COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

IN REPLY PLEASE
REFER TO OUR FILE

September 8, 2016

Secretary Rosemary Chiavetta
Pennsylvania Public Utility Commission
P.O. Box 3265
Harrisburg, PA 17105-3265

Re: Joint Application of Pennsylvania American Water Company (PAWC) 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 PAWC, and 2) the right of PAWC 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:

Enclosed please find an original copy of the Bureau of Investigation and Enforcement's (I&E) **Reply Exceptions** in this proceeding

Copies of this letter are being served on all active parties of record as evidenced in the attached Certificate of Service. Should you have any questions or need additional information, please contact me at (717) 783-7998.

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ACK/GLL/sea
Enclosure

cc: ALJ Steven K. Haas
ALJ David A. Salapa
Certificate of Service

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Application of Pennsylvania American Water Company (PAWC) 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 PAWC, and 2) the right of PAWC 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

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing **Reply Exceptions** dated September 8, 2016, in the manner and upon the persons listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a party):

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Joint Application of Pennsylvania American Water Company (PAWC) 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 PAWC, and 2) the right of PAWC 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**

REPLY EXCEPTIONS OF THE BUREAU OF INVESTIGATION & ENFORCEMENT

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Dated: September 8, 2016

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I. INTRODUCTION

By Order dated August 17, 2016, Administrative Law Judges David A. Salapa and Steven K. Haas ("ALJs") issued a Recommended Decision ("RD") denying the Joint Applicants' request for the Commission to approve Pennsylvania American Water Company's ("PAWC") acquisition of substantially all the assets of the Sewer Authority of the City of Scranton's ("SSA" or "Authority")(collectively, "Joint Applicants") sewer system and sewage treatment works and to approve PAWC's application to render wastewater service in the areas served by SSA.

This transaction presented two issues of first impression. The first related to whether the Commission has jurisdiction over the provision of stormwater service because SSA's system is a combined wastewater and stormwater system. The second novel issue was the proposed Variance Adjustment, which is a complex term contained in the Asset Purchase Agreement ("APA") that potentially adjusts the $195 million purchase price ten years following Closing of the transaction if the annual revenues in the current SSA service territory exceed the agreed upon 1.9% Compound Annual Growth Rate ("CAGR") over the ten year period.

The Bureau of Investigation and Enforcement ("I&E") argued that both provisions harm PAWC's current customers; therefore, approval of the APA without modification was not in the public interest. To ensure that the public interest is protected, I&E argued that approval of the Application must be conditioned upon adopting I&E's proposed recommendations concerning the ratemaking recovery of the Variance Adjustment payment and a stormwater cost of service study so that those costs can be properly

allocated in PAWC's next base rate proceeding.[1] Specifically, I&E proposed that (1) PAWC be required to provide costs of service studies that separate sanitary sewer and stormwater flows, capital expenses and operating costs in its next base rate proceeding and (2) PAWC be prohibited from recovering the Variance Adjustment from ratepayers.

In the RD, the ALJs determined that the Commission has jurisdiction over stormwater service; therefore, SSA's combined wastewater and stormwater system is subject to Commission regulation. However, the ALJs found that the proposed Variance Adjustment was unreasonable, contrary to the public interest, and violated the Public Utility Code ("Code"); therefore, the ALJs recommended that the proposed transaction be denied.

I&E did not file Exceptions to the recommendations contained in the RD. In response to the Joint Applicants' Exceptions, I&E now files these timely Reply Exceptions and maintains that the ALJs properly denied this transaction. However, if the Commission reconsiders the ALJs' recommendation to deny this transaction as requested in the Joint Applicants' Exceptions, I&E maintains that its conditions with respect to the separate wastewater and stormwater cost of service studies and the disallowance of Variance Adjustment from rates must be approved to protect the interest of PAWC's current customers.

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[1] The Commission may impose conditions on granting a certificate of public convenience as it may deem to be just and reasonable. 66 Pa. C.S. § 1103(a).

II. REPLY EXCEPTIONS

As accurately summarized in the RD, I&E took issue with Variance Adjustment because it is not an asset purchase or related to used and useful plant, but is additional compensation for SSA ten years after the Closing if revenues are higher than the arbitrary 1.9% CAGR.[2] Moreover, the Variance Adjustment is intertwined with several ratemaking limitations contained in the APA because it provides an incentive to keep SSA rates low for the ten year period over which the adjustment is calculated.[3] Given the potential ratemaking impacts of the Variance Adjustment, I&E argued that the risk for this unprecedented term should remain with PAWC, not its customers. After evaluating all of the testimony, presiding over an evidentiary hearing, and reviewing the Main Briefs and Reply Briefs submitted in this proceeding, the ALJs properly recommended the denial of the Application finding that the Variance Adjustment is not reasonable or in the public interest and violates the Public Utility Code.

