



September 2, 2016

**VIA E-FILE**

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Rosemary Chiavetta, Secretary  
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**Re: In 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**

**EXCEPTIONS OF JOINT APPLICANTS, PENNSYLVANIA-AMERICAN WATER COMPANY AND THE SEWER AUTHORITY OF THE CITY OF SCRANTON**

Dear Secretary Chiavetta:

Enclosed for filing with the Commission are the Exceptions of the Joint Applicants, Pennsylvania-American Water Company and The Sewer Authority of the City of Scranton, in the above-referenced matter. Copies have been served upon parties in accordance with the attached Certificate of Service. A copy has also been delivered to the Commission's Office of Special Assistants by electronic mail.

Thank you for your attention to this matter. Please date-stamp the extra copy and return it with our courier. Please do not hesitate to contact me if you have any questions.

Sincerely,

COZEN O'CONNOR

  
By David P. Zambito  
Counsel for Pennsylvania-American Water Company

DPZ/kmg  
Enclosure

Rosemary Chiavetta  
September 2, 2016  
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cc: Honorable David A. Salapa *via Electronic Mail and First Class Mail*  
Honorable Steven K. Haas *via Electronic Mail and First Class Mail*  
Office of Special Assistants @ ra-OSA@pa.gov  
Per Certificate of Service

**CERTIFICATE OF SERVICE**  
**In Re: Joint Application of Pennsylvania-American Water Company and**  
**The Sewer Authority of the City of Scranton**  
**Docket No. A-2016-2537209**

I hereby certify that I have this day served a true copy of the Exceptions of the Joint Applicants, Pennsylvania-American Water Company and The Sewer Authority of the City of Scranton, upon the parties, listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a party).

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DATED: September 2, 2016

  
\_\_\_\_\_  
David P. Zambito, Esquire  
Counsel for *Pennsylvania-American Water Company*

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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Administrative Law Judges  
David A. Salapa and  
Steven K. Haas

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In 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

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**EXCEPTIONS OF JOINT APPLICANTS,  
PENNSYLVANIA-AMERICAN WATER COMPANY AND  
THE SEWER AUTHORITY OF THE CITY OF SCRANTON**

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## I. INTRODUCTION

Pennsylvania-American Water Company (“PAWC”) and The Sewer Authority of the City of Scranton (“SSA”) (collectively, the “Joint Applicants”), pursuant to 52 Pa. Code § 5.533, file these exceptions to the Recommended Decision of the Honorable Administrative Law Judges David A. Salapa and Steven K. Haas, dated August 17, 2016, and issued August 24, 2016, in the above-captioned proceeding (“Recommended Decision” or “R.D.”).

This proceeding involves PAWC’s proposed acquisition of the SSA wastewater system (“System”). On March 29, 2016, PAWC and SSA entered into an asset purchase agreement (“APA”) for the sale of substantially all of SSA’s assets, properties, and rights related to the System (the “Transaction”). PAWC St. No. 1, 5:8-21; PAWC Ex. BGJ-1. On March 30, 2016, PAWC and SSA filed with the Pennsylvania Public Utility Commission (“Commission”) a joint application (“Joint Application”) requesting that the Commission approve the Transaction and authorize PAWC to render, pursuant to Section 1102 of the Pennsylvania Public Utility Code (“Code”), wastewater service in the areas currently served by SSA. On April 5, 2016, the Office of Consumer Advocate filed a protest and public statement. On April 5, 2016, the Commission’s Bureau of Investigation & Enforcement (“I&E”) filed a notice of appearance. On April 25, 2016, the Office of Small Business Advocate (“OSBA”) filed an answer, notice of intervention, and public statement. Following extensive discovery, hearings, and briefing, the Recommended Decision was issued. The due date for filing Exceptions to the Recommended Decision was extended by the Commission to September 2, 2016 and the due date for Replies to Exceptions was extended to September 8, 2016.

The Joint Applicants agree with the Recommended Decision on two fundamental issues. First, the Recommended Decision properly concludes that: “The combined system is a sewage

system as defined by 66 Pa. C.S. § 102 and subject to regulation by the Commission.” R.D. Conclusion of Law No. 8; *see also* R.D., pp. 17-23. Second, the Recommended Decision also properly concludes that “PAWC is technically, legally and financially capable of owning and operating the assets it will acquire from SSA.” R.D., p. 27; *see also* R.D. pp. 25-27, Conclusions of Law Nos. 9, 10, 11.

Despite these conclusions in favor of approval of the Joint Application, the Recommended Decision errs in several material respects: (i) failing to recommend approval of the Transaction in its entirety; (ii) not considering the public benefits of the Transaction; (iii) suggesting that an acquisition purchase price must be absolutely certain in order to obtain Commission approval; and, (iv) failing to recommend the conditional issuance of certificates of filings for the APA and seven other agreements between PAWC and various municipal corporations. The public benefits of the Transaction are very substantial and, as such, the Commission should approve it or conditionally approve it rather than simply denying it.

## **II. EXCEPTIONS**

### **A. JOINT APPLICANTS’ EXCEPTION NO. 1: The Recommended Decision errs in finding the Variance Adjustment term of the APA to be unreasonable and unlawful. Conclusion of Law No. 12; R.D. at 27-42.**

The Variance Adjustment is a mechanism included in APA Section 7.07(d), and illustrated by example in APA Schedule 7.07(d), that potentially adjusts the purchase price paid by PAWC of the SSA assets in the event that the Commission does not approve PAWC’s attempts to abide by SSA’s requirements to keep rates for the former SSA customers at reasonable levels in the first ten years after closing of the Transaction. As explained in the testimony of Mr. Eugene Barrett, the Executive Director of SSA, “[t]he Authority determined that PAWC was the bidder best positioned to meet the objectives of the RFP, including the goal

of keeping rate increases at affordable levels...[and] [t]he APA uses a 1.9% per year compound annual growth rate (“CAGR”) as a benchmark or guideline of affordable rate increases to wastewater customers in the Service Area for the first ten years of PAWC ownership of the System.” SSA St. No. 1, 6:25-26; 7:5-7. At the end of the ten years, if revenues from the applied-for service area (“Service Area”) exceed the revenue growth assumed in the 1.9% CAGR, an upward adjustment to the Transaction purchase price would be paid by PAWC to the SSA, or its successor. Importantly, the Variance Adjustment does not require PAWC to credit its customers for rates previously paid; nor does it supplant the rate authority the Commission has to set rates for utilities such as PAWC. SSA St. No. 1, 7:8-11.

