



September 8, 2016

VIA OVERNIGHT MAIL

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Rosemary Chiavetta, Secretary
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Commonwealth Keystone Building
400 North Street, 2nd Floor North, P.O. Box 3265
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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**

REPLIES OF JOINT APPLICANTS, PENNSYLVANIA-AMERICAN WATER COMPANY AND THE SEWER AUTHORITY OF THE CITY OF SCRANTON, TO EXCEPTIONS OF THE OFFICE OF CONSUMER ADVOCATE

Dear Secretary Chiavetta:

Enclosed for filing with the Commission are the Replies of the Joint Applicants, Pennsylvania-American Water Company and The Sewer Authority of the City of Scranton, to the Exceptions of the Office of Consumer Advocate 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 via electronic mail.

Thank you for your attention to this matter. 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

cc: Honorable David A. Salapa (via Electronic Mail and First Class Mail)
Honorable Steven K. Haas (via Electronic Mail and First Class Mail)
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Per Certificate of Service

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

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 : Docket No. A-2016-2537209
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 :

**REPLIES OF JOINT APPLICANTS,
PENNSYLVANIA-AMERICAN WATER COMPANY AND
THE SEWER AUTHORITY OF THE CITY OF SCRANTON,
TO THE EXCEPTIONS OF THE OFFICE OF CONSUMER ADVOCATE**

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

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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 § 5.535, file these replies to the exceptions of the Office of Consumer Advocate (“OCA”).¹ Through these replies, the Joint Applicants further demonstrate that: (a) consistent with the Recommended Decision’s Conclusion of Law No. 8, the Commission has jurisdiction under the Code to regulate the collection, treatment, and disposal of a combined wastewater stream consisting of flows of sewage from homes and businesses, infiltration and inflow, and stormwater (“Combined Wastewater”); (b) because the Commission has jurisdiction over Combined Wastewater, there is no need for a separate allocation of stormwater-related costs; (c) any issue related to the Variance Adjustment is moot as a result of the Joint Applicants’ election in these replies to exceptions to withdraw their Exception No. 1 (defending the Variance Adjustment) on the basis that the Commission conditions approval of the Transaction upon PAWC’s filing of an amendment to the APA which eliminates the Variance Adjustment; and, (d) the Transaction will result in affirmative public benefits of a substantial nature. Indeed, when viewed closely, OCA’s arguments are actually contrary to the public interest and potentially fatal to the timely financial recovery of the City of Scranton (“City”). The Joint Applicants’ goal in submitting these replies to exceptions is to limit the issues that must be adjudicated by the Commission, and thereby fostering the timely entry of a Commission final order and limiting potential appellate issues.

¹ For purposes of these replies to exceptions, the Joint Applicants utilize terms as defined on pages one through three of the Joint Applicants’ Exceptions filed in this matter on September 2, 2016.

II. JOINT APPLICANTS' REPLIES TO EXCEPTIONS OF OCA

A. *The Recommended Decision properly concludes that the Commission has jurisdiction over Combined Wastewater service. Joint Applicants' Reply to OCA Exception No. 1.*

The Recommended Decision presents a thorough and well-reasoned analysis on the issue of Commission jurisdiction over Combined Wastewater System service and properly concludes that “[t]he 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. Nevertheless, the OCA misguidedly argues that the cases involving the Wayne Sewerage Company are not dispositive, the General Assembly has provided for alternative methods of stormwater management, and the *City of Lancaster* decisions are persuasive authority for the OCA’s position. The OCA’s arguments are without merit and are contrary to the express language of the Code.

1. **The *Wayne Sewerage Cases*, as well as the Joint Applicants’ other compelling arguments, support a conclusion of law that the Commission has jurisdiction over Combined System service.**

The ALJs properly relied on *Wayne Title & Trust Co., v. Wayne Sewerage Co.*, 3 Pa. P.S.C. 1170 (1919), *Wayne Sewerage Co. v. Fronfield*, 76 Pa. Super. 491 (Pa. Super. 1921), and *Dickson v. Drexel*, 132 A. 284 (Pa. 1926) (the “*Wayne Sewerage Cases*”) to support the conclusion that the Commission has jurisdiction over combined sewer systems. As the Commission and the courts explained when describing the background of the *Wayne Sewerage Cases*, the original developer of the properties installed a system of “drains” in the streets. Residents owning or thereafter purchasing homes had the right by deed to use the drainage system free of charge and connect to and discharge their sanitary sewage into that system. Alternatively, the homeowners had the right by deed to “private sewage disposal” as long as they used “sealed receptacles.” When the Wayne Sewerage Company acquired the system and later

charged rates to recover costs of new treatment and discharge facilities, some owners objected based on deed provisions granting the right to free use of the drainage system. The Commission's predecessor (the Public Service Commission) exercised jurisdiction and authorized rate recovery despite the "free use" deed provisions, and the courts later agreed that the Public Service Commission was authorized to do so.