1. Reply to Joint Applicants' Exceptions No. 1(1) and 2: The ALJs Properly Considered the Uncertainly of the Final Acquisition Purchase Price in Their Determination that the Acquisition Is Not in the Public Interest

In their first Exception, the Joint Applicants argue that the ALJs erred in asserting that the Commission is required to determine if the total price of the acquisition is reasonable and in the public interest in this proceeding. Later, in their second Exception, the Joint Applicants take their argument further by asserting that the final acquisition purchase price does not have to be known with "absolute certainty" in order to obtain

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2 RD at 31-32.

3 I&E Main Brief at 22-25; I&E Reply Brief at 20-22.

Commission approval. Because the Joint Applicants' arguments on these points are interrelated, I&E will address them both here. I&E asserts that the ALJs' inquiry into whether the total purchase price was reasonable and in the public interest was not only appropriate, but consistent with the Commission's duty to determine whether granting PAWC's request for a certificate of public convenience is necessary or proper for the service, accommodation, convenience, or safety of the public.[4] Moreover, the inquiry was mandated by rate treatment conditions that the Joint Applicants themselves placed upon approval of the Application.

A. Purchase Price is a Relevant Public Interest Consideration in this Proceeding

While PAWC and SSA are the only signatory parties to the APA, which provides the basis and governing terms of the proposed acquisition, PAWC's captive ratepayers would undoubtedly face ratemaking consequences if this acquisition is approved. For this reason, it is important to recognize that "in passing upon an application for a certificate of public convenience, the Public Utility Commission must consider the interest of the public, as distinguished from the interest of the corporation or individual making the application."[5] This case presents an unparalleled scenario under which neither the parties to the APA, nor the Commission, will know the actual acquisition purchase price until ten years after the Closing of the transaction. The ambiguous purchase price is thoroughly explained in the RD:

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4 66 Pa. C.S. 1103(a).

5 *Pittston Gas Co. v. Pennsylvania Public Utility Commission*, 190 Pa.Super. 365, 154 A.2d 510 (1959).

> Under Section 3.01 of the APA, PAWC has agreed to purchase the combined wastewater system from SSA for $195 million, subject to certain adjustments set forth in the APA. Section 707(d) of the APA describes one such adjustment, the variance adjustment. The variance adjustment is based on the provision of the APA that limits the level to which PAWC can increase rates to customers in the SSA service area over the ten year period following the closing date of the transaction. As explained by PAWC and SSA, "the variance adjustment was specifically incorporated into the APA to allow for a *possible* (but by no means certain or guaranteed) change in the overall purchase price for the Combined Wastewater System if the revenues actually collected by PAWC from the former SSA customers exceed the predetermined level based on the 1.9% CAGR during the 10 years following the closing of the Transaction.[6]

The analysis of the APA's purchase price, as provided above, reveals two alarming facts: (1) no defined purchase price actually exists; and, (2) the purchase price, when it is finally determined in a decade, will have been inextricably tied to PAWC's rate increases. Despite these facts, the Joint Applicants claim that

> [t]he 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 base rate case. It is at that time that the Commission's duty to set "just and reasonable" rates is triggered.[7]

I&E disagrees and maintains that it is contrary to the interests of PAWC and its customers to ignore the pending rate impacts of the undefined purchase price and delay resolution of this issue to a future base rate proceeding. If the acquisition is approved without resolving the ratemaking issues surrounding the Variance Adjustment, the deal

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6 RD at 27-28.

7 JA Exceptions at 5.

will move to Closing despite the fact that PAWC will not know who is responsible for this cost for a decade. However, addressing the recovery of the Variance Adjustment in this proceeding before Closing occurs, allows PAWC to potentially renegotiate the Variance Adjustment with SSA or reconsider whether moving toward Closing is in its financial interest. Neither of those options will be available if the Commission approves the acquisition now but delays resolution of the ratemaking concerns to a future base rate proceeding. In short, the Joint Applicants' proposed wait-and-see approach is the worst possible outcome for PAWC and its customers. To be clear, I&E supports the ALJs' denial of this transaction; however, if the Commission reverses this recommendation, I&E maintains that the Commission must expressly disallow recovery of the Variance Adjustment from ratepayers in this proceeding so that PAWC can review its options and make an informed decision before Closing occurs.

