 at 26-27.

The ALJs observed that the actual amount of the variance adjustment is “unknown and unknowable at this time and bears no relationship to either the value of the assets or estimated operating costs.” R.D. at 28-29, 31-34. This is correct, however, they make one misstatement within their discussion. Specifically, on page 29 of the R.D., they state that the potential for the addition of customers in the SSA service area could affect the revenue calculation under the variance adjustment. This is not correct. The calculation of the variance adjustment ignores any change in number of customers or sales over the 10-year period. See APA §§ 7.07(d), (e), and (f).

Specifically, Schedule 7.07(d) to the APA contains the details of the variance adjustment calculation.<sup>3</sup> That schedule describes the calculation of the starting level of revenues at the time of acquisition (Year 0). It then discusses the revenue calculation in Year X (that is, a time period after the acquisition occurs). The Year X revenue calculation is described as follows: “Calculate Wastewater Revenue from Scranton System Wastewater Customers at Year X (*based on Year 0 billing determinants* and PaPUC approved rates in Year X) = Year X Revenue.” *Id.* (emphasis added). Thus, customer growth has no effect on the calculation of the variance adjustment – the adjustment is calculated using billing determinants (customers and usage) at the time of acquisition.

The calculation of the variance adjustment, however, does demonstrate that the adjustment has absolutely no relationship to the value of the assets. For example, if PAWC triples its sales in the SSA service area (making the asset much more valuable than when it was acquired), it might not have to pay a variance adjustment (that would depend on the level of rate changes). Similarly, if PAWC’s sales in the SSA service area are cut in half (making the asset less valuable), it could still have to pay the variance adjustment (again, depending on the level of rate changes adopted by PAWC). The ALJs correctly concluded, thus, that the variance adjustment is not reasonable or in the public interest because it has no relationship to the value of the assets being purchased.

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<sup>3</sup> Section 7.07(f) states: “Variance Adjustment shall be calculated in accordance with Schedule 7.07(d).”

OCA Exception No. 4: The ALJs Erred By Not Addressing the Additional Harms the Transaction Would Cause to Existing PAWC Customers. R.D. at 27-42; OCA M.B. at 29-41; OCA R.B. at 14-21.

As discussed in the foregoing exception and in the OCA and I&E briefs, the ALJs correctly recommended that the transaction proposed by PAWC and Scranton should not be approved because the variance adjustment “is unreasonable, not in the public interest and violates the Public Utility Code.” R.D. at 1, 27-42. With regard to the public interest, the ALJs indicate their support for the intention of the City to protect the SSA customers from future anticipated rate increases, although they disapprove of the variance adjustment through which they proposed to do it. R.D. at 33-34. The RD does not recognize the other detriments of the transaction to PAWC’s existing water and wastewater customers.<sup>4</sup> These adverse impacts of the proposed acquisition of the SSA system outweigh any claimed benefits and provide additional basis to determine that the transaction is not in the public interest.

A. There Is No Affirmative Benefit for Existing PAWC Customers, Only Detriments.

The primary deficiency of the transaction negotiated between PAWC and Scranton is the absence of benefit for the existing PAWC wastewater and water customers. One claim by the Joint Applicants was that, at some unknown future date, the PAWC customers will benefit from sharing costs among a larger customer base. PAWC St. 1 at 8; PAWC St. 4-R at 4-5. PAWC witness Nevirauskas stated:

While Scranton-area customers may benefit from the sharing of costs initially, PAWC’s other customers will undoubtedly benefit from the revenues generated from Scranton-area customers in the future as the systems servicing those other customers require capital improvement. Indeed, the Commission should analyze the rate impact of this Transaction not from a 13-year perspective but from a 100-

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<sup>4</sup> When the “public interest” is considered, the benefits and detriments to all affected parties must be considered. Middletown Twp. v. Pa. P.U.C., 85 Pa. Commw. 191, 482 A.2d 674, 682 (1984); Application of CMV Sewage Co., Inc., 2008 PaPUC LEXIS 950, \*43.

year perspective and recognize that other PAWC customers will benefit from the addition of over 31,000 wastewater customers.

PAWC St. 4-R at 4-5. The PAWC customer base would not actually expand, however, because essentially all of the 31,000 customers served by SSA are already PAWC water customers. OCA St. 2 at 34. PAWC's total customer count would not increase as a result of the acquisition.

