

September 8, 2016

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

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

Docket No. A-2016-2537209

Dear Secretary Chiavetta:

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

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

Respectfully submitted,

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cc: Honorable David A. Salapa, ALJ  
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Certificate of Service

225667

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

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

Dated this 8<sup>th</sup> day of September 2016.

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Joint Application of Pennsylvania-American Water Company and the Sewer Authority of the City of Scranton for Approval of (1) the transfer, by sale, of substantially all of the Sewer Authority of the City of Scranton's Sewer System and Sewage Treatment Works 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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REPLY EXCEPTIONS OF THE  
OFFICE OF CONSUMER ADVOCATE

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Dated: September 8, 2016

**TABLE OF CONTENTS**

I. INTRODUCTION ..... 1

II. REPLY EXCEPTIONS ..... 2

OCA Reply to JA Exc. 1: The Recommended Decision Properly Determined That The Variance Adjustment Is Unreasonable and Unlawful ..... 2

OCA Reply to JA Exc. 2: The Variance Adjustment Is Different Than Other Factors That The Joint Applicants Argue Can Change The Purchase Price Set Forth In An Asset Purchase Agreement And Result In The Final Acquisition Purchase Price Not Being Known With Absolute Certainty ..... 10

OCA Reply to JA Exc. 3: The ALJs Correctly Determined that the Transaction Is Not in the Public Interest because the Harms Outweigh the Benefits..... 11

    A. There Is No Evidence That PAWC Will Perform the Improvements at Less Cost or More Quickly ..... 13

    B. Benefits to the City of Scranton Are Not Determinative of the Public Interest..... 16

    C. The Benefit to PAWC’s Existing Customers From Operating the SSA Treatment Plant Is Speculative ..... 17

OCA Reply to JA Exc. 4: The ALJs Correctly Determined that the Transaction Is Not in the Public Interest because the Harms Outweigh the Benefits..... 18

III. CONCLUSION..... 20

**TABLE OF AUTHORITIES**

**Page(s)**

**Cases**

Middletown Twp. v. Pa. P.U.C.,  
85 Pa. Commw. 191, 482 A.2d 674 (1984) .....16

**Administrative Decisions**

Application of CMV Sewage Co., Inc.,  
2008 PaPUC LEXIS 950 .....13, 16

Application of North Heidelberg Water Co.,  
2010 PaPUC LEXIS 919 .....14

Application of Pennsylvania-American Water,  
2001 PaPUC LEXIS 10 .....4

Application of Shenango Valley Water Co.,  
1994 PaPUC LEXIS 110 .....4

Application of West Penn Power,  
1996 PaPUC LEXIS 32 .....4

Application of WP Water and Sewer,  
2009 PaPUC LEXIS 691 .....4

Pa. P.U.C. v. Citizens Util. Water Co. of Pa.,  
1996 PaPUC LEXIS 164 .....5

Pa. P.U.C. v. Citizens Util. Water Co. of Pa.,  
1996 PaPUC LEXIS 167 .....5

**Statutes**

66 Pa. C.S. § 507.....4

66 Pa. C.S. § 529(e) .....4

66 Pa. C.S. § 1311(c) .....3

66 Pa. C.S. § 1327.....5, 6

66 Pa. C.S. § 1327(a)(5).....5

66 Pa. C.S. § 1327(a)(6).....5

**Regulations**

52 Pa. Code § 69.711 .....5

52 Pa. Code § 69.711(d) .....5, 6

## I. INTRODUCTION

The Office of Consumer Advocate (OCA) submits this Reply to the Exceptions of Pennsylvania-American Water Company (PAWC) and the Sewer Authority of the City of Scranton (SSA or the Authority) (together Joint Applicants). The OCA urges the Public Utility Commission (Commission) to adopt the Administrative Law Judge's determination that the proposed transaction is not in the public interest because the substantial detriments outweigh the alleged benefits.

For the reasons below, and those contained in the ALJ's Recommended Decision, the OCA's Main Brief and the OCA's Reply Brief, the Exceptions of the Joint Applicants should be rejected.