The only reasonable legal interpretation of the *Wayne Sewerage* Cases is that the Commission historically has exercised jurisdiction over what would be referred to today as a "combined system" given that the developer established a drainage system for the development and then allowed abutting property owners to connect and discharge their sewage into that system. The OCA nevertheless contends that the ALJs erred by relying on the *Wayne Sewerage* Cases -- arguing that (a) the cases "do not conclusively show that the Wayne system was a combined system," (b) "there is no information to show that [the system] was still a combined system when the Public Service Commission was created in 1913," and (c) only sewer rates were at issue. *See* OCA Exceptions, p. 5. The Commission should reject OCA's arguments.

First, the OCA ignores the fact that most community sewer systems in Pennsylvania since the 1800s until relatively recently² accepted combined stormwater and sanitary sewage such as the one described in the *Wayne Sewerage* cases. As the ALJs concluded at page 22 of the Recommended Decision, the record provides substantial evidence to support that finding. Given the history of combined sewers in Pennsylvania, the Commission may safely presume that the sewer system at issue in the *Wayne Sewerage* Cases involved a combined system particularly when nothing in those cases suggests that the system was anything other than a combined system.

² Efforts to develop modern wastewater treatment plants and separate combined sewer systems into stormwater and sanitary were undertaken following passage of the Federal Clean Water Act in 1972, and has been a long and arduous process.

Second, the ALJs' reasoning is consistent with court decisions that interpret the phrase "sewer system" as the courts and the Commission used in the *Wayne Sewerage* Cases to include storm drains. See, e.g., *Medicus v. Upper Merion Tp.*, 475 A.2d 918 (Pa. Cmwlth. 1984), (recounting the historical use of the term "sewer system" as including storm drains and holding in the context of exceptions to municipal tort immunity "that the term 'sewer' systems as used in Section 202(b)(5) of the Act encompasses storm drains.").

Finally, the rate schedule approved in the *Wayne Sewerage* cases is irrelevant to the analysis despite the OCA's contrary suggestion. The *Wayne Sewerage* Cases involved one combined system. The company sought rate recovery to pay for new treatment and discharge facilities for the entire system to render the sewage discharged to the nearby creek "innocuous" as ordered by the Pennsylvania Health Commissioner. The rates charged to customers paid for system improvements to treat and dispose of combined flows.

Accordingly, the Commission should reject the OCA's arguments that the ALJs erred by relying on the *Wayne Sewerage* Cases and deny OCA's first exception to the Recommended Decision. The Recommended Decision properly concludes that Combined Wastewater service is jurisdictional to the Commission.

2. Rules of statutory interpretation clearly support a conclusion that the Commission has jurisdiction over Combined Wastewater service.

The Commission need not rely solely on the Recommended Decision's rationale to support its jurisdiction over Combined Wastewater service. As the Joint Applicants have demonstrated, see Joint Applicants Main Brief at 13-30 and Reply Brief at 4-7, the rules of statutory interpretation compel the conclusion that the Commission has jurisdiction over combined wastewater systems because the Commission has jurisdiction over public utilities and their facilities that collect and treat sewage (wastewater). The record is undisputed that the

Combined Wastewater system at issue here collects and treats sewage whether or not stormwater also enters that system. The OCA ignores this straightforward and dispositive analysis.

Section 1921(a) of the Statutory Construction Act, 1 Pa. C.S. § 1921(a), provides that the object of all statutory interpretation is to determine the General Assembly's intent based on the express words used in the statute. *See* 1 Pa. C.S. § 1921(b); *Meier v. Maleski*, 670 A.2d 755 (Pa. Cmwlth. 1996). When a statute's words might not be viewed as explicit, courts and agencies may consider other matters such as the occasion and necessity for the statute, the object to be obtained, the consequences of a particular interpretation and administrative interpretations. 1 Pa. C.S. § 1921(c); *Meier, supra*. Except for those statutes subject to strict construction rules (which is not the case here), all statutory provisions "shall be liberally construed to effect their objects and promote justice." *See* 1 Pa. C.S. § 1928(c).