The Recommended Decision errs by: (i) asserting that the Commission is required as part of this Application proceeding to determine if the total purchase price of the Transaction was reasonable and in the public interest; (ii) concluding that if the Commission approves the APA, including the Variance Adjustment as filed, it is also finding the final purchase price of the Transaction to be reasonable for ratemaking purposes; (iii) interpreting the APA to require the distribution of any Variance Adjustment paid to customers and finding that its payment to SSA violates Code Section 1303; and, (iv) finding that the Variance Adjustment violates the Commonwealth Court of Pennsylvania’s holding in *Philadelphia Suburban Water Co. v. Pa. Pub. Util. Comm’n*, 808 A.2d 1044 (Pa. Cmwlth. 2002) (“*Philadelphia Suburban*”). Due to these errors, Conclusion of Law No. 2 should be rejected and the APA approved without modification.

- 1. It was error for the Recommended Decision to assert that the Commission is required as part of this Application proceeding to determine if the total purchase price of the Transaction is reasonable and in the public interest.**

The Recommended Decision states that “[w]e are being asked to determine, among other things, whether the total purchase price is reasonable and in the public interest...” R.D., p. 28. It cites no legal authority for the assertion that the Commission is required as part of this Application proceeding to determine if the total Transaction purchase price for acquisition is reasonable. That is because the Commission does not look at the “reasonableness” of the purchase price when a public utility seeks approval of an application for a Certificate of Public Convenience (“CPC”) to acquire property.

When presented with an asset purchase agreement as part of a Code Section 1102 application, the Commission most frequently acknowledges that the purchase price was determined “based on arm’s length negotiations.” *See Joint Application of Aqua Pennsylvania, Inc. (Aqua) and Robin Hood Lakes Water Company, Inc. (RHLWC) for approval of (1) the acquisition by Aqua of the water system assets of RHLWC situated in Polk Township, Monroe County, Pennsylvania (2) the right of Aqua to begin to offer, render, furnish and supply water service to the public in a portion of Polk Township, Monroe County, Pennsylvania and (3) the abandonment by RHLWC of public water service in Polk Township, Monroe County, Docket No. A-2014-2440042 and A-2014-2440043 (Final Order entered Jul. 30, 2015); Joint Application of Philadelphia Suburban Water Company and the Borough of Chalfont for approval of: 1) the transfer, by sale, of the water supply system assets of the Borough of Chalfont to Philadelphia Suburban Water Company; 2) the right of Philadelphia Suburban Water Company to begin to offer, render, furnish or supply service to the public in the Borough of Chalfont and portions of New Britain Township and New Britain Borough, Bucks County, PA; and 3) the abandonment by*

*the Borough of Chalfont of all water service to the public*, Docket Nos. A-212370, F0066, and A-220450 F2000 (Final Order entered Oct. 25, 2001).

The record of this proceeding demonstrates that the Transaction purchase price, including a potential Variance Adjustment, was determined by arm's-length negotiations. SSA issued a request for proposals ("RFP") that received four responses. Thereafter, a winning bidder, PAWC, was selected. SSA St. No. 1, 5:6-24. This market-based, competitive process produced an arm's-length purchase price. The Commission should neither expect nor require applicants to reveal and defend publicly why, from a business standpoint, they believe an asset has a particular business value. The appropriate time for the Commission to evaluate the reasonableness of the purchase price of an asset acquisition is when a successful applicant proposes to claim all or part of a particular purchase price in a subsequent rate case. It is at that time that the Commission's duty to set "just and reasonable" rates is triggered. *See* 66 Pa. C.S. § 1301 ("Rates to be just and reasonable").

Issues regarding ratemaking are not properly within the scope of a Code Section 1102 application, but are better-suited for post-application rate proceedings. *See Joint Application of Pittsburgh Thermal, LP, NRG Energy Center Pittsburgh, LLC and North American Thermal Systems, LLC for approval of (a) the transfer of Control of Pittsburgh Thermal, LP to NRG Energy Center Pittsburgh, LLC and NRG Thermal Corp., (b) the right of NRG Energy Center, LLC to begin service and (c) the right of Pittsburgh Thermal, LP to abandon service*, Docket Nos. A-130001, and A-130000 F2000 (Final Order entered Sept. 1, 2000); *Re PG Energy, Inc., Applications 120011, 120011F0002, 121200F2000, A-122150F2000* (Final Order entered Sept. 15, 1999) (citing *Joint Application of Philadelphia Suburban Water Co. and the Borough of Media*, Docket No. A-212370.F0018, at 8-9 (Order entered Mar. 31, 1995) (explaining that

certain accounting entries made with respect to pending transfer by sale were ratemaking issues that could proceed separately in a rate case proceeding); *Joint Application of TCG Pittsburgh and Digital Direct of Pittsburgh, Inc.*, Docket No. A-310213, at 6-7 (Order entered Oct. 4, 1994) (holding that potential rate cross-subsidization issues are not relevant in a 66 Pa. C.S. § 1102 application proceeding). While the Commission looks at a proposed transaction's impact on future rates when considering a Code Chapter 11 application in broad general terms, there is no legal requirement to review and approve the reasonableness of the purchase price at all; let alone with the precision the Recommended Decision requires.