## II. REPLY EXCEPTIONS

OCA Reply to JA Exc. 1: The Recommended Decision Properly Determined That The Variance Adjustment Is Unreasonable and Unlawful. R.D. at 27-42; JA Exc. at 2-15; OCA M.B. at 44-47; OCA R.B. at 35-37.

As part of the Asset Purchase Agreement (APA), PAWC agrees to pay a “variance adjustment” to SSA if, at the end of 10 years, the approved increases to the Scranton customers have exceeded 1.9% compound annual growth rate (CAGR).<sup>1</sup> APA § 7.07(d). The OCA opposed the variance adjustment and recommended that it not be permitted to be charged to ratepayers. OCA St. 2 at 23-28. I&E and OSBA also opposed the variance adjustment. I&E M.B. at 15-19; OSBA M.B. at 1-6. The ALJs found 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 risk of paying that imprecise sales price on PAWC and its customers.” R.D. at 32. The ALJs noted that the Joint Applicants are asking that the Commission approve the terms of the APA, including the formula used to calculate the variance adjustment. R.D. at 33. The ALJs found that:

If the Commission approves the method for calculating the variance adjustment as reasonable and in the public interest now, it is also approving the amount that results from using that method as reasonable and in the public interest without knowing what that amount is. This is neither reasonable nor in the public interest.

R.D. at 33. The ALJs also found that the variance adjustment “bears no relationship to either the value of the assets that PAWC is acquiring or the estimated future revenue needs for SSA’s system based on estimated operating costs.” Id. In addition, the ALJs concluded that the variance adjustment violates Section 1303 of the Public Utility Code. R.D. at 34-40.

The Joint Applicants filed an exception to the ALJs’ conclusion that the variance adjustment violates the Public Utility Code, is not reasonable and is not in the public interest.

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<sup>1</sup> The APA is contained in PAWC Exhibit BJK-1, Att. F.

The Joint Applicants argue, *inter alia*, that the Commission does not need to approve the final purchase price and that approving the APA does not mean that it is finding that the purchase price is reasonable. JA Exc. at 3. As explained below, the Commission can review the purchase price as part of its determination of whether the proposed transaction is in the public interest and whether there are affirmative public benefits. Moreover, as the ALJs correctly found, if the APA is approved in this proceeding, the approval would include the variance adjustment and the request that the Company be permitted to use Section 1311(c), 66 Pa. C.S. § 1311(c). Thus, by approving the APA,, the Commission would be approving an unknown purchase price that would be borne by PAWC's existing ratepayers, which is not reasonable.

As explained in more detail below, Mr. Rubin calculated the effect of the 1.9% CAGR, compounded over 10 years to be equal to a total increase of 20.7% over the 10 year period. OCA St. 2 at 23. The shortfall over the 10 year period, using SSA's cost of capital, is \$104 million. OCA St. 2 at 24; Sch. SJR-1. This would be paid to SSA as an adjustment to the initial \$195 million purchase price, which is already more than 2 times the book value of the SSA assets. OCA St. 2 at 23-24. The variance adjustment is also not reasonable in light of the known capital investment of \$146 to \$199 million that would be made in the SSA system over the same 10 year period. Id.

The Joint Applicants argue that “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.” JA Exc. at 6. Joint Applicants also imply that Commission concerns about the purchase price are limited to original cost studies and that those are provided after approval of the application. Id.

The Commission is not prohibited from reviewing the purchase price as part of an application proceeding. See, e.g., Application of Pennsylvania-American Water, 2001 PaPUC LEXIS 10; Application of Shenango Valley Water Co., 1994 PaPUC LEXIS 110. The relevance of the purchase price in reviewing the merits of an acquisition is demonstrated by Section 529, which requires the Commission to determine that the purchase price is reasonable. 66 Pa. C.S. § 529(e); Application of WP Water and Sewer, 2009 PaPUC LEXIS 691.