While the Joint Applicants have not provided any analysis of the Variance Adjustment's potential impact on the purchase price, the OCA has determined that the amount that PAWC could potentially owe SSA at the end of ten years may be as high as $104 million.[8] Acknowledging this potential rate impact, the ALJs correctly recognized the risk of the undefined purchase price as a public interest concern:

> 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.[9]

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8 OCA St. 2 at 24-25.

9 RD at 32.

In further evaluating the Variance Adjustment's correlation to the future purchase price, the ALJs recognized the lack of a meaningful connection between those two elements of the transaction. Specifically, the ALJs noted that the Variance Adjustment "is open ended, bears no relationship to either the value of the assets or estimated operating costs, it is not in the public interest or reasonable as an adjustment to the purchase price."[10] Although the Joint Applicants aver that they should not be required to reveal and defend why, from a business standpoint, they "believe that an asset has a particular business value,"[11] it is clear that the purchase price is premised, at least in part, on the amount of future rate increases. Thus, it is unclear whether and to what extent "business value" was even a factor in the purchase price determination. I&E agrees with the ALJs that the public interest is not served by permitting the calculation of the Variance Adjustment to be pre-approved in this proceeding as proposed by the Joint Applicants. Accordingly, the ALJs correctly considered the acquisition purchase price in their RD.

B. Purchase Price is An Essential Element to Any Contract, But Especially in the Public Utility Realm

It is an axiom of contract law that essential terms of a contract must be readily defined in the contract. Pennsylvania law has recognized that price is an essential contract term in transactions such as the one that the Joint Applicants have proposed in this proceeding. Specifically, both the Supreme and the Commonwealth Courts of Pennsylvania have recognized that "[p]rice is an essential term of a contract for the

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10 RD at 33.

11 JA Exceptions at 5.

transfer of property and must be sufficiently definite and certain or capable of being ascertained from the contract between the parties.[12] I&E submits that in no venue is the certainty of a purchase price more crucial than in the public utility realm. After all, captive ratepayers may be forced to face the rate consequences of this "arms-length" transaction in which they were powerless to participate.

The APA contemplates a method of calculating the Variance Adjustment that is contingent on the amount of base rate increases that PAWC will pass on to customers in the former SSA territory over the next ten years. Conditioning the purchase price on such a variable makes ascertaining the purchase price impossible for the next decade. I&E submits that the public interest is harmed given that under the structure of the APA both the acquisition purchase price and amount of the Variance Adjustment will be unknown for ten years. Thus, the ALJs correctly considered the acquisition purchase price in their RD.

C. The Conditions Imposed by the Joint Applicants Necessitated Evaluation of the Purchase Price in this Case

While the Joint Applicants aver that the acquisition purchase price should not be considered in this proceeding, they ignore the fact that they actually placed conditions upon approval of the Application that necessitated consideration of the purchase price. More specifically, in their Main Brief, the Joint Applicants describe the dilemma they will face under the purchase price provisions of the APA unless the Commission grants PAWC pre-approval of Act 11 treatment for costs arising out of the transaction:

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12 *Portnoy v. Brown*, 430 Pa. 401, 243 A.2d 444 (1968); *Peerless Publications, Inc. v. City of Montgomery*, 656 A.2d 547, 552 (Pa.Cmwlth. 1995).

> The **APA provides for an adjustment to the purchase price of the Transaction** (a "Variance Adjustment") "if revenues from wastewater customers in the service area formerly served by the SSA exceed the 1.9% CAGR [compound annual growth rate] after year ten following closing of the Transaction . . ." PAWC St. No. 4, 6:11-14; see also PAWC Ex. RIG-1 (Section 7.07 and Schedule 7.07(d) of APA). **If the Commission fails to allow Act 11 treatment for PAWC's costs associated with the Combined Wastewater service, PAWC could significantly exceed the 1.9% CAGR and have to pay a significant Variance Adjustment.** PAWC St. No. 4-R, 21:17-21.
> PAWC's ability to ask in future rate proceedings that the Commission exercise its discretion under Act 11 to allocate all or a portion of the revenue requirement of the Authority's System to all of PAWC's water and wastewater customers was an important premise underlying the APA. If the Commission either affirmatively states that PAWC cannot avail itself of Act 11 for the Combined Wastewater System (or even remains silent on the issue), **it would be imprudent for PAWC to proceed with closing on this Transaction.** A decision by the Commission on this fundamental issue, as reflected in a conclusion of law, is necessary in this proceeding.[13]

Thus, in the Joint Petitioners' own words, the implications of the purchase price had to be considered in the Commission's overall evaluation of the acquisition. It is disingenuous of them to use the ratemaking impact of the Variance Adjustment as grounds for approval of Act 11 treatment in this proceeding, but then argue that the ALJs' review of the Variance Adjustment is untimely now and should occur in some later proceeding. Accordingly, the ALJs' consideration of the purchase price in this case was not only warranted, but also mandated by the Joint Applicants, and their attempt to argue otherwise should be rejected.