More often, when a Code Section 1102 application warrants additional information on the purchase price of the transaction, the Commission simply orders that original cost studies be reviewed in the next general rate case to determine if claims relating to the purchase price require further inquiry. *See, e.g., Application of Pennsylvania-American Water Company (PAWC) for approval of (1) the transfer, by sale, of waterworks property and rights of the Fernwood Community Water System (Fernwood) to PAWC, (2) the commencement by PAWC of water service to the public in additional portions of Middle Smithfield Township, Monroe County, presently being served by Fernwood*, Docket No. A-2012-2311434 (Final Order entered Sept. 27, 2012); *Application of Aqua Pennsylvania, Inc. (Aqua) for approval of the acquisition by Aqua of certain water system assets in the Concord Park section of Bensalem Township from the Bucks County Water & Sewer Authority (BCWSA) and the related transfer to Aqua of 168 customers presently served by BCWSA from the acquired assets in Bensalem Township, Bucks County, Pennsylvania*, Docket No. A-2012-2282709 (Final Order entered Mar. 15, 2012); *Re The Columbia Water Company*, Docket Nos. A-210540F0003, A-210540F0004 (Final Order entered Mar. 2, 1998); *Application of Aqua Pennsylvania, Inc. (Aqua) for approval of: 1) the acquisition*

*by Aqua of the water system assets of Bristol Township (“Bristol”) situated in a portion of Bristol Township, Bucks County; and 2) the right of Aqua to begin to offer, render, furnish and supply water service to the public in an additional portion of Bristol Township, Bucks County, Pennsylvania, Docket No. A-2012-2282704 (Final Order entered Mar. 29, 2012); Application of the City of Bethlehem for approval of: 1) the transfer, by sale, of the water works property and rights of the East Allen Township Municipal Authority to the City of Bethlehem, and 2) the commencement by the City of Bethlehem of water service to the public in East Allen Township and a portion of Allen Township located in Northampton County, Pennsylvania, Docket No. A-2012-2286041 (Final Order entered Dec. 20, 2012); Application of Pennsylvania-American Water Company (PAWC) for approval of (1) the transfer, by sale, of waterworks property and rights of the Indian Rocks Property Owners Association, Inc. of Ledgedale (Indian Rocks) to PAWC, (2) the commencement by PAWC of water service to the public in Salem Township, Wayne County, presently being served by Indian Rocks, Docket No. A-2012-2328361 (Final order entered Feb. 14, 2013); Application of Aqua Pennsylvania, Inc. (Aqua) for approval of: 1) the acquisition by Aqua of the water system assets of Mifflin Township Water Authority; and 2) the right of Aqua to begin to offer, render, furnish and supply water service to the public in a portion of Mifflin Township, Columbia County, Pennsylvania, Docket No. A-2011-2272163 (Final Order Entered Feb. 17, 2012).*

It is entirely appropriate, lawful and customary for the Commission to separate ratemaking issues (like the reasonableness of an acquisition’s purchase price) from the central issues presented in a Code Section 1102 evaluation, such as the legal, technical and financial fitness of the acquiring party, and the presence of affirmative public benefits in the transaction. In this application case, the Recommended Decision errs in finding that the Commission was

incapable of maintaining this historic distinction and deferring consideration of the Transaction purchase price until a future rate proceeding. The reasonableness of the Transaction's purchase price is not a required finding.

**2. The Recommended Decision errs in concluding that if the Commission approves the APA as filed, including the Variance Adjustment, the Commission is also finding the final purchase price reasonable for ratemaking purposes.**

The Recommended Decision states that “[i]f the Commission approves the method for calculating the variance adjustment as reasonable and in the public interest now, it is also approving that amount that results from using that method as reasonable and in the public interest.” R.D., p. 33. The Variance Adjustment is a term in the APA which was submitted to the Commission, not pursuant to its Chapter 11 authority, but pursuant to its authority under Code Section 507. The Joint Applicants succinctly explained in their Main Brief the Commission's legal standard of review under Code Section 507 for agreements between public utilities and municipalities, such as the APA:

With respect to public utility agreements, Code Section 507, 66 Pa. C.S. § 507, requires that contracts between a public utility and a municipal corporation, except for contracts to furnish service at regular tariff rates, be filed with the Commission at least 30 days before the effective date of the contract. The Commission approves the contract by issuing a certificate of filing unless it decides to institute proceedings to determine whether there are any issues with the reasonableness, legality, or any other matter affecting the validity of the contract. Should the Commission initiate proceedings, the contract or agreement is not effective until the Commission grants its approval. 66 Pa. C.S. § 507. Code Section 507 is a filing requirement and does not require service of the filing on any potentially interested parties.

Joint Applicants Main Brief, pp. 7-8. There is nothing unreasonable about the APA.

First, the Commission has made no determination to institute a proceeding to determine the reasonableness of the APA. However, the opposing parties have had a full opportunity to

challenge the terms of the Variance Adjustment. Second, and more importantly, the Recommended Decision errs by concluding that, if the Commission approves the *methodology* for calculating the Variance Adjustment, it was also approving the *product* of that methodology as a reasonable purchase price for ratemaking purposes.