In the case of an acquisition of a municipal entity, such as this, the PUC must approve the asset purchase agreement itself. 66 Pa. C.S. § 507; see JA Exc. at 22 (“Code Section 507 approval of the APA is required for the Transaction to move to closing.”) Where the APA provides a purchase price, the purchase price is part of what must be approved. See Application of West Penn Power, 1996 PaPUC LEXIS 32, \*17-18, 32-35 (R.D.) (citing 66 Pa. C.S. § 507). In this case, the APA contains a provision that adjusts the purchase price by an amount that will not be calculated until 10 years after closing. The APA sets forth exactly how the variance adjustment will be calculated. APA § 7.07(d). In 10 years, when the variance adjustment is calculated, the APA also requires PAWC to request Commission approval to shift the additional costs of the variance adjustment to existing water customers. APA § 7.09(x). Thus, only the question of allocation, *i.e.* which customers will pay, is reserved for a future proceeding. The Joint Applicants are seeking Commission approval of the **rate recovery** of the variance adjustment in this proceeding, as part of the approval of the APA. This directly contradicts the Joint Applicants’ statement that ratemaking issues are not properly within the scope of an application proceeding (JA Exceptions at 5),

Joint Applicants also argue that the purchase price was the result of an arms-length transaction and thus, is reasonable. JA Exc. at 5. To the contrary, the Commission has held that

an arms-length transaction is not determinative of whether the purchase price is reasonable. Pa. P.U.C. v. Citizens Util. Water Co. of Pa., 1996 PaPUC LEXIS 164, \*37 (R.D.) (Citizens).<sup>2</sup> In Citizens, the ALJ rejected the company’s claim that reasonableness of the purchase price could be inferred from the fact that it was an arms-length transaction, stating that the requirement of arms-length negotiation is a separate requirement of the statute (66 Pa. C.S. § 1327), and that “the framers of the statute recognized that an arms-length transaction, even between nonaffiliated entities, could produce an unreasonable price. Id. at \*37. Moreover, under Section 1327, the Commission must find that the purchase price was negotiated at arms-length **and** that the purchase price is reasonable. 66 Pa. C.S. § 1327(a)(5), (6). This is consistent with the Commission’s policy statement at 52 Pa. Code § 69.711, where the Commission looks for a purchase price that is reasonable **and** the result of an arms-length transaction.

Next, the Joint Applicants compare the variance adjustment to a proceeding where an original cost study is ordered by the Commission and it is reviewed in the next general rate case “to determine if claims relating to the purchase price require further inquiry.” JA Exc. at 6. This comparison is without merit. An original cost study may be used by water and sewer utilities to establish the amount of the positive acquisition adjustment that they want to claim in rates when acquisition costs are greater than depreciated original cost. 52 Pa. Code § 69.711(d); see 66 Pa. C.S. § 1327. The original cost study is generally done after the Commission approves the application and before the next rate case. 52 Pa. Code § 69.711(d). The Commission then reviews the claim for an acquisition adjustment calculated based on the difference between the acquisition cost and the original cost study in the first base rate case following the acquisition. The original cost study does not change the purchase price or impact it in any way. Here, the

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<sup>2</sup> The Commission adopted the ALJ’s recommendation denying the acquisition adjustment. Pa. P.U.C. v. Citizens Util. Water Co. of Pa., 1996 PaPUC LEXIS 167, \*27-28.

variance adjustment could change the purchase price by \$104 million and will not be known for 10 years. Moreover, the acquisition adjustment and its calculation are provided by statute and regulation. 66 Pa. C.S. § 1327; 52 Pa. Code § 69.711(d). The variance adjustment was created by the Joint Applicants and included in the APA.

Joint Applicants also argue that the reasonableness of an acquisition's purchase price should be separate "from the central issues presented in a Code Section 1102 evaluations, such as the legal, technical and financial fitness of the acquiring party, and the presence of affirmative public benefits in the transaction." JA Exc. at 7. However, in this case, the purchase price, along with the variance adjustment, has a large impact on ratemaking over the first 10 years after closing and, thus, the determination of affirmative public benefits.