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[13] JA Main Brief at 37-38 (emphasis added).

D. The Purchase Price Adjustment is Not a Routine "Course of Business" Adjustment

In their second Exception, the Joint Applicants ask the Commission to clarify that a final acquisition purchase price does not have to be known with absolute certainty in order to obtain Commission approval. The Joint Applicants purport to need this clarification because the RD "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."[14]

Seeking to support the premise that absolute certainty regarding purchase price is not a condition precedent to Commission approval of Application, the Joint Applicants point to several purchase price adjustments that are "found in virtually all sale transactions."[15] Examples include an adjustment to the purchase price based on the amount of cash transferred to PAWC at Closing, the amount of indebtedness repaid or assumed by PAWC at Closing and the amount of withdrawal liability due as a result of SSA's withdrawal from pension plans.[16] Although these adjustments and the Variance Adjustment both impact the purchase price, the similarities end there. Unlike the examples cited by the Joint Applicants, the Variance Adjustment is premised on future rate increases, will not be known for a decade, and exposes jurisdictional ratepayers to untold risk. As such, the proposed Variance Adjustment is not common in the ordinary course of business or in any way analogous to the adjustments referenced in the Joint Applicants' Exceptions. Rather, it is an unprecedented term that has never been proposed

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14 JA Exceptions at 15-16.
15 JA Exceptions at 16.
16 JA Exceptions at 17.

in Commission proceeding; therefore, attempts to minimize its import must be rejected as it has potentially lasting ratemaking consequences for PAWC's current customers.

2. <u>Reply to Joint Applicants' Exception No. 1(2)</u>: The ALJs Properly addressed the ratemaking impact of the Variance Adjustment and found that it was not in the public interest

The Joint Applicants argue that the ALJs erred in addressing the ratemaking impact of the Variance Adjustment in this proceeding because it should be deferred to a subsequent proceeding. In summary, the Joint Applicants maintain that the Variance Adjustment methodology can be approved in this proceeding but that the amount that would be paid as a result of the methodology is better addressed ten years from now when the calculation is made.[17] This position is flawed and the ALJs properly determined that approving the methodology is tantamount to approving the amount that results from the methodology, which is contrary to the public interest because the there is no way to currently know what the amount will be.[18]

In support of its argument, the Joint Applicants state that the Variance Adjustment contained in the APA was submitted to the Commission, not under its Chapter 11 authority, but under Section 507 of the Code which governs contracts between public utilities and municipal corporations. This position is in error. The Joint Applicants are requesting that the Commission issue certificates of public convenience under Section 1102(a) of the Code for PAWC to acquire the Authority's sewer system assets and for PAWC to begin to offer wastewater service in the Authority's service area. It is

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17 JA Exceptions at 9.
18 RD at 30, 33.

undisputed that a certificate of public convenience shall be granted "only if the commission shall find or determine that the granting of such certificate is necessary or proper for the service, accommodation, convenience or safety of the public,"[19] which has been interpreted by the Pennsylvania Supreme Court in the *City of York v. Pennsylvania Public Utility Commission* that a proposed transaction must be shown to affirmatively promote the service, accommodation, convenience or safety of the public in some substantial way.[20] The APA encapsulates this transaction and explains, in detail, the assets, properties and rights of the Authority's systems that are being sold to PAWC. As a result, if there are terms in the APA that are not in the public interest, like the Variance Adjustment, those issues must be addressed in this proceeding. Any argument by the Joint Applicants that this Commission does not have the authority to review the APA under its Chapter 11 authority is wholly incorrect as this transaction, as defined in the APA, must withstand public interest scrutiny. Accordingly, the ALJs correctly conducted a public interest analysis of the terms of the APA and concluded that the "variance adjustment set forth in the APA is not reasonable or in the public interest and violates the Public Utility Code."[21]