The statutory construction rules compel the conclusion that the Commission has jurisdiction over Combined Wastewater service. The Commission has jurisdiction over "public utilities," defined as (among other things) "[a]ny person or corporations now or hereafter owning or operating in this Commonwealth equipment or facilities for: ... (vii) [s]ewage collection, treatment, or disposal for the public for compensation." 66 Pa. C.S. § 102(1)(v).

The terms "sewage" and "wastewater" as used in the Code and Commission regulations are synonymous. *See, e.g.*, 66 Pa. C.S. § 102 (using "sewage" to define "public utility"); *compare id.* § 1311 (using "wastewater" in context of Act 11); 28 Pa.B. 801; Commission Docket No. L-00950112. The OCA essentially conceded that "sewer" and "wastewater" are synonyms and that the Commission regulates wastewater service. *See* OCA Main Brief, p. 10.

As detailed in Joint Applicant's Main Brief at pages 13-30 and in the testimony of James Elliott, based on accepted regulatory definitions of "Sewage" and "Wastewater," any water,

including stormwater, when mixed with sewage and other wastewater becomes wastewater. In the field of wastewater engineering, once flows from various sources are comingled, one cannot differentiate between the wastewaters flowing through sewerage facilities that need to be managed, treated and discharged in a responsible matter. When water becomes contaminated, no matter how, it becomes wastewater, and that wastewater must be collected, treated and managed responsibly by the operator of the wastewater system. PAWC St. No. 6-R, 6:13-21. Where human and animal wastes are mixed with other waters, whether they come from industrial users, groundwater or stormwater, the resulting flows are all “sewage” under the definitions contained in the Pennsylvania Clean Streams Law, 35 P.S. §691.1, and Sewage Facilities Act, 35 P.S. § 750.2. PAWC St. No. 6-R, 5:14-16.

The Code does not exclude Combined Wastewater service from the Commission’s jurisdiction – using instead the unqualified terms of “sewage” and “wastewater” interchangeably. If the Code does not exclude Combined Wastewater systems from the Commission’s jurisdiction, then the Commission has jurisdiction and has a mandatory duty to regulate them. *See* 66 Pa. C.S. § 501(a) (“In addition to any powers expressly enumerated in this part, the commission shall have full power and authority, and it shall be its duty to enforce, execute and carry out, by its regulations, orders, or otherwise, all and singular, the provisions of this part, and the full intent thereof; and shall have the power to rescind or modify any such regulations or orders. The express enumeration of the powers of the commission in this part shall not exclude any power which the commission would otherwise have under any of the provisions of this part.”).

The General Assembly had the opportunity to exclude Combined Wastewater service from the Commission’s jurisdiction, but it never did. When the General Assembly enacted Act

11 in 2012, it used the term “wastewater” (as opposed to the arguably more narrow terms “sewer” or “sewage”) in connection with the combined revenue provisions for water and wastewater utilities. *See* 66 Pa. C.S. § 1311. At that time, there were hundreds of Combined Wastewater systems in Pennsylvania. PAWC St. No. 6-R, 18:1-2. The General Assembly – presumed to know the existence of numerous Combined Wastewater systems in the Commonwealth at the time it enacted Act 11 – had every opportunity to exclude Combined Wastewater service from Act 11 and (for that matter) from the jurisdiction of the Commission altogether. Yet, the General Assembly never excluded Combined Wastewater from the pre-existing phrase “sewage” under Code Section 102 or the more contemporary term “wastewater” in Act 11.

Thus, the Commission may safely conclude that the General Assembly never intended to exclude Combined Wastewater systems from the Commission’s jurisdiction, and neither the Commission (nor the Courts nor the OCA) may read into a statute an express exclusion to the Commission’s jurisdiction that the legislature itself never added.

Having determined that the Commission has jurisdiction over Combined Wastewater systems such as the one at issue here, the question then becomes whether substantial evidence supports the conclusion that the Combined Sewer system collects, treats, and disposes of wastewater to or for the public for compensation. Again, the answer is “yes.” The Joint Applicants submitted testimony from Mr. James Elliot, a very credible witness with decades of engineering experience with the Combined Wastewater system, explaining how every element of the system relates to the management and treatment of sewage and wastewater, and thus wastewater services. *See* PAWC St. No. 6-R, 10:15-14:14. There is no evidence in the record to the contrary.