Mr. Rubin explained that this provision of the APA limits the amount of the rate increases for the SSA customers for wastewater and storm water service for the next 10 years. OCA St. 2 at 23. The 1.9% annual increase compounded for 10 years is equal to a total increase over the 10-year period of 20.7%. Id. Mr. Rubin found that this limitation was not reasonable in conjunction with the capital investments that must be made in the SSA system. Id. He provided the following explanation:

To illustrate the problem, I will use figures from SSA's most recent annual report for the 12 months ending March 31, 2015, which appears as the first document in Schedule 4.05 to the Asset Purchase Agreement. During that year, SSA had total operating revenues of \$22,694,320. If that figure is increased by 20.7% total allowable revenues would be \$27,392,000, an increase of \$4.7 million over 10 years.

At the same time, as OCA witness Fought discusses, SSA is in the midst of an extensive capital program required by a Consent Decree with federal and state environmental regulators, that requires the investment of more than \$140 million over the next 20 years. SSA has projected that by 2026, its revenue requirement would be \$45.0 million. Moreover, this projection is calculated under SSA ownership; it does not include the significantly higher cost of capital under PAWC ownership that I discuss in the next section of my testimony.

For the sake of illustration, though, I will use the \$45.0 million revenue requirement under SSA ownership. In 2026, the 20.7% rate increase limitation in the Asset Purchase Agreement would result in a shortfall of \$17.7 million in revenues in just that one year. On Schedule SJR-1, I use the data provided by SSA and PAWC to calculate that in total over the first 10 years, the shortfall would total \$104 million. I would reiterate that this uses SSA's projected cost of capital; it does not use PAWC's significantly higher cost of capital.

In other words, if the Company were to charge SSA customers the actual cost of serving them, the charges would be at least \$104 million higher over the next 10 years than the rate limitation contained in the agreement. If the Commission were to require PAWC to charge cost-based rates to SSA customers, then section 7.07 of the Asset Purchase Agreement would require PAWC to pay SSA an additional \$104 million or more as an enhanced "purchase price."

OCA St. 2 at 23-25. Mr. Rubin concluded that it was not reasonable or consistent with the public interest for the purchase price to be \$104 million more than the \$195 million purchase price<sup>3</sup>, noting that the book value of SSA's property, plant and equipment to be acquired by PAWC is something less than \$74 million. OCA St. 2 at 25. Mr. Rubin also noted that PAWC already is paying more than twice book value for the assets it is proposing to acquire. Id. With the addition of the variance adjustment, the purchase price could increase by up to \$104 million, which would mean that PAWC would spend more than **three** times book value for the assets. Id. at 26. Mr. Rubin stated "There is no basis for determining that such a purchase price would be reasonable or consistent with the public interest. OCA St. 2 at 26. Mr. Rubin concluded that "the real purchase price for SSA's assets is \$260 million: \$156.66 million paid for the assets and \$104 million provided in guaranteed rates below the cost of service over the next 10 years."<sup>4</sup> Id. at 27.

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<sup>3</sup> SSA is obligated to provide cash and equivalents totaling \$38,340,626 (or the purchase price will be adjusted up or down to provide equivalent value to PAWC). OCA St. 2 at 25.

<sup>4</sup> The \$156.66 million is the purchase price net of \$38.34 million in cash and equivalents, which SSA is required to provide to PAWC pursuant to the APA. OCA St. 2 at 25.

Mr. Rubin recommended that if the Commission determines that it has jurisdiction over the storm water service, the Commission should prevent PAWC's existing customers from paying \$104 million over the next ten years to subsidize the purchase price. OCA St. 2 at 27-28.

He explained how that would be done, as follows:

I recommend, therefore, that the Commission prohibit the Company from transferring cost responsibility away from SSA customers, either through single-tariff wastewater pricing or by using the revenue-sharing provision of Section 1311(c) of the Public Utility Code for SSA for at least the first 10 years after closing. This will require the Company to be responsible for the entire purchase price to which it agreed: the initial net cash payment of \$156.66 million as well as an additional \$104 million (or more) payable either through reduced revenue collections from customers or through a one-time payment in 10 years.

OCA St. 2 at 28.