PAWC also claimed that there will be no "immediate" rate impact on PAWC's existing customers. PAWC St. 1 at 8. This is not an affirmative benefit. It is ephemeral. While PAWC does not propose to increase rates for existing customers in this Application proceeding, the Company plans for its existing wastewater and water customers to begin paying between \$146 and \$199 million of the costs of improvements to the SSA system when it increases rates in its next base rate case – as soon as January 1, 2018.<sup>5</sup> PAWC St. 4 at 4, 7. The large, long-term capital improvements under the consent decree will have a major impact on the rates of existing customers. According to a rate study prepared for SSA in 2012, stormwater-related capital investments are projected to total between \$146 million and \$199 million (in 2011 dollars) over the next 20 years. OCA St. 1 at 31 (citing PAWC Response to OCA II-6, Att. B, Table 2). Further, the impact of the purchase price will be layered on top of all of these costs that are proposed to be borne by the existing wastewater and water customers – anticipated to be in excess of \$120 million in subsidies over 13-years and \$360 million over 30 years. OCA St. 2 at 33 citing the Joint Applicants response to I&E-10, Att. A and OCA Set II-6, Att. C.

The detriment to PAWC's existing customers is underscored by the fact that those customers already pay taxes or other fees to control storm water in their communities. Mr. Rubin provided the following example:

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<sup>5</sup> PAWC intends to seek Commission approval to spread the costs of improving SSA's system to its existing water customers. OCA St. 2 at 33-35; PAWC St. 4 at 4; PAWC Exh. BCG-1, Att. F, Section 7.09(x).



PAWC customers in Mount Lebanon, PA, currently pay PAWC for water, pay the Borough of Mount Lebanon \$4.05 per 1,000 gallons for wastewater disposal and \$8.00 per month for stormwater control. Now PAWC suggests that a Mount Lebanon customer -- who already is paying for her own wastewater disposal and stormwater control -- must provide additional subsidies each year to help pay for wastewater disposal and stormwater control in Scranton and Dunmore.

OCA St. 2 at 34-35.

For all of these reasons, the Joint Applicants have not established that the transaction provides an affirmative benefit to the existing PAWC customers. Instead, the record shows conclusively that these customers will suffer considerable harm.

B. There Is No Evidence That PAWC Will Perform the Improvements at Less Cost or More Quickly; The Mere Assertion That There Will Be “Economies of Scale” or That Service Will Be “Enhanced” Is “Speculative” and Does Not Establish an Affirmative Benefit.

The Joint Applicants provided no documentation that PAWC can construct, operate and maintain the existing SSA system and proposed LTCP improvements at a lesser cost than SSA. OCA St. 1 at 4; OCA St. 2 at 32; OCA Brief at 39. Mr. Rubin testified that PAWC’s cost of capital will likely be higher compared to SSA, which does not have to pay income taxes and state and federal taxes on its equity earnings and has the advantage of being able to issue tax exempt debt. Id. at 30-31; Tr. 98; OCA Brief at 40.

In addition, PAWC will not meet the obligations under the Consent Decree on a faster timeframe than that committed to by SSA – PAWC, using the same employees, will follow the same time frame under the Consent Decree as SSA. OCA St. 2 at 29. There is no evidence that the current owner is not technically or managerially fit. Tr. 154; OCA St. 1 at 4; OCA Brief at 38-39. The statements that customer service will be enhanced do not establish an affirmative public benefit. See Application of CMV Sewage Co., Inc., 2008 PaPUC LEXIS 950.

In order to determine whether benefits meet this standard, the Commission may consider: “(1) the legal and technical fitness of the purchasing entity to provide service; (2) the public need

for service; (3) the inadequacy of the existing service; and (4) any other relevant evidence.” Application of North Heidelberg Water Co., 2010 PaPUC LEXIS 919, \*20. The ALJs concluded that the legal and technical fitness of PAWC is sufficient, but so is the existing service by SSA. There is no indication on the financial side that SSA cannot meet its obligations under the Consent Decree so long as it continues to raise rates in accordance with its rate plan. Although PAWC witness Merante claimed that PAWC is in a much stronger financial position than SSA, Mr. Rubin pointed out that Standard & Poor’s noted SSA’s healthy financial profile, its strong debt service coverage and liquidity. Tr. 98-99; OCA Brief at 39. He also testified that there is no reason to believe that SSA could not finance the capital improvements over the next 20 years that it agreed to implement in its consent decree with the federal and state governments. Tr. 99-100; OCA Brief at 39. Mr. Rubin also observed that Standard & Poor’s noted that, assuming SSA can implement reasonable rate increases over time, it will be able to finance the obligations it has agreed to. Id. at 100. Moreover, the cost to the public of having PAWC undertake those projects is likely to be substantially greater than the costs that would be incurred by the Authority. Id. The most recent bond ratings for SSA by Standard & Poor’s was an A minus and for PAWC by Moody’s was A3. Tr. 99. As Mr. Rubin explained, those ratings are essentially equivalent. Id. In rating SSA, Standard & Poor’s highlighted the authority’s healthy financial profile, its strong debt service coverage and liquidity. Id. Mr. Rubin concluded that the financial markets are not finding that PAWC is significantly different from SSA. Tr. 99.