Simply put, applying the rules of statutory construction, the Commission has jurisdiction over Combined Wastewater service. That conclusion harmonizes all the provisions of the Code regarding jurisdiction over sewage or wastewater service and does not read into the Code any exclusion from the Commission's jurisdiction that is not there. Substantial record evidence supports the fact that stormwater combined with any sewage or wastewater becomes "wastewater" (which all parties agree is a Commission jurisdictional service). The OCA did not come forward with any evidence suggesting that stormwater commingled with sewage is anything other than wastewater. Accordingly, no other conclusion can be supported by the law and the record evidence.

3. The Commission should reject the OCA's arguments based on other statutes.

Notwithstanding the straightforward analysis under the applicable provisions of the Code, OCA contends in its exceptions that the ALJs erred by overlooking how the General Assembly has distinguished "stormwater" and "sewer" service in other statutes such as the Municipality Authorities Act, the Storm Water Management Act, and the Pennsylvania Sewage Facilities Act -- arguing that (a) "where the General Assembly has intended to include storm water in the types of service an entity can provide, it has amended the statute to add 'storm water' where the existing statute already authorized the provision of 'sewer' service," and (b) the lack of the word "stormwater" in the Code forecloses the Commission from exercising jurisdiction over a Combined Wastewater system. The Commission should reject OCA's arguments.

First, the OCA's reliance on the recent amendments to the Municipality Authorities Act is misplaced. Municipal authorities have long been empowered to operate "sewer, sewer systems, or parts thereof" and "sewage treatment works." 53 Pa. C.S. § 5607(a)(5),(6). The 2013 amendment to the Municipality Authorities Act, Act of July 9, 2013, P.L. 569, No. 2013-

68, added clause (18) to 53 Pa. C.S. §5607(a), empowering municipal authorities to undertake projects involving “stormwater planning, management and implementation.” From this, OCA contends that if “stormwater” were commonly understood to be included in the term “sewage” or “wastewater,” the addition of Section 5607(a)(18) to allow for stormwater projects would be redundant and “mere surplusage.” But OCA’s misconstruction leads to a logical absurdity.

If, as the OCA argues, Combined Wastewater systems involve some aspect of “stormwater services” and if “stormwater” is not part of sewage, then under the OCA’s logic, municipal authorities would not have been legally-authorized to operate Combined Wastewater systems prior to 2013. Such an interpretation contradicts the reality that numerous municipal authorities, including the SSA, have long owned and operated Combined Wastewater systems under the Municipality Authorities Act.³ Such Combined Wastewater systems have existed, and exist today, under the “sewer” and “sewage” project powers of municipal authorities, because they are sewage systems.

What, in fact, the 2013 Municipality Authorities Act amendment did was clarify the power of municipal authorities to undertake *pure* stormwater projects and activities – what are typically understood to be MS4 systems. It is important to note that the MS4 system, a pure stormwater system, has been excluded from the Transaction.

Second, the fact that the Storm Water Management Act separately defines “public utility service” (as “sewage collection, treatment or disposal”) and “storm water” (as “drainage runoff from the surface of the land resulting from precipitation or snow or ice melt”) is irrelevant. As the Joint Applicants Main Brief explains, any stormwater combined with sanitary sewage is

³ The Pennsylvania Department of Environmental Protection’s listing of combined sewer systems (PAWC Ex. JCE-3) is replete with references to municipal authority operated combined systems.

wastewater based on accepted regulatory and industry definitions of “sewage” and “wastewater”.
See Joint Applicants Main Brief at 19-24.

Finally, the OCA incorrectly relies on the definition of “sewage” in the Pennsylvania Sewage Facilities Act, Act of January 24, 1966, P.L. (1965) 1535, *as amended*, 35 P.S. § 750.1 *et seq.*, for the proposition that stormwater is excluded from “sewage” as defined in that act. The Sewage Facilities Act contains a very broad definition of sewage:

“Sewage” means any substance that contains any of the waste products or excrement or other discharge from the bodies of human beings or animals and any noxious or deleterious substances being harmful or inimical to the public health, or to animal or aquatic life, or to the use of water for domestic water supply or for recreation, or which constitutes pollution under the act of June 22, 1937 (P.L.1987, No.394), known as “The Clean Streams Law,” as amended.

Under that definition, where human and animal wastes are mixed with any other flow, whether they come from industrial users, groundwater or stormwater, the resulting flows are all “sewage” under the Pennsylvania Clean Streams Law and Sewage Facilities Act. *See* PAWC St. No. 6-R, 5:14-16. Contrary to OCA’s misconception, stormwater is not excluded from that definition; where stormwater mixes with sewage in combined systems, it becomes “sewage.”