The Commission is well-accustomed to distinguishing between approving mechanisms such as automatic adjustment clauses under Code Section 1307 and the subsequent audit and review process for collecting over- or under-recovery of utility costs. Such clauses illustrate the difference between approving a methodology and receiving Commission approval for amounts collected and subsequently refunded or recouped. While the Variance Adjustment is not an automatic adjustment mechanism, it is a method of measuring PAWC's compliance with the 1.9% CAGR benchmark. Whether any Variance Adjustment ultimately paid should be allowed in PAWC's rates or collected from customers is an issue for a subsequent proceeding much like the automatic adjustment clause process. The Recommended Decision errs by equating a review of the reasonableness of the Variance Adjustment methodology with the reasonableness of any positive Variance Adjustment that may be actually paid by PAWC under the APA. These are separate questions, and the Recommended Decision errs by assuming it was required to determine now the reasonableness of both the methodology and the result of applying that methodology that will only be known ten years after closing of the Transaction.

The Variance Adjustment tracks PAWC's level of success or failure in achieving its goal of keeping rates in the Service Area reasonable compared to the benchmark of the 1.9% CAGR. Just as the initial Transaction purchase price was a measure of the superiority of PAWC's bid, its willingness to strive for achieving rate levels through prudent cost management that prove consistent with the 1.9% CAGR goal is an additional measure of it meeting SSA's objectives for

the RFP. The Variance Adjustment is simply a method for measuring the extent of PAWC's success in reaching that objective. Although the Recommended Decision and I&E question the relationship between the monetary value of assets and the revenue stream they produce, which the Variance Adjustment captures, that basic relationship is well-accepted in the business world as a measure of an asset's value.

- 3. It is unnecessary and unlawful for the Recommended Decision to make any findings with respect to the Transaction purchase price and any potential adjustments based upon a prospective Variance Adjustment. The Recommended Decision errs in interpreting the APA to require the distribution of any Variance Adjustment paid to customers and errs in concluding that its payment to SSA violates Code Section 1303.**

The Recommended Decision incorrectly describes the distribution of any Variance Adjustment paid at the end of ten years after closing as follows:

Under this provision of the APA, PAWC will either pay the variance adjustment directly to the then customers in the SSA service area, or it will make the payment directly to the SSA which in turn, will distribute the payment, via a third party administrator, to those customers.

R.D., p. 35. Because the Recommended Decision concludes that the Variance Adjustment could only be paid to customers either directly by PAWC or via a third party administrator, it finds that the Variance Adjustment would constitute *de facto* refunds to customers. The Recommended Decision reaches this erroneous interpretation, first, by not accepting the Joint Applicants' representations as to why multiple distribution methods were offered and, second, by ignoring the clear language of the APA itself.

The Recommended Decision notes that PAWC stated "SSA as the seller holds all of the rights to determine what happens to the variance adjustment, not PAWC or any customers." R.D., p. 36; Joint Applicants Reply Brief, p. 33. The Recommended Decision also acknowledges the Joint Applicants' position that, "if the Commission has any concern about any

distribution of the variance adjustment to customers potentially being characterized as a refund or tariff deviation, the Commission could direct SSA to retain the variance adjustment.” R.D., p. 37.

Thus, the Joint Applicants provided three options to the Commission to review on distributing any Variance Adjustment. It could opt for the efficiency of PAWC’s making the distribution since it would know who the then-current customers would be ten years from now when making the payment. If that approach is unacceptable, a third party administrator could handle the distribution with assistance from PAWC on identifying then-current customers. PAWC would have some role in both of these options. Third, if the Commission believes that both methods of distribution are unreasonable, SSA could retain the payment just as it will retain the initial proceeds of the Transaction.

If the Commission is concerned that distributing the Variance Adjustment to customers would be the equivalent of crediting Commission set rates, it could condition approval of the APA on the removal of both methods of distributing the Variance Adjustment to customers. The APA anticipates precisely this option because, contrary to the Recommended Decision’s interpretation, the APA clearly contemplates SSA’s or its successor’s retaining any Variance Adjustment. Indeed, the Recommended Decision quotes the first reference to “Seller” in the APA (*i.e.*, SSA) having the option of keeping or distributing the Variance Adjustment to customers:

Within thirty (30) days of final resolution of the calculation of the Variance Adjustment, **Seller shall notify Buyer whether the adjustment to the purchase price shall be paid directly to the Seller** or distributed to Buyer’s then current wastewater customers in the Service Area...**If** Seller elects distribution of the adjustment of the Purchase Price for the Variance Adjustment to Buyer’s then-current wastewater customers in the Service Area...

R.D., p. 34 (emphasis added); APA, Section 7.07(e). The Recommended Decision overlooks additional language in Section 7.07(e) of the APA which confirms the Joint Applicants' intent to accept direction from the Commission on this issue of whether *any* distribution to customers would be acceptable:

**In the event the PaPUC fails to allow Buyer to timely implement procedures and protocols and make distributions to customers in the Service Area as aforesaid, Buyer shall pay the Variance Adjustment as an adjustment to the Purchase Price directly to Seller within thirty (30) days of final resolution of the calculation of the Variance Adjustment. If Buyer fails to pay the Variance Adjustment as an adjustment to the Purchase Price within thirty (30) days of the final resolution of the calculation of the Variance Adjustment (whether where Seller initially requests direct payment or the PaPUC fails to allow distribution to customers)....**

APA, Section 7.07(e) (emphasis added). In short, the Joint Applicants have asked the Commission for direction on how to handle the Variance Adjustment.

By not recognizing all of the options for paying any future Variance Adjustment in the APA and the Joint Applicants willingness to accept a potential rejection of those options, the Recommended Decision creates a Code Section 1303 issue where no such issue exists. The remedy for this error is simple. The Commission need only direct in its Order that the options for distributing the Variance Adjustment directly to customers are unreasonable and the alternative of SSA's retention of the Variance Adjustment is the only acceptable approach. No amendment of the APA would be needed to implement this finding. It was error for the Recommended Decision to find that directing retention of the Variance Adjustment by the SSA is not a Commission option and that the Variance Adjustment on its face violates Code Section 1303.