There are no advantages to the public (or to the environment) from having PAWC own the Scranton-Dunmore system because PAWC is not committing to undertake any physical construction or studies that the Authority is not already required to undertake. PAWC does not claim that it has significant expertise in the operation of a combined wastewater-stormwater

utility and, in fact, it appears that it would rely on existing Authority employees for most of that expertise. OCA St. 2 at 29. In other words, it appears that the level and quality of service will be the same under PAWC ownership as it would be under SSA ownership. Id.

PAWC is unable to “precisely quantify” any efficiencies or decreased operating costs resulting from the proposed transaction or indicate when they might occur. PAWC St. 4 at 5. It relies on the vague supposition that at some unknown time efficiencies “will inevitably be realized because of the size of PAWC’s water and wastewater operations.” PAWC St. 1 at 8; PAWC St. 4 at 5. All of the risk and all of the costs are being shifted to the existing PAWC water customers.

C. SSA Rates May Benefit in the Short-Term, But Not In Years 11 to 13 or Thereafter.

Even the benefits to the SSA customers are limited. In addition to any rate limitations for years 1 through 10, SSA customers will not pay a DSIC prior to January 1, 2019 and the substantial costs of improving the system will be subsidized by PAWC’s existing wastewater customers and, potentially, by its water customers.<sup>6</sup> PAWC St. 4-R at 2; APA §§ 7.09(x); PAWC Exh. BJG-1, Att. J at 3. In years 11 through 13, however, PAWC intends to move the SSA customers to its system rates in equal increments following closing of the transaction.

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<sup>6</sup> WHEREAS, pursuant to the terms of the APA, the customers of the System will experience in the first ten years after the transaction a significant reduction in the Authority’s currently planned sewer rates, meaning that, as per the terms of the APA, the sewer rates will not increase to the extent that the Authority, acting on its own, would require; and  
WHEREAS, the APA sets forth that during the first ten years of ownership PAWC may not raise the sewer rates more than an average of 1.9% compound annual growth rate (“CAGR”) per year; and  
WHEREAS, the APA will shift to PAWC the obligations of Consent Decree compliance and Long Term Control Plan implementation currently estimated to be at or near \$140,000,000; and  
WHEREAS, the purchase price for the sale, transfer, assignment conveyance and delivery of the assets shall be One Hundred Ninety-Five Million Dollars (\$195,000,000.00) subject to the adjustments contemplated in the APA. . . .

PAWC Exh. J at 3.

PAWC St. 4 at 3; PAWC St. 4-R at 2. If approved as proposed, PAWC would charge an SSA customer using 3,000 gallons of water per month \$34.50 compared to charging an existing Rate Zone 1 customer \$46.14 for the same usage.<sup>7,8</sup> In the 10 years post-acquisition, the rate disparity will grow if PAWC proposes rate increases for Rate Zone 1 that exceed the rate increases proposed for SSA customers due to the CAGR limitation. This means that moving SSA customers to system rates in years 11 through 13 could require severe increases because of the rate provision in the Asset Purchase Agreement that shifts costs to existing customers during the first 10 years.

D. Conclusion

The transaction negotiated by PAWC and SSA cannot be approved as it was proposed to the Commission. For the reasons discussed in the Recommended Decision and herein, it would impose unreasonable cost and risk on the existing PAWC wastewater customers and, particularly, its water customers with no offsetting, meaningful benefit. There are other ways, however, that the transaction could be structured to reduce the burden for PAWC customers. Most important, as discussed in the prior exception, is that separate rates are established for wastewater service and storm water service and that the Company is prohibited from transferring cost responsibility for the SSA system away from SSA customers, either through single-tariff wastewater pricing or by using the revenue-sharing provision of Section 1311(c) of the Public Utility Code for SSA for at least the first 10 years after closing.

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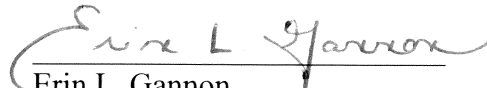
<sup>7</sup> \$19.50 service charge + (\$0.50 usage charge per 100 gallons x 30) = \$34.50 per month. PAWC Exh. BJG-1, Att. L.

<sup>8</sup> \$7.50 customer charge + \$1.2880 usage charge per 100 gallons x 30) = \$46.14 per month. See App. B attached to OCA's main brief (Supp. 2, PAWC Tariff-Wastewater Pa. P.U.C. No. 15 at 4).

### III. CONCLUSION

For the reasons set forth in the OCA's Main and Reply Briefs and above, the OCA respectfully excepts to the Recommended Decision of Administrative Law Judges David A. Salapa and Steven K. Haas regarding the jurisdiction of the Commission over storm water service. If the Commission determines that it has jurisdiction, it is necessary to separate the storm water costs from the sewer costs so that PAWC's existing water and wastewater customers do not pay the costs associated with the improvement, operation and maintenance of the City of Scranton and Borough of Dunmore's storm water systems.

Respectfully Submitted,



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