Accordingly, the Commission should reject the OCA’s attempt to construe various Pennsylvania laws as distinguishing between “sewage” and “wastewater,” on the one hand, and “stormwater” on the other because the arguments are incorrect. The laws support the position of the Joint Applicants.

4. The *City of Lancaster* decisions are not controlling or even persuasive.

The Recommended Decision correctly recognizes that the *City of Lancaster* decisions are not “controlling or persuasive” regarding Commission jurisdiction over Combined Wastewater service. R.D., pp. 18-19. As succinctly explained by the Recommended Decision: “There were no combined sewers located within the area where the jurisdictional customers resided. . . . The Commission concluded in *Lancaster* that the City of Lancaster was unfairly allocating storm

water costs to jurisdictional customers. . . . Nowhere in *Lancaster* or *Lancaster Remand* decisions did the Commission state that it lacked jurisdiction over a combined sewer system.” *Id.*, p. 19; *see Pa. Pub. Util. Comm’n v. City of Lancaster-Sewer Fund*, Docket No. R-00049862 (Opinion and Order entered Aug. 26, 2005); *Pa. Pub. Util. Comm’n v. City of Lancaster-Sewer Fund*, Docket No. R-00049862 (Opinion and Order entered Sept. 15, 2008).

In essence, the *City of Lancaster* decisions involved the Commission’s exercise of its discretion to allocate costs between jurisdictional customers (outside the City who did not benefit from Combined Wastewater service in the City) and non-jurisdictional customers (within the City whose Combined Wastewater service would have been subsidized by jurisdictional customers) in the context of a ratemaking proceeding. The decisions do not, as suggested by the OCA, constitute persuasive authority that the Commission cannot or should not exercise its jurisdiction over Combined Wastewater service. *See also* Joint Applicants Main Brief, pp. 32-33; Joint Applicants Reply Brief, p. 36.

5. The OCA’s position on Commission jurisdiction over Combined System service is contrary to the public interest.

The OCA has taken a position on Commission jurisdiction that is contrary to the public interest. There are approximately 129 Combined Wastewater systems in the Commonwealth. PAWC St. No. 6-R, 18:1-2; PAWC Exh. JCE-3. Many of these Combined Wastewater systems serve relatively small communities, such as the towns of the anthracite region in Schuylkill, Carbon, Luzerne and Lackawanna counties, and likewise a myriad of small communities in western Pennsylvania. These communities are typically older and have more-limited financial capabilities. They experience difficulty in increasing user fees, often have limited staffing for complex programs, and have significant other municipal infrastructure demands upon available funding. *Id.* at 18:12-20.

At least 11 municipalities enrolled in Act 47 are Combined Wastewater system communities. *Id.* at 19:4-7. As explained by PAWC expert witness Mr. James Elliott: “A number of these communities have limited technical and financial capabilities, and their distressed status presents even greater challenges in terms of being able to address federal and state mandates for managing their combined sewer systems and reducing overflows while meeting a myriad of other financial demands, including structural budget deficits, unfunded pension obligations and the like.” *Id.* at 19:7-12. These communities would benefit not only from the monetization of their wastewater systems assets, but also from professional operation of their systems.

The OCA’s position on Commission jurisdiction would effectively deprive Pennsylvania communities of the chance to pursue an acquisition of their Combined Wastewater system by a willing and capable investor-owned public utility and, additionally, would thwart Commonwealth policy efforts to regionalize wastewater services. Both Act 11 of 2012 (regarding a combined water and wastewater revenue requirement) and Act 12 of 2016 (regarding fair market valuation of a municipal system) were intended to foster these public policy goals. If adopted, the OCA’s position would deprive the 129 Combined Wastewater systems in the Commonwealth of the intended benefits of these two significant pieces of legislation.

B. The Recommended Decision did not err in failing to prescribe a cost allocation for Combined Wastewater service. Joint Applicants’ Reply to OCA Exception No. 2.

Once the Commission determines that Combined Wastewater service is jurisdictional, there is no reason for the Commission to direct the allocation of costs associated with any stormwater component of the service to particular group of customers. Combined Wastewater is a form of “sewage” or “wastewater,” as those terms are used in the Code, and the Commission

should not attempt to differentiate between types of wastewater. The costs of Combined Wastewater service can be allocated among customers in the same manner that costs of any other wastewater service may be allocated. Moreover, ratemaking issues are not properly resolved in the context of this acquisition application proceeding.