Thus, the Joint Applicants' argument that the reasonableness of the purchase price "is not a required finding" is incorrect because it is a provision of the APA and because it is of such magnitude that it bears on the determination of affirmative benefits.

The Joint Applicants also argue that approving the variance adjustment methodology is not the same as approving the product of that methodology. JA Exc. at 8-10. The OCA submits that this argument should be rejected because the Joint Applicants are seeking approval for both the methodology and the product of that methodology, when it can be calculated in ten years.

Mr. Rubin addressed the portion of the APA that deals with the ratemaking requirements associated with the variance adjustment:

The Asset Purchase Agreement is quite explicit on this point: the agreement is predicated on PAWC being able to charge that \$104 million (or more) to PAWC's existing water customers. Specifically, Section 7.09(x) of the Asset Purchase Agreement states, in part: "in Buyer's first base rate proceeding with respect to the System following the Closing, Buyer shall include a request in such proceeding to combine partially, under Pennsylvania's System Improvement Charges Act 11 of 2012 ("Act 11"), Buyer's water and wastewater revenue requirements for ratemaking purposes to ensure the System's customers benefit from Act 11 in the same manner as its other customers throughout Pennsylvania

....” Thus, through the Agreement, PAWC is attempting to obligate its existing water customers to pay more than \$104 million for the privilege of adding SSA’s assets to the PAWC system, even though existing customers receive absolutely no benefit from the proposed transaction.

OCA St. 2 at 26-27. The variance adjustment is not similar to automatic adjustment clauses as the Joint Applicants argue. JA Exc. at 9. The variance adjustment is not a true up of certain expenses on an annual or quarterly basis, but rather is a shifting of costs from one group of customers to another. As the ALJs noted, the variance adjustment is a buffer for SSA’s customers against future anticipated rate increases. R.D. at 33. The ALJs noted that there is no adjustment under the APA provision if the increase to Scranton customers is less than the 1.9% CAGR. Id.



OCA Reply to JA Exc. 2: The Variance Adjustment Is Different Than Other Factors That The Joint Applicants Argue Can Change The Purchase Price Set Forth In An Asset Purchase Agreement And Result In The Final Acquisition Purchase Price Not Being Known With Absolute Certainty. R.D. at 27-42; JA Exc. at 15-17

In their second exception, the Joint Applicants argue that the purchase price can change for a number of reasons and thus, the variance adjustment is consistent with other reasons why the purchase price changes. The examples provided by the Joint Applicants are cash on hand at closing, indebtedness levels at closing, and compensation changes as of closing. JA Exc. at 16-17. All of the Joint Applicants' examples recognize that there are changes during the normal course of business from the date that an asset purchase agreement is executed to the closing date. The variance adjustment, however, is not something that changes over the course of a number of months from the execution of the asset purchase agreement to closing. Rather, the variance adjustment will be calculated ten years after closing by comparing the increases under the 1.9% CAGR to the actual increases received by the Scranton customers over the ten-year period. The specific calculation of the variance adjustment is set forth in the APA. The variance adjustment is dissimilar in scope, time, and impact to the adjustments that are made at closing due to changes in the cash balance or any of the examples used by Joint Applicants. Accordingly, this exception should be denied.

OCA Reply to JA Exc. 3: The ALJs Correctly Determined that the Transaction Is Not in the Public Interest because the Harms Outweigh the Benefits. R.D. at 42.

Based on their review of all of the evidence, the ALJs determined that any alleged benefits to PAWC's customers, SSA's customers and the City of Scranton cannot overcome the evidence showing that the transaction is not in the public interest. R.D. at 42. In their third exception, the Joint Applicants claim that the Recommended Decision did not address the substantial public benefits of the transaction. The Joint Applicants contend that there are at least six specific benefits and suggest that these benefits outweigh any detriment associated with the variance adjustment. JA Exc. at 18-21. This argument ignores the enormity of the potential variance adjustment and that there are other detriments that will result from the transaction. These harms considerably outweigh the benefits claimed by the Joint Applicants, which are overstated. The Joint Applicants' exception should be denied and, consistent with the Recommended Decision, the transaction should not be approved.