**4. It was error for the Recommended Decision to find that the Variance Adjustment violates the Commonwealth Court’s holding in *Philadelphia Suburban*.**

After wrongfully concluding that any payment of the Variance Adjustment constitutes a *de facto* refund to SSA customers (R.D. at 37), the Recommended Decision errs by relying on *Philadelphia Suburban*. As discussed below, *Philadelphia Suburban* is not controlling or relevant to the approach used by the APA to adjust the Transaction purchase price in the APA. The Variance Adjustment in the APA does not violate the Commonwealth Court’s holding in *Philadelphia Suburban* because that case is distinguishable from this matter in a few material respects.

First, as noted above, the APA – as a matter of fact – does not require any distribution of the Variance Adjustment to SSA customers. Rather, in accordance with the literal words of the APA, SSA or its successor have the option to determine whether any such Variance Adjustment payment will be retained by SSA or returned to customers. There is no automatic return of the Variance Adjustment to customers under any predetermined formula or otherwise. Moreover, the APA gives the Commission the opportunity to find that no distribution to customers is acceptable.

As noted during briefing, the Variance Adjustment is specifically designed to address legal defects identified in *Philadelphia Suburban*. In that case, the City of Coatesville (“Coatesville”) was selling its water system and mandated that it receive free fire hydrant service from the buyer in perpetuity. In a proceeding before the Commission in 2000, the free hydrant service requirement was modified to address claims it violated various Code provisions. The revised fire hydrant provision required the utility to bill Coatesville for the fire hydrant service, Coatesville to pay for the amount billed, and the utility to contribute on an annual basis to

Coatesville's Economic Development Fund the exact same amount paid by Coatesville for the fire hydrant service. This arrangement -- offered as an alternative to free fire hydrant service -- was also found to violate Code Section 1303, which prohibits a utility from straying from its approved tariff "directly or indirectly, by any device whatsoever, or in anywise . . . ." 66 Pa. C.S. § 1303; *Philadelphia Suburban*.

The facts are issue here are completely different than *Philadelphia Suburban*. Under the APA, if a Variance Adjustment is ultimately paid by PAWC, it may, at the option of SSA or its successor, be retained by SSA or its successor-in-interest or distributed to customers. In *Philadelphia Suburban*, no such option was available to Coatesville as the seller. Rather, the payment by the utility to the Economic Development Fund was "hard wired" into the underlying agreement and designed to reflect a "one for one" (*i.e.*, dollar for dollar) annual arrangement based on the exact amount of money paid by Coatesville for fire hydrant service. *Philadelphia Suburban* involved a constant true up of Commission set rates by the utility which created the equivalent of free utility service. In contrast, in this proceeding, the APA does not reference any PAWC services used and paid for by SSA that form the basis for a PAWC payment to SSA. Moreover, SSA or its successor has a true option after year 10 post-closing of the Transaction to direct how the Variance Adjustment -- if any -- will be treated. There is no requirement that any or all of the Variance Adjustment payment be provided to customers.

In this proceeding, SSA customers have no right to determine how and under what circumstances the Variance Adjustment payment is paid. In *Philadelphia Suburban*, the opposite was true. That is, Coatesville as the ultimate customer directed at the outset where the monetary value of the fire hydrant service would be paid -- *i.e.*, Coatesville's Economic Development Fund. Moreover, such payment was in the exact same amount as the value of the fire hydrant

service. There was a clear nexus in *Philadelphia Suburban* between the payment into the Economic Development Fund and the free hydrant service. There is no such nexus in this case between any Variance Adjustment payment and SSA customers.

Given the unequivocal facts of record, there is no way the Variance Adjustment can be characterized as a refund to customers or as a deviation from PAWC's retail tariff. Not only does PAWC have no choice in the matter, there is no intention through the Variance Adjustment for customers to pay less than what is authorized by the Commission. This is confirmed by the fact that customers have no right to determine what, if anything, will happen with the Variance Adjustment payment, if one ever exists.

Any potential future distribution of the Variance Adjustment to SSA customers could not reasonably be considered a rate "refund" or in any way analogous to *Philadelphia Suburban* because, in accordance with the APA, it would be a one-time, equal distribution payment to then-existing customers and not tied or related to any rate any particular customer actually paid. PAWC Exhibit BJJ-1 (APA Section 7.07(e)). Furthermore, if the Commission deems such a distribution to be problematic, it can indicate that the APA is approved provided the Variance Adjustment is paid to SSA. Accordingly, the Recommended Decision's reliance on *Philadelphia Suburban* to reject the Variance Adjustment is error and not supportable.

**B. JOINT APPLICANTS' EXCEPTION NO. 2: The Commission should clarify that a final acquisition purchase price does not have to be known with absolute certainty in order to obtain Commission approval.**

In recommending denial of the Joint Application on the basis the Variance Adjustment, the Recommended Decision makes several overly-general statements regarding an inability to determine whether the Transaction is in the public interest because the total purchase price is

unknown.<sup>1</sup> While the Recommended Decision expresses concern regarding the specific nature of the Variance Adjustment, the Commission should clarify that absolute certainty with regard to purchase price is not necessary to obtain Commission approval. Indeed, purchase price adjustments to account for a wide range of financial matters are found in virtually all sale transactions and, as such, there cannot reasonably be a blanket requirement that the final purchase price be known at the time of Commission approval. If this were the case, few acquisitions could obtain Commission approval.