The OCA argues that PAWC must develop separate rates and charges that are proportional to a customer's contribution of stormwater to the system and that such charges could be billed to the City and the Borough of Dunmore or a municipal authority. OCA Exceptions, p. 9-11. However, the OCA cites no binding legal authority for this proposition and, instead, simply references the opinions of its own witnesses as to how they believe stormwater costs should be billed and collected. The opinions ignore the fact that Combined Wastewater service is a jurisdictional service and the costs of such service can be recovered under the traditional ratemaking methodologies permitted by the Code.

The OCA's arguments, citing a so-called "national trend" and a Canadian regulatory scheme, are premised on a utopian vision of how it believes Combined Wastewater should be managed and paid for, and not the practical realities of how Combined Wastewater systems operate or what is permitted under existing law. *See* Joint Applicants Reply Brief, pp. 13-19. Indeed, there is no legal authority to impose stormwater fees in the manner proposed by the OCA. *Id.*, pp. 14-16. Even where certain municipalities or municipal authorities have been granted limited authority to impose stormwater fees, the establishment of stormwater fees of the type advocated by the OCA is a complex, time-consuming, and expensive process beyond the capabilities of most Pennsylvania communities. *Id.*, pp. 16-17.

In contrast, Commission regulation of Combined Wastewater service as a public utility service is fair, straightforward, and -- most importantly -- permitted by Pennsylvania law. The

OCA's position would effectively preclude investor-owned utilities from owning a Combined Wastewater system – despite the fact that such ownership is permitted by Pennsylvania law and in the public interest.

Because Combined Wastewater is jurisdictional wastewater, PAWC should not be precluded as a condition of application approval from utilizing the ratemaking tools legally available to it under Pennsylvania law -- including Act 11 of 2012. Recognizing that PAWC will have the burden of demonstrating that a claim under Act 11 is in the public interest at such time that the claim is actually made, the Commission should reject any request in this proceeding for a special cost of service study as unnecessary and premature. *See* 66 Pa. C.S. § 1311(c).

C. In order to streamline a Commission final order and limit potential appellate issues, the Joint Applicants propose that the Commission condition approval of the Transaction upon elimination of the Variance Adjustment from the APA. Joint Applicants' Reply to OCA Exception Nos. 3 and 4.

Having found that the Commission has jurisdiction over Combined Wastewater service and that PAWC is technically, legally and financially fit, the Recommended Decision recommends denial of the Joint Application solely on the basis of a single, limited issue -- the Variance Adjustment. The Recommended Decision concludes that the Variance Adjustment is contrary to the public interest because it violates Code Section 1303. R.D., pp. 27-42, Conclusion of Law No. 12; 66 Pa. C.S. § 1303 (regarding "Adherence to tariffs").

In order to obtain timely entry of a Commission final order approving the Transaction and to limit potential appellate issues, the Joint Applicants respectfully request permission to withdraw their Exception No. 1, which defends the Variance Adjustment, on the basis that the Commission issue a conditional approval of the Transaction. The Joint Applicants request that the Commission condition its approval of the Transaction upon the elimination of the Variance

Adjustment from the APA -- a reasonable remedy which the Recommend Decision appears to have overlooked.

The Code explicitly permits the Commission to condition the issuance of a certificate of public convenience. 66 Pa. C.S. § 1103(a) (“The commission, in granting such certificate, may impose such conditions as it may deem to be just and reasonable.”); *see also Seaboard Tank Lines, Inc. v. Pa. Pub. Util. Comm’n*, 502 A.2d 762 (Pa. Cmwlth. 1985) (explaining that the Commission has great latitude in determining conditions). In fact, the Recommended Decision explicitly recognizes the Commission’s authority to impose conditions on an acquisition approval. R.D., Conclusion of Law No. 7 (“The Commission has the discretion to impose conditions which it deems just and reasonable.”). Yet, the Recommended Decision recommends denial of the Joint Application without considering or establishing any conditions.

The Recommended Decision extensively cites *Philadelphia Suburban Water Co. v. Pennsylvania Public Utility Commission* as the seminal case supporting its recommendation to deny the Joint Application. 808 A.2d 1044 (Pa. Cmwlth.) (“*Philadelphia Suburban*”). In that case, the Commonwealth Court of Pennsylvania reversed a Commission order approving an acquisition in which the public utility would have been contractually obligated to make an annual contribution to a municipal economic development fund in an amount equal to the municipality’s annual charge from the utility for fire hydrant service. The Commission order at issue in *Philadelphia Suburban* reversed an Administrative Law Judge’s recommended decision which, if adopted, would have approved the transaction subject to removing from the asset purchase agreement the requirement that the utility make the annual payment to the municipality’s economic development fund. *Philadelphia Suburban*, 808 A.2d at 1048; *see also* R.D., p. 38. In other words, the Administrative Law Judge in that case recommended that the transaction be

approved conditioned upon the removal of the legally-offensive provision from the asset purchase agreement -- rather than simply recommending denial of the application. The Recommended Decision in the instant proceeding should have taken a similar path.