The Joint Applicants further argue that the ALJs erred in concluding that approval of the Variance Adjustment methodology necessarily also approved the product of the methodology as a reasonable for ratemaking purposes.[22] The Joint Applicants liken the Variance Adjustment to automatic adjustment clauses where the mechanisms are

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19 66 Pa. C.S. § 1103(a).
20 *City of York v. Pennsylvania Public Utility Commission*, 449 Pa. 136, 295 A.2d 825, 828 (1972).
21 RD at 42.
22 JA Exceptions at 9.

approved and the amounts are subsequently refunded or recouped in separate proceedings.[23] I&E submits that this is precisely the ALJs' concern. In automatic adjustment proceedings, parties do not argue public interest concerns; rather, a mathematical calculation is conducted and parties review the calculation for accuracy in determining any over- or under-recovery of costs. Here, Section 7.07(d) of the APA establishes the methodology for calculating the Variance Adjustment:

> Not later than ninety (90) days after the end of year ten (10) following the Closing Date, Buyer shall provide to Seller a written statement and calculation showing as accurately as possible the cumulative positive difference, if any, over that ten-year period between (i) the annual revenues associated with the provision of wastewater service to customers in the Service Area calculated at PaPUC rates in accordance with Schedule 7.07(d) and (ii) a 1.9% Compound Annual Growth Rate (CAGR) rate increase in annual revenues associated with the provision of wastewater service to customers in the Service Area over that ten-year period relative to the starting amount of annual revenues calculated in accordance with Schedule 7.07(d).

The mathematical calculation explained above will produce some amount that will have to be paid to SSA ten years following Closing. Parties will have an opportunity to review the calculation for accuracy, but they will not be able to argue that the methodology was flawed. Moreover, I&E is struggling to understand how the Joint Applicants believe that some type of meaningful review will occur ten years from now given that when I&E sought information and supporting calculations about how the 1.9% was developed in this proceeding, PAWC merely replied that the 1.9% CAGR was the

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23 JA Exceptions at 9.

result of arms-length negotiations.[24] In short, I&E was unable to obtain any information in this proceeding about the CAGR and it is likely that the same will be true ten years from now. Accordingly, the ALJs were correctly concerned that by approving the methodology in this proceeding, they were also approving whatever amount that results from that methodology. The unknown cost of the Variance Adjustment appropriately concerned the ALJs given that they do not know what that amount will be, especially since the OCA demonstrated it could reach $104 million.[25] PAWC shareholders are not agreeing to absorb this amount; rather, it is looking to its water and wastewater customers to shoulder this burden. Accordingly, the ALJs properly recognized that it was not in the public interest to approve this Variance Adjustment methodology as reasonable because, by doing so, the unknown amount that results from the methodology ten years from now would also have to be determined to be reasonable.

The Joint Applicants' final argument is that the Variance Adjustment is designed to capture the relationship between the monetary value of an asset and its revenue stream, which is "well-accepted in the business world as a measure of an asset's value."[26] First, this statement is overly broad and unsupported. The Joint Applicants fail to point to another similar term where years after the closing of a transaction a purchase price is adjusted in order to capture the value of the asset. A person who sells a house or a piece of art cannot demand more money ten years later if the asset becomes more valuable, yet this is precisely what the Variance Adjustment attempts to do. Moreover, the price

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24 I&E St. No. 1, p. 9; I&E Exh. No. 1, Sch. 1.
25 RD at 29, 31, 33.
26 JA Exceptions at 10.

adjustment is one-directional as only the Authority benefits from the Variance Adjustment payment and the Joint Applicants have failed to demonstrate that such a one-sided term is often used in business settings. Second, the Joint Applicants failed to demonstrate how this term is appropriate in a regulated setting. The Joint Applicants' state that 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."[27] This fails to appreciate that the Code mandates that rates must be just and reasonable.[28] There is no way of knowing whether the 1.9% CAGR benchmark is appropriate to develop just and reasonable rates over the next decade. Additionally, as argued by I&E and recognized by the ALJs, looking solely at revenue growth in a vacuum is improper. Revenue increases greater than 1.9% may be required to cover normal operating expenses, not because SSA's assets were somehow more valuable than anticipated. Accordingly, the ALJs correctly determined that the Variance Adjustment bears no relationship to the value of SSA's assists or the future revenue needs for SSA's system.[29] This analysis was properly conducted in the instant proceeding as part of the public interest consideration; therefore, the Joint Applicants' request to approve the transaction and delay resolution to a future base rate proceeding must fail.

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27 JA Exceptions at 9.
28 66 Pa.C.S. § 1301.
29 RD at 33.