By way of example, the purchase price in the current Transaction is subject to adjustment based on the amount of cash actually transferred to PAWC at the closing subject to certain adjustments (*see, e.g.*, APA, §§ 3.01(d) and 3.02), the amount of indebtedness repaid or assumed by PAWC at the closing (*see, e.g.*, APA, § 3.01(a) and 3.01(d)) and the amount of the withdrawal liability due as a result of the SSA's withdrawal from its multiemployer pension plan in connection with the transaction (*see, e.g.*, APA, § 3.01(c) and 3.01(d)). These adjustments to the Transaction purchase price are meant to preserve the bargain struck by the parties between March 2016 when the APA was executed and the later closing. The amount of cash and indebtedness on the SSA's balance sheet, and the amount of the withdrawal liability, will inevitably fluctuate from the date that the APA was executed when the valuation was initially made by the parties, through the Commission approval process, and until closing on the

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<sup>1</sup> *See, e.g.*, R.D., pp. 28 (“Our difficulty in analyzing and evaluating the reasonableness of the transaction is that . . . the total purchase price, including the variance adjustment, an essential term of the transaction, is unknown at this time.”), 29 (“We are being asked to determine, among other things, whether the total purchase price is reasonable and in the public interest when we do not know what the amount of the variance adjustment is and therefore, we also do not know what the total purchase price is.”)(“Since the transaction will ultimately be borne by PAWC's customers, the Commission must have accurate information indicating the total purchase price in order to approve the transaction.”), 32 (“We conclude that the proposed variance adjustment, which is an adjustment to the purchase price, fails to provide a fixed sales price but rather creates an imprecise sales price and places the risks of paying that imprecise sales price on PAWC and its customers.”), 33 (“[A]t this time the variance adjustment amount is unknown and unknowable because it is based on future revenues which in turn are based on the rates the Commission will approve in the future.”).

Transaction. Without an adjustment at closing to account for these fluctuations, neither party would receive the full benefit of their arms-length and previously negotiated bargain reflected in the APA. Even after closing, the purchase price is often further adjusted to account for the final determination of certain closing date financial measures. *See, e.g.*, APA, § 3.02.

In addition, as in the case of the APA, purchase price adjustments are made at or, as is more common, following the closing for such things as indemnification claims for the failure of the seller's identified representations and warranties to be true and correct at the time of closing of the transaction or for the failure of the seller to satisfy all of its obligations under the purchase agreement at or prior to the closing. *See, e.g.*, APA, Articles IV and VIII. For instance, indemnification claims (*i.e.*, purchase price adjustments) are frequently made for such matters as increased executive or employee compensation, failure to deliver upon real property commitments (such as obtaining necessary easements), changes to the operating condition of facilities and equipment, changes to the enforceability of intellectual property rights, changes to employee benefit plans, undisclosed labor arrangements, environmental compliance issues, failure to obtain or maintain licenses and permits, failure to disclose contracts, failure to comply with the law, and potential litigation that was not disclosed at the time of execution of the asset purchase agreement. Such adjustments are common and in many instances cannot be determined with certainty until following the closing when the buyer has the opportunity to discover issues while actually running the acquired business.

The Commission should clarify that it recognizes that purchase price adjustments are common in the ordinary course of business and, accordingly, the purchase price of an acquisition does not have to be absolutely certain in order to obtain Commission approval. In recognition that the final purchase price may be reviewed in the context of a future base rate proceeding, a

transaction may be approved without a specifically-known purchase price so long as the Commission, upon review of the asset purchase agreement, determines that the overall transaction is in the public interest.

**C. JOINT APPLICANTS' EXCEPTION NO. 3: The Recommended Decision did not address the substantial public benefits of the Transaction.**

But for the decision on the Variance Adjustment, the evidentiary record in this proceeding clearly demonstrates that the Joint Applicants have satisfied their burden of proof. The Commission has jurisdiction over SSA's assets and PAWC is technically, legally, and financially fit.

In addition to jurisdiction and fitness, the Joint Applicants must demonstrate by a preponderance of the evidence that the Transaction will "affirmatively promote the service, accommodation, convenience, or safety of the public in some substantial way" in order for the Commission to issue a certificate of public convenience. *City of York v. Pa. Pub. Util. Comm'n*, 449 Pa. 136, 151, 295 A.2d 825, 828 (1972); *Popowsky v. Pa. Pub. Util. Comm'n*, 594 Pa. 583, 611, 937 A.2d 1040, 1057 (2007). As detailed more-fully in the Joint Applicants' Main Brief and Reply Brief, the Transaction will present at least six affirmative public benefits of a substantial nature. *See* Joint Applicants Main Brief, pp. 44-58; Joint Applicants Reply Brief, pp. 43-48.

First, the Transaction will benefit Scranton-area customers by giving them access to enhanced services over those offered by SSA. According to the unrefuted testimony of PAWC witness James F. Sheridan, PAWC Vice President - Operations, the enhancements include, but are not limited to: (a) extended call center hours for customers; (b) additional bill payment options for customers; (c) enhanced customer information and education programs; and, (d)

access to PAWC's customer assistance program. PAWC St. No. 3, 25:4-10; Joint Applicants Main Brief, pp. 45-46.

Second, because PAWC has access to equity markets, in addition to its strong balance sheet and credit ratings, it is better positioned than SSA to address the myriad of costs and obligations associated with present and future improvements to and operation of the System. PAWC witness James S. Merante, Director of Financial Strategy, Planning, and Decision Support for the Mid-Atlantic Division of American Water Works Service Company ("AWWSC"), explained in detail why PAWC's financial capabilities are superior to those of SSA. PAWC St. No. 5-R, 4:11 - 8:19. The reasons include PAWC's superior credit rating, PAWC's access to a \$220 million line of credit, the highly-leveraged position of SSA, and the effect of service affordability for Scranton-area customers on SSA's access to capital through credit or otherwise. Joint Applicants Main Brief, pp. 46-49.