Instead of recommending outright denial of the Transaction, the Recommended Decision should have recommended approval subject to removal of the Variance Adjustment from the APA. By conditioning approval of the Joint Application upon removal of the Variance Adjustment, the substantial public benefits of the Transaction could still be realized.

As extensively explained by the Joint Applicants throughout this proceeding, timely Commission approval of the Transaction is a key element to the City's financial recovery. *See* Joint Applicants Exceptions, pp. 20-21. In waiving their defense of the Variance Adjustment, the Joint Applicants are attempting to address the very concerns raised by the statutory advocates and the Administrative Law Judges in this proceeding.

In addition, as noted throughout this proceeding, timely consummation of the Transaction by early Fall 2016 is a critical component of the City's long awaited exit from the strictures of Act 47 (dealing with financially distressed municipalities) and upcoming 2016-2017 budget crisis. To facilitate closing of the Transaction consistent with this timing it is essential that as many challenges/appeals as possible to any Commission order approving the relief requested in the proceeding are eliminated or minimized.⁴ It is within this spirit and goal that the Joint Applicants are requesting Commission approval conditioned upon the elimination of the

⁴ Section 7.12(d) of the APA provides the following with regard to an appeal of the Commission's order: "Notwithstanding anything to the contrary in this Agreement, in the event the PaPUC issues an order approving the transaction as contemplated by this Section 7.12 and if all other conditions precedent to Closing have been fully satisfied in accordance with the terms of this Agreement, the Parties may elect in their discretion and by mutual agreement to close on the transaction (i) notwithstanding a pending appeal or request for reconsideration with respect to such order or (ii) during the otherwise applicable appeal/reconsideration periods if no party has been aggrieved by the PaPUC order and the Parties reasonably believe there is little likelihood of a successful legal or other challenge to said PaPUC order."

Variance Adjustment from the APA. To demonstrate the overwhelming public benefits from the Transaction and their overall confidence in the legal merits of the proposed acquisition, the Joint Applicants will consummate the Transaction, subject to the satisfaction or waiver of all other conditions to the obligations of each of the Joint Applicants to consummate the Transaction, regardless of the fact that a "Final Order" (as defined in the APA) has not been issued due to any pending appeal by the OCA or the OSBA.

D. The Joint Applicants' have clearly met their burden of demonstrating that the Transaction will produce affirmative public benefits of a substantial nature. Joint Applicants' Reply to OCA Exception No. 4.

The Transaction will produce an affirmative public benefit of a substantial nature, including but not limited to: enhanced customer service to Scranton-area customers; PAWC's stronger financial status to operate the System and make necessary improvements; the benefits to Scranton-area customers associated with being part of a larger customer base; the benefits to PAWC's existing customers associated with adding an additional 31,000 wastewater customers (including long-term cost-sharing); the creation of 100 new jobs; the benefits to PAWC's existing customers from the addition of SSA's expertise in large wastewater system operations; and, the financial relief that the Transaction will provide to the City of Scranton and its taxpayers (who are also PAWC water customers and will be PAWC wastewater customers). Joint Applicants Exceptions, pp. 18-21.

Despite these obvious public benefits, the OCA contends that the Transaction would produce harms to PAWC's existing customers. This is simply not the case for several reasons.

First, the addition of 31,000 additional wastewater customers will undoubtedly benefit all PAWC customers in the long-term. See Joint Applicants Reply Brief, pp. 40-41. As summarized by PAWC witness Mr. Rod Nevirauskas, Director of Rates and Regulations for American Water Works Service Company:

While Scranton-area customers may benefit from the sharing of costs initially, PAWC's other customers will undoubtedly benefit from the revenues generated from Scranton-area customers in the future as the systems servicing those customers require capital improvement. Indeed, the Commission should analyze the rate impact of this Transaction not from a 13-year perspective but from a 100-year perspective and recognize that other PAWC customers will benefit from the addition of over 31,000 wastewater customers.