As discussed in the Recommended Decision and in the OCA's testimony, the variance adjustment to the purchase price places the risk of paying an additional amount – which could be as much or more than \$104 million – on PAWC's existing water and wastewater customers. R.D. at 28-29, 31-34; OCA St. 2 at 28. The base purchase price of \$195 million is already more than twice the \$74 million book value of the assets being acquired. OCA St. 2 at 25. The actual amount of the variance adjustment and thus the purchase price will not be known for ten years. PAWC R.D. at 32-33; PAWC Exh. BJG-1, Att. F (Sections 7.07(d), (e)). Moreover, the amount of the variance adjustment has no correlation to the value of the assets. It is based solely on revenue, which is based on rates the Commission will approve in the future, and ignores changes in expenses and customer growth. See OCA Exc. at 14-15; R.D. at 31. The ALJs correctly

concluded, for this reason among others, that the variance adjustment and the transaction as a whole are not reasonable or in the public interest. R.D. at 28-29, 31-34, 42.

Any alleged benefits to SSA's customers, PAWC's customers and the City of Scranton cannot overcome the fact that the variance adjustment violates the Public Utility Code, is not reasonable and is not in the public interest. The Commission should therefore deny PAWC's and SSA's joint application.

R.D. at 42.

If approved as proposed, the proposed transaction will cause substantial harms to PAWC's existing wastewater and water customers. PAWC intends to assume responsibility for the capital improvements required by the Consent Decree between the U.S. Department of Justice, U.S. Environmental Protection Agency, Pennsylvania Department of Environmental Protection and SSA. PAWC plans for its existing wastewater and water customers to pay between \$146 and \$199 million of the storm water-related compliance costs over the next 20 years, beginning when PAWC increases rates in its next base rate case – as soon as January 1, 2018.<sup>5</sup> PAWC St. 4 at 4, 7; OCA St. 2 at 31 (citing PAWC Response to OCA II-6, Att. B, Table 2). In addition to the purchase price and variance adjustment, the transaction is anticipated to require existing customers to pay subsidies in excess of \$120 million over 13-years and \$360 million over 30 years. OCA St. 2 at 33 citing the Joint Applicants response to I&E-10, Att. A and OCA Set II-6, Att. C.

Moreover, the Joint Applicants overstate the benefits that will result from the proposed transaction. The Joint Applicants claim that SSA customers will benefit from enhanced services and lower rates than if they remained SSA customers. PAWC St. 3, 25; PAWC St. 5R at 4-8; PAWC St. 4 at 5-6. They also point to the benefit of adding 100 new jobs and how the proceeds

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

from the transaction will balance the City of Scranton's 2017 budget and improve its overall economic position for the next 10 years. PAWC St. 3 at 3; PAWC St. 2 at 2-3, 5. The Joint Applicants also contend that PAWC's existing customers will benefit from the expertise PAWC will gain from operating the SSA's treatment plant. SSA St. 2R at 7-8. The OCA will address each of these claims, in turn, and show that the alleged benefits cannot overcome the substantial harms that will accrue to PAWC's existing water and wastewater customers if the transaction is approved.

A. There Is No Evidence That PAWC Will Perform the Improvements at Less Cost or More Quickly.

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

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

In order to determine whether the alleged benefits meet the required standard, the Commission may consider: “(1) the legal and technical fitness of the purchasing entity to provide