Third, Scranton-area customers will benefit by being part of a larger customer base. PAWC is the largest investor-owned water and wastewater provider in the Commonwealth and provides water service to more than 653,000 customers and wastewater service to more than 21,000 customers. PAWC St. No. 3, 3:14-16. These services are provided in approximately 400 communities across the Commonwealth with a combined population of approximately 2.3 million people. *Id.* at 3:16-17. Because of its size and expertise in wastewater management and the leveraging of economies of scale, PAWC will be able to improve efficiencies and lower the costs to operate the System. As explained by PAWC witness Rod P. Neviraukas, Director of Rates and Regulations for the Mid-Atlantic Division of AWWSC, these efficiencies -- in conjunction with a combined water and wastewater revenue requirement under Act 11 of 2012 (66 Pa C.S. §1311(c)) -- will help keep rates lower for System customers than they would be if

not allowed to become part of PAWC's customer base. PAWC St. No. 4, 5:15 - 6:2; Joint Applicants Main Brief, p. 50.

Fourth, the Transaction offers a substantial public benefit because PAWC has committed to create 100 new jobs in the Scranton area by the end of calendar year 2020. PAWC St. No. 3, 20:2-6. These will be new jobs in addition to the SSA employees whom will be engaged by PAWC once the Transaction is approved. PAWC St. 3-R, 2:10-15. PAWC anticipates that the employees will serve PAWC or its parent organization (American Water Works Company) to accommodate future growth. *Id.* at 3:7-12. The costs of those new jobs will be subject to standard review for reasonableness in a subsequent rate case. PAWC St. No. 3-R, 4:1-6; PAWC St. 4-R, 14:12-16; N.T. 118:14-20; Joint Applicants Main Brief, pp. 50-52.

Fifth, to the extent the opposing parties argue that the Transaction conveys no benefits to PAWC's existing customers, that erroneous proposition is contradicted by the testimony of Mr. Barrett who stated that "the Transaction will also provide PAWC with the Authority's large treatment plant and its skilled personnel familiar with the complex business of treating wastewater processed at the end of a large combined system. The Authority's unique and specialized expertise will serve PAWC and its existing customers well if the Transaction is approved. These mutual best practices will benefit all customers, both the Authority and PAWC." SSA St. No. 2-R 7:7; 8:1-5. Mr. Barrett's testimony is unrefuted. PAWC's experience with the SSA's treatment plant will assist it in the operation of its other presently-owned smaller plants.

Finally, approval of this Transaction is of critical importance to the financial situation of the City of Scranton ("City") and its taxpayers (who are also SSA ratepayers). The City is a financially distressed municipality, subject to state supervision under Act 47, known as the

Municipalities Financial Recovery Act, 53 P.S. § 11701.101 *et seq.* As explained in great detail in the testimony of the Scranton's Mayor, William L. Courtright, the Transaction is the cornerstone of the City's economic recovery plan. SSA St. No. 2, 2:21 - 3:3. The monetization of SSA assets is necessary to put the City on the path of reducing the otherwise projected operating budget deficits through 2020. *Id.*, 5:10-13; SSA St. No. 3-R, 10:6-14. The City's realization of its portion of the anticipated Transaction proceeds will provide immediate relief for its 2017 budget and establish a platform for possible departure from the strictures of Act 47 for the first time in over two decades. Joint Applicants Main Brief, pp. 52-58; Joint Applicants Reply Brief, pp. 43-48. In the context of this Transaction, the Commission should recognize the public interest in addressing the financial plight of distressed municipalities that the General Assembly clearly declared as part of Section 102 of Act 47:

(a) Policy.—It is hereby declared to be a public policy of the Commonwealth to foster fiscal integrity of municipalities so that they provide for the health, safety and welfare of their citizens; pay due principal and interest on their debt obligations when due; meet financial obligations to their employees, vendors and suppliers; and provide for proper financial accounting procedures, budgeting and taxing practices. The failure of a municipality to do so is *hereby determined to affect adversely the health, safety and welfare not only of the citizens of the municipality, but also of other citizens in this Commonwealth.*

53 P.S. §§ 11701.102(a) (emphasis added). The General Assembly could hardly have been clearer: addressing the financial problems of distressed municipalities is essential to protecting the health, safety and welfare of not only the citizens of the directly impacted communities, but the citizens of the Commonwealth as a whole.

As noted above, the Recommended Decision properly found that the Commission has jurisdiction over a combined system and that PAWC is technically, legally, and financially fit. So, in light of the substantial public benefits to be realized through the Transaction, the Commission should approve the Transaction without modification (*see* Exception No. 1 above).

**E. JOINT APPLICANTS' EXCEPTION NO. 5: The Commission should, subject appropriate compliance filings, issue certificates of filing under Code Section 507 for the APA and the *pro forma* agreements with various municipal corporations.**

The Recommended Decision declines to recommend the issuance of certificates of filing under Code Section 507 for the APA and seven other agreements, filed on July 1, 2016 (*i.e.*, prior to the evidentiary hearings in this matter), under which PAWC will agree to assume, subject to Commission approval, certain contractual obligations of SSA. The Recommended Decision is silent on the issuance of a certificate of public convenience for the APA -- presumably because of the recommendation that the Joint Application be denied. Likewise, the Recommended Decision fails to make any recommendation with regard to issuance of certificates of filing for the other seven agreements -- noting that "PAWC has not filed executed versions of these agreements." R.D., p. 5.

If the Commission conditions approval of the Transaction upon PAWC's filing of an amendment to the APA which eliminates the Variance Adjustment, the Commission at that time should issue a certificate of filing for the APA. Code Section 507 approval of the APA is required for the Transaction to move to closing.

With regard to the other seven agreements with municipal corporations, PAWC filed *pro forma* versions of such agreements on July 1, 2016, because PAWC was still moving the agreements through the local municipal approval processes. No party objected to the *pro forma* agreements as being unreasonable.