3. **Reply to Joint Applicants' Exception No. 1(4): The ALJs Correctly Determined that the Variance Adjustment Violates the Commonwealth Court's Holding in *Philadelphia Suburban***

Although the Joint Applicants argue that *Philadelphia Suburban*[30] is not controlling or relevant to the approach used by the APA to adjust the transaction purchase price, the ALJs correctly relied upon it in their RD. In their RD, the ALJs recite the pertinent facts of *Philadelphia Suburban* as follows:

> In Philadelphia Suburban, PAWC executed an asset purchase agreement with the City of Coatesville Authority for the purchase of the city's water system. The agreement, as subsequently amended, required PAWC to make an annual contribution to the Coatesville Economic Development Fund in an amount equal to Coatesville's annual charge from PAWC for fire hydrant service. The Commonwealth Court noted that this arrangement failed to provide a fixed sales price and placed the risk of future fire hydrant service on PAWC.[31]

I&E agrees with the ALJs that that the Commonwealth Court's rejection of PAWC's asset purchase agreement with the City of Coatesville was premised upon the facts that the transaction failed to established a fixed sales price and placed the risk of future obligations under the agreement solely upon PAWC. Similarly, in the instant case, the Variance Adjustment component of the APA makes it impossible for the Commission to determine a fixed sales price because one will not be available for a decade. Like the transaction in *Philadelphia Suburban*, PAWC would assume all of the risk of future costs under the Variance Adjustment. In fact, as I&E pointed out in its Reply Brief, the Joint

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30 *Philadelphia Suburban Water Co. v. Pennsylvania Public Utility Commission,* 808 A.2d 1044 (Pa.Cmwlth. 2002).

31 RD at 32.

Applicants have acknowledged this high degree of risk and PAWC has sought to be insulated from it by passing it onto its customers.[32]

As noted in *Philadelphia Suburban*, the Joint Applicants could have structured their transaction in a way that respected their needs without violating the Public Utility Code. The Commonwealth Court even outlined a few viable options that considered the financial plight of the Seller in that case, the City of Coatesville, which, like the seller in this transaction, the Authority and the City of Scranton ("City"), was experiencing financial difficulty at the time of the sale:

> We are not unmindful of or unsympathetic to the economic plight of Coatesville. As a matter of course, it needed to consider the cost of future fire hydrant service, which was free so long as it owned the water system, when it developed its sales price. **The transaction could have been structured to accomplish Coatesville's budgetary needs in a way that complied with the Public Utility Code. For example, part of the sale proceeds could have been placed in a segregated account established to generate income sufficient to cover the expected future cost of fire hydrant service. Alternatively, the parties could have agreed that Pennsylvania-American would pay part of the sales price in installments for some period of time that would ease Coatesville's transition to having to budget for fire hydrant service**. The key difference between these suggested alternatives and the arrangement between Pennsylvania-American and Coatesville is a fixed sales price. Here, the Amendment makes the purchase price an imprecise number and places all risk of the cost of future hydrant service on the utility, Pennsylvania-American.[33]

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32 I&E Reply Brief at 12-13.

33 *Philadelphia Suburban Water Co. v. Pennsylvania Public Utility Commission*, 808 A.2d 1044, 1057–58 (Pa.Cmwlth. 2002)(emphasis added).

Despite this guidance provided by the Commonwealth Court, instead of structuring their transaction in a matter that respects the Public Utility Code, the Joint Applicants simply argue that Philadelphia Suburban is inapplicable.

Although the Joint Applicants seek to distinguish the instant transaction from the one that PAWC entered in *Philadelphia Suburban,* its attempts to do so are not convincing. The Joint Applicants argue that the terms of the APA are different from the agreement in *Philadelphia Suburban* because the APA provides several options for distributing the Variance Adjustment, the APA does not contemplate the provision of free service, and the APA was designed to overcome the deficiencies identified in *Philadelphia Suburban.*[34] These arguments are unpersuasive because the key deficiencies still exist: the APA provides an imprecise purchase price and PAWC assumes all the risk of the purchase price adjustment through the agreed upon Variance Adjustment. Accordingly, the ALJs correctly determined that the Variance Adjustment violates the Commonwealth Court's holding in *Philadelphia Suburban.*

4. Reply to Joint Applicants' Exception No. 3: The RD Considered and Properly Rejected the Alleged Substantial Public Benefits of the Transaction.