service; (2) the public need for service; (3) the inadequacy of the existing service; and (4) any other relevant evidence.” Application of North Heidelberg Water Co., 2010 PaPUC LEXIS 919, \*20. The ALJs determined that the legal and technical fitness of PAWC is sufficient (RD at 25-27), but so is the existing service by SSA. There is no indication on the financial side that SSA cannot meet its obligations under the Consent Decree so long as it continues to raise rates in accordance with its rate plan. Although PAWC witness Merante claimed that PAWC is in a much stronger financial position than SSA, Mr. Rubin pointed out that Standard & Poor’s noted SSA’s healthy financial profile, its strong debt service coverage and liquidity. Tr. 98-99; OCA Brief at 39. He also testified that there is no reason to believe that SSA could not finance the capital improvements over the next 20 years that it agreed to implement in its consent decree with the federal and state governments. Tr. 99-100; OCA Brief at 39. Mr. Rubin also observed that Standard & Poor’s noted that, assuming SSA can implement reasonable rate increases over time, it will be able to finance the obligations it has agreed to. Id. at 100. Moreover, the cost to the public of having PAWC undertake those projects is likely to be substantially greater than the costs that would be incurred by the Authority. Id. The most recent bond ratings for SSA by Standard & Poor’s was an A minus and for PAWC by Moody’s was A3. Tr. 99. As Mr. Rubin explained, those ratings are essentially equivalent. Id. In rating SSA, Standard & Poor’s highlighted the authority’s healthy financial profile, its strong debt service coverage and liquidity. Id. Mr. Rubin concluded that the financial markets are not finding that PAWC is significantly different from SSA. Tr. 99.

There are no advantages to the public (or to the environment) from having PAWC own the Scranton-Dunmore system because PAWC is not committing to undertake any physical construction or studies that the Authority is not already required to undertake. PAWC does not

claim that it has significant expertise in the operation of a combined wastewater-storm water utility and, in fact, it appears that it would rely on existing Authority employees for most of that expertise. OCA St. 2 at 29; PAWC Exc. at 20. In other words, it appears that the level and quality of service will be the same under PAWC ownership as it would be under SSA ownership. Id.

PAWC is unable to “precisely quantify” any efficiencies or decreased operating costs resulting from the proposed transaction or indicate when they might occur. PAWC St. 4 at 5. It relies on the vague supposition that at some unknown time efficiencies “will inevitably be realized because of the size of PAWC’s water and wastewater operations.” PAWC St. 1 at 8; PAWC St. 4 at 5; OCA Brief at 40. There are no economies of scale, however, because PAWC already provides water service to the SSA customers. Indeed, because of the ratemaking concessions that PAWC is seeking, the existing PAWC customers in the SSA service area will be harmed by paying rates above their cost of service so that storm water improvements can be funded over a greater number of customers and in 10 years, may have to pay up to \$104 million more in rates because of the variance adjustment. All of the risk and all of the costs are being shifted to the existing PAWC water customers, including those served by the SSA combined system.

Further, while SSA rates may benefit in the short-term, they will not benefit in years 11 to 13 or thereafter. PAWC indicates that it intends to move the SSA customers to its system rates in equal increments in years 11 through 13 following closing of the transaction. PAWC St. 4 at 3; PAWC St. 4-R at 2. If approved as proposed, PAWC would charge an SSA customer using 3,000 gallons of water per month \$34.50 compared to charging an existing Rate Zone 1 customer \$46.14 for the same usage. In the ten years post-acquisition, the rate disparity will

grow if PAWC proposes rate increases for Rate Zone 1 that exceed the rate increases proposed for SSA customers due to the CAGR limitation. This means that moving SSA customers to system rates in years 11 through 13 could require severe increases because of the rate provision in the Asset Purchase Agreement that shifts costs to existing customers during the first 10 years.

In addition, if, at the end of ten years, PAWC pays a variance adjustment, the Authority has sole discretion whether the funds will be distributed wastewater customers in the City of Scranton and Borough of Dunmore or paid directly to the Authority with no limitation on how the funds are used. PAWC Exh. BJK-1, Att. F (Section 7.07(d), (e)); OCA St. 2 at 23. Even if the adjustment is paid to wastewater customers in the Scranton area, it will be partly recovered from the same customers in their water rates. Id., Section 7.09(x). As such, there is no certainty that the adjustment will offset the rate increases for SSA customers in years 11 through 13.

**B. Benefits to the City of Scranton Are Not Determinative of the Public Interest.**

The Joint Applicants state that the proposed transaction is a cornerstone of the City's economic recovery. JA Exc. at 20-21. In addition, they emphasize the creation of 100 jobs in the Scranton area by the end of 2020 as another benefit to the City of Scranton. JA Exc. at 20. Although there is no doubt that the City of Scranton will benefit, that is not determinative of whether there are affirmative public benefits.