The Commission should conditionally approve the seven agreements subject to PAWC's filing of an amendment to the APA that eliminates the Variance Adjustment and filing of the executed versions of the agreements. Code Section 507 does not restrict the Commission's

ability to conditionally approve agreements subject to the filing of executed versions. In this case, it is reasonable for the Commission to do so in order to allow the Transaction to move promptly to closing.<sup>2</sup>

### **III. REQUEST FOR RELIEF**

WHEREFORE, Pennsylvania-American Water Company and The Sewer Authority of the City of Scranton respectfully request that the Pennsylvania Public Utility Commission grant these exceptions, reverse the Recommended Decision issued in this matter on August 24, 2016, and order that:

- (i) The Joint Application is approved without modification;
- (ii) The Commission's Secretary issue a Certificate of Public Convenience evidencing Pennsylvania-American Water Company's right under Sections 1102(a)(1) and 1102(a)(3) of the Pennsylvania Public Utility Code, 66 Pa. C.S. §§ 1102(a)(1), (a)(3), to (a) acquire, by sale, 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 (the "Transaction"), and (b) begin to offer or furnish wastewater service, which includes Combined Wastewater service, to the public in the City of Scranton and the Borough of Dunmore, Lackawanna County, Pennsylvania;
- (iii) The Commission's Secretary issue a Certificate of Filing under Section 507 of the Pennsylvania Public Utility Code, 66 Pa. C.S. § 507, for the Asset Purchase Agreement By and Between The Sewer Authority of the City of Scranton, as Seller, and Pennsylvania-American Water Company, as Buyer, dated March 29, 2015;

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<sup>2</sup> If any of the agreements were to change, PAWC would, of course, be required to file the changed agreement for Commission review.

(iv) The Commission's Secretary issue Certificates of Filing under Section 507 of the Pennsylvania Public Utility Code, 66 Pa. C.S. § 507, for the following agreements between Pennsylvania-American Water Company and a municipal corporation upon Pennsylvania-American Water Company's filing of executed versions of assignment and assumption agreements which are substantially-similar in all material respects to the *pro forma* assignment and assumption agreements filed with the Commission on July 1, 2016;

a. Interjurisdictional Agreement Between The Sewer Authority of The City of Scranton and The Borough of Dickson City, Pennsylvania, dated April 14, 2003 (as will be assigned and assumed by an assignment and assumption agreement which is substantially-similar in all material respects to the *pro forma* assignment and assumption agreement filed with the Commission on July 1, 2016);

b. Interjurisdictional Agreement Between The Sewer Authority of The City of Scranton and The Borough of Taylor, Pennsylvania, dated April 9, 2003 (as will be assigned and assumed by an assignment and assumption agreement which is substantially-similar in all material respects to the *pro forma* assignment and assumption agreement filed with the Commission on July 1, 2016);

c. Interjurisdictional Agreement Between The Sewer Authority of The City of Scranton and The Borough of Moosic, Pennsylvania, dated May 13, 2003 (as will be assigned and assumed by an assignment and assumption agreement which is substantially-similar in all material respects to the *pro forma* assignment and assumption agreement filed with the Commission on July 1, 2016);

d. Agreement for the Acceptance, Conveyance, Treatment, and Disposal of Wastewater Received from the Siniawa Enterprises Wastewater Collection System at the Scranton Wastewater Collection System and Wastewater Treatment Plant, as of June 14, 1989 (as will be assigned and assumed by an assignment and assumption agreement which is substantially-similar in all material respects to the *pro forma* assignment and assumption agreement filed with the Commission on July 1, 2016);

e. Agreement for the Acceptance, Conveyance, Treatment, and Disposal of Wastewater Received from the Montage, Inc. Wastewater Collection System at the Scranton Wastewater Collection System and Wastewater Treatment Plant, as of July 24, 2003 (as will be assigned and assumed by an assignment and assumption agreement which is substantially-similar in all material respects to the *pro forma* assignment and assumption agreement filed with the Commission on July 1, 2016);

f. Agreement Providing for Uniformity of Charges Applicable to Residents of Taylor Borough and Residents of the City of Scranton, as of January 12, 1976 (as will be assigned and assumed by an assignment and assumption agreement which is substantially-similar in all material respects to the *pro forma* assignment and assumption agreement filed with the Commission on July 1, 2016); and,

g. Agreement for the Transfer, Conveyance, and Acceptance of the Davis Street, Greenwood Avenue, and Corey Street Sanitary Sewer Conveyance Line from Moosic Borough to the Sewer Authority of the City of Scranton, as of April 16, 2008 (as will be assigned and assumed by an assignment and assumption agreement which is substantially-similar in all material respects to the *pro forma* assignment and assumption agreement filed with the Commission on July 1, 2016);

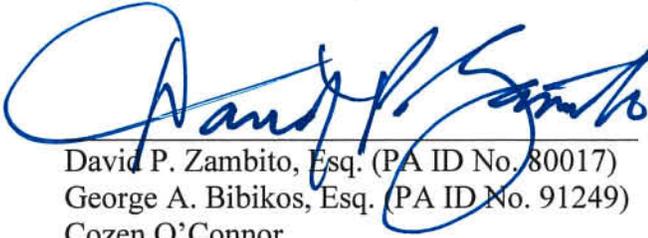
(v) All other approvals required by the Pennsylvania Public Utility Code to carry out the Transaction be granted;

(vi) Upon closing of the Transaction, PAWC issue, to become effective on the same date as issuance, a compliance tariff supplement consistent with the *pro forma* tariff supplement attached to the Joint Applicants' Main Brief as Appendix D;

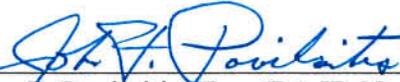
(vii) All protests filed against the Joint Application be dismissed; and,

(viii) This docket be marked closed.

Respectfully submitted,



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