In Exceptions, the Joint Applicants state that the RD fails to address the substantial public benefits of the acquisition. I&E maintains that all of the stated benefits accrue to the Authority, SSA customers or the City of Scranton ("City"), not to PAWC's existing customers. As explained at length in I&E's Main and Reply Briefs, approving this transaction to benefit those entities at the expense of current PAWC customers is in error

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34 JA Exceptions at 13-14.

as they are not properly included in the public interest consideration before this Commission.[35]

In their Exceptions, the Joint Applicants list six benefits that will result from this transaction: (1) SSA customers will now have enhanced services, such as extended customer service hours and access to PAWC's customer assistance program, under PAWC ownership; (2) PAWC is better positioned to address the costs of improvements to SSA system given its access to equity markets, strong balance sheet and credit ratings; (3) SSA customers will benefit by being part of a larger customer base; (4) PAWC has committed to create 100 new jobs in the Scranton area; (5) PAWC customers will benefit from the sharing of best practices with SSA's skilled personnel; and, (6) Scranton needs the proceeds of the transaction due to its financial distress.[36]

Only SSA customers, the Authority and the City stand to benefit from these enumerated benefits, which is improper because those entities are not properly included in the public interest consideration. The Commission has recognized that its "statutory obligations under Title 66 is to protect the public interest. Historically, the public interest has been defined, in our view, to include ratepayers, shareholders, and the regulated community."[37] Attempts to broaden the public interest consideration to include municipal authorities and their ratepayers have been rejected, especially when doing so would potentially harm the regulated utility or its customers:

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35 I&E Main Brief at 4-7; I&E Reply Brief at 2-5.

36 JA Exceptions at 18-21.

37 *Pennsylvania Public Utility Commission v. Bell Atlantic-Pennsylvania, Inc.*, 1995 Pa. PUC LEXIS 193, 34.

> ...many of the benefits of this proposal for NCTSA [North Codorus Township Sewer Authority] and its customers are the mirror images of the adverse impacts of the proposal for CMV and its customers. Considering that this Commission is statutorily charged with the regulation of public utilities and the protection of their customers, we are reluctant to define the public interest in a way that minimizes the adverse impact of a proposal on public utilities and their customers. Consequently, we are not persuaded that we should expand our previous definition of the public interest to include the interests of municipal authorities and their ratepayers.[38]

Further, I&E maintains that the Commission should reject the Joint Applicants' invitation to insert itself into the realm of Act 47 municipal recovery by recognizing "the public interest in addressing the financial plight of distressed municipalities...."[39] A simple review of the Public Utility Code reveals that municipal finance issues are beyond the scope of the Commission's jurisdiction and authority. According to the Public Utility Code, "[t]he commission shall have general administrative power and authority to supervise and regulate all public utilities doing business within this Commonwealth."[40] This plain language in no way contemplates the Commission's duty to resolve the financial problems of distressed municipalities, which would produce the troubling result of requiring jurisdictional utility ratepayers to bear the burden of municipal financial decisions. To that end, the Commission has previously recognized its jurisdictional limitations:

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38 *Application Of CMV Sewage Company, Inc. for Approval To Transfer To North Codorus Township Sewer Authority All Assets Used And Useful In The Provision Of Sewage Collection Service In North Codorus Township, York County, Pennsylvania; and Application of CMV Sewage Company, Inc. For Approval To Abandon Its Provision Of Sewage Service To The Public In North Codorus Township, York County, Pennsylvania*, Docket No. A-230056F2002 at 29 (Order Entered December 23, 2008).

39 JA Exceptions at 20-21.

40 66 Pa.C.S. § 501.

> It is axiomatic that this Commission only has the authority granted to it explicitly or implicitly by the General Assembly. The General Assembly has given us no such authority over the finances or rates of municipal authorities.[41]

Likewise, in this proceeding, the Commission has no explicit or implicit authority over the Authority's rates or the City's finances. In short, the Joint Applicants' argument that the Commission should approve the acquisition on the basis of the City of Scranton's financial plight is misplaced and must be rejected.

In contrast, PAWC customers are undoubtedly a component of the public interest consideration before this Commission and the most the Joint Applicants' can offer these existing customers is some sharing of best practices with SSA's skilled personnel. There is no evidence that such sharing is necessary for PAWC to continue to provide safe and reliable service to its existing wastewater customers. Moreover, this purported benefit comes at a hefty price given the $195 million purchase price, the additional $140 million needed to make infrastructure improvements required by the Long Term Control Plan and the unknown Variance Adjustment payment, all of which the Joint Applicants are seeking to recover from PAWC customers.