A determination of the public interest involves examining the impact of the proposed acquisition on all parties that would be affected by the transaction, as opposed to only considering "one particular group or geographic subdivision." Middletown Twp. v. Pa. P.U.C., 85 Pa. Commw. 191, 202, 482 A.2d 674, 682 (1984); CMV at \*43. When the benefits to the City of Scranton are weighed against the known detriments to existing PAWC customers, the proposed transaction does not establish the substantial, affirmative benefits necessary for approval.

C. The Benefit to PAWC's Existing Customers From Operating the SSA Treatment Plant Is Speculative.

The Joint Applicants also contend that customers of PAWC's presently-owned smaller plants will benefit from the transaction through the expertise PAWC will gain from operating the SSA's treatment plant. JA Exc. at 20; SSA St. 2R at 7-8. There is no evidence, however, that PAWC is not currently providing adequate service to customers it serves through smaller treatment plants. Moreover, to the extent that PAWC is suggesting that existing customers will benefit if it gains the experience to acquire other, larger wastewater treatment plants or other combined storm water/wastewater systems, this benefit is speculative at best. The other acquired systems may, like SSA, require hundreds of millions of dollars in capital improvements that PAWC will propose be subsidized by existing customers. The other systems may, like SSA, be in areas where PAWC already provides water service, so there is no expansion of the customer base. Further, if the other systems are combined systems, existing PAWC customers (who already pay taxes or other fees to control storm water in their community) may be required to subsidize storm water control in additional communities.

For these reasons and those discussed above and in the OCA's testimony and briefs, the Joint Applicants have not established that the transaction provides an affirmative benefit to the existing PAWC customers. The record shows conclusively that these customers will suffer considerable harm.



OCA Reply to JA Exc. 4: The ALJs Correctly Determined that the Transaction Is Not in the Public Interest because the Harms Outweigh the Benefits. R.D. at 42.

The Joint Applicants except to the Recommended Decision because the ALJs did not recommend issuing certificates of filing under Section 507 of the Public Utility Code for the APA and seven other agreements, filed on July 1, 2016, which address PAWC's commitment to assume, subject to Commission approval, certain contractual obligations of SSA. R.D. at 4. The ALJs noted that PAWC has not filed executed versions of the seven agreements. R.D. at 5. The Joint Applicants recognize that this is likely due to the ALJ's recommendation to reject the APA. JA Exc. at 22.

The Joint Applicants request, however, that the Commission conditionally approve the seven agreements. Specifically, the Exceptions state:

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.

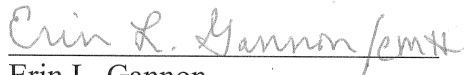
JA Exc. at 22-23. This assumes that the only defect in the APA is the variance adjustment. This is not correct. As discussed in the OCA's Exceptions and, *supra*, in these Reply Exceptions, there are other reasons that the proposed transaction fails to provide affirmative benefits. In addition to the purchase price and variance adjustment, the APA is expected to cost PAWC's existing ratepayers \$146 million to \$199 million dollars over the next 20 years in storm water related capital improvements and subsidies. PAWC St. 4 at 4; OCA St. 2 at 31-33. The thirty year projection is more than \$300 million, without adjusting for PAWC's higher cost of capital. In the prior section, the OCA showed that each of the benefits alleged by the Joint Applicants is overstated and lacking. See OCA Reply to JA Exception No. 3, *supra*. Thus, even if the

variance adjustment were removed, the substantial detriments of the transaction outweigh the alleged benefits. There is no basis on which to approve the APA or issue certificates of filing for the seven agreements. The Exception and the request should be denied.

III. CONCLUSION

For the reasons set forth above and in its Main Brief and Reply Brief, the Office of Consumer Advocate respectfully requests that the Pennsylvania Public Utility Commission deny the Exceptions of the Joint Applicants.

Respectfully submitted,



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