5. Reply to OCA Exception No. 2: If the Commission Reverses the RD and Approves this Transaction, Stormwater Allocation Issues Will Become Ripe for Resolution.

In its Exceptions, the OCA argues that the ALJs erred by failing to address the need for the separate allocation of sewage and storm water rates arising under the

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41 *CMV* at 29.

acquisition.[42] Although I&E opines that the ALJs likely determined that there was no need to address these issues in light of their recommendation that the Commission deny the transaction, if the Commission approves the Application, this issue will be ripe for resolution and must be addressed. Alongside the OCA, I&E has consistently argued throughout this proceeding that if the Commission approves this transaction, stormwater costs in SSA's service territory must not be recovered from PAWC's current customers.[43]

As set forth in its Main Brief,[44] I&E argued that PAWC's request for pre-approval to recover stormwater costs from its current customers should be denied:

> [t]his acquisition presents an issue of first impression regarding the regulation of a utility that provides stormwater service. SSA's system was designed as a combined system to remove both sanitary sewage and stormwater. Of its approximately 275 miles of mains, approximately 172 miles are combined sewer and stormwater mains.[45] In a standalone stormwater system, the stormwater is discharged with little or no treatment; however, in a combined system like SSA, stormwater commingles with wastewater and is directed to a wastewater treatment plant which increases the volumes to be treated.[46] PAWC contends that recovery of all stormwater costs across its customer base is necessary in order to make this transaction financially feasible.[47] I&E maintains that preapproval in this proceeding of these undetermined stormwater costs from PAWC customers who do not benefit from stormwater service must be rejected.

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42 OCA Exceptions at 8-14.
43 I&E St. No. 1 at 4-5, 14-15; Tr. at 85-89; I&E Main Brief at 9-14; I&E Reply Brief at 6-15.
44 I&E Main Brief at 9.
45 SSA St. No. 1, p. 3.
46 OCA St. No. 2, p. 10.
47 PAWC St. No. 4-R, p. 21.

I&E reasserts this same argument now, and incorporates, by reference, pages 9 through 14 of its Main Brief and pages 6 through 11 of its Reply Brief which further bear out this issue for the Commission's consideration.

In its Main Brief,[48] I&E recommended that, if the Commission approves the acquisition, it should require PAWC to develop a separate cost of service study to isolate stormwater costs and protect existing ratepayers from paying those costs:

> [t]o ensure that costs related to the provision of stormwater service are not spread to PAWC's other customers, I&E recommended that PAWC be required to provide a cost of service study in its next base rate case that separates sanitary sewer and stormwater flows along with the capital expense and operating costs for these two functions.[49] Because this is a combined system, PAWC will incur additional costs to operate the stormwater component that would not be present if this was a standalone wastewater system. Such costs include additional plant for stormwater catch basins, overflows for when volumes exceed the capacity of treatment facility, and additional maintenance expenses for cleaning catch basins, repairing mains and chemical expenses for treating higher volumes during storm events.[50] A separate cost of service study would provide ratemaking solutions to this stormwater issue by potentially charging SSA customers or the City for these stormwater costs.[51] Alternatively, it would allow these costs to be imputed to PAWC to ensure that it is not recovered from its current customers.[52]

I&E reasserts this same argument now, and incorporates, by reference, pages 9 through 14 of its Main Brief and pages 6 through 11 of its Reply Brief which further bear out this issue for the Commission's consideration.

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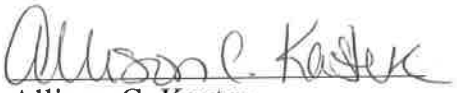
48 I&E Main Brief at 12-13.
49 I&E St. No. 1, p. 15.
50 I&E St. No. 1, p. 13.
51 I&E St. No. 1, p. 15.
52 I&E St. No. 1, p. 16.

Accordingly, if the Commission approves the acquisition, I&E respectfully requests that the Commission expressly consider the above issues in its final determination.

III. CONCLUSION

For the reasons stated herein, the Bureau of Investigation & Enforcement respectfully requests that the Commission deny the exceptions of the Joint Applicants and adopt the Recommended Decision of the Administrative Law Judges without modification. In the alternative, if the Commission approves the acquisition, the Bureau of Investigation & Enforcement respectfully requests that the Commission condition its approval on (1) requiring PAWC to provide costs of service studies that separate sanitary sewer and stormwater flows, capital expenses and operating costs in its next base rate proceeding and (2) prohibiting the recovery of the Variance Adjustment from ratepayers.

Respectfully submitted,



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