PAWC St. No. 4-R, 4:21-5:4. Through regionalization and the sharing of costs, PAWC's customers will undoubtedly benefit in the long-term from the Transaction.

Second, the prospective rate issues raised by the OCA are beyond the limited scope of review for this acquisition application and properly reserved for a future PAWC base rate proceeding. At best, the OCA's arguments are premature and, in any event, do not undermine the public interest nature of the Transaction. In this regard, the APA makes it abundantly clear that Commission approval of the Transaction would neither bind the parties nor the Commission in future PAWC base rate proceedings. *See* Joint Applicants Reply Brief, pp. 27-28.

Third, the OCA's allegation that the Transaction is not in the public interest is based on the false assumption that Combined Wastewater service is non-jurisdictional. As explained above and as concluded by the Recommended Decision, the OCA's position is incorrect as a matter of law. Consistent with applicable law, PAWC is legally entitled to request that the costs of Combined Wastewater service be spread across PAWC's combined water and wastewater customer base under Act 11 of 2012.

Fourth, the OCA's contention that SSA is fit to continue to own and operate its system is irrelevant to the standard of review for the Joint Application. The Commission's task is to evaluate whether the new owner is fit and whether there is an affirmative public benefit to the proposed transaction. The fitness of the prior owner is irrelevant except to the extent that the new owner is more fit – in which case, there is an affirmative public benefit to the transaction. *See* Joint Applicants Reply Brief, pp. 38-39. In this regard, the record in this proceeding clearly

demonstrates that PAWC is more fit – particularly with regard to its financial ability to fund the system’s needed capital improvements. *See id.*, pp. 41-43.

Finally, the OCA’s assertion that Scranton-area customers will be harmed by PAWC’s proposed rates in years 11 through 13 following closing on the Transaction are unfounded. PAWC has made several commitments to SSA in the APA intended to phase in rate increases for Scranton-area customers in a gradual manner and to avoid rate shock, including the commitment to bring the customers in line with system average rates. The phase in is also intended to ensure that Scranton-area customers do not unreasonably benefit through low rates at the expense of PAWC’s other customers. In any event, the APA makes clear that the Commission maintains absolute discretion to set “just and reasonable” rates. If appropriate, the Commission could phase in rates for Scranton-area customers over a longer period of time. It is premature, and would be inappropriate, to speculate as to how the Commission may exercise its ratemaking authority in the future. *See Joint Applicants Reply Brief*, p. 38.

III. CONCLUSION

The Recommended Decision correctly concludes that the Commission has jurisdiction over Combined Wastewater service. While the Recommended Decision’s rationale for this conclusion of law is sound, the Joint Applicants have offered other compelling arguments in favor of a conclusion that the Commission has jurisdiction. In contrast, the OCA has offered little more than its preference for how stormwater-related costs should be collected – a preference that has not been adopted by the Pennsylvania General Assembly. The Commission has only such powers as have been expressly granted to it by, or as are necessarily-implied from, the Code. The Code refers to “sewage” and “wastewater” (inter-exchangeable terms under the Commission’s own rulemaking) and, as clearly demonstrated by the evidentiary record in this proceeding, stormwater indisputably becomes “sewage” or “wastewater” upon entry into a

Combined Wastewater system. This Commission cannot change that fact and, likewise, cannot change the Code.

The OCA is advocating a position on Commission jurisdiction regarding Combined Wastewater service that is contrary to the public interest. Aside from the financial relief that the Transaction will bring the City, Pennsylvania currently has approximately 129 Combined Wastewater systems – mostly in small communities. At least 11 municipalities enrolled in Act 47 are Combined Wastewater system communities. Adoption of the OCA’s position on jurisdiction would deprive those communities of the possibility of an acquisition by an investor-owned utility and the associated financial relief. The OCA’s position is also contrary to the intent of Act 11 of 2012 and Act 12 of 2016 – which were intended to encourage regionalization of wastewater services and to facilitate acquisitions of municipal wastewater systems.

The OCA’s request for an allocation of stormwater-related costs in a Combined Wastewater system is without basis in Pennsylvania law and unduly complicated for public utilities as well as customers. Because Combined Wastewater service is jurisdictional, Combined Wastewater service costs should be treated like all other wastewater service costs. Act 11 of 2012 applies to wastewater service and, as the Recommended Decision concludes, Combined Wastewater service falls within the definition of wastewater.

The Commission should not entertain ratemaking issues, such as cost allocation, as part of this acquisition application proceeding. Interested parties would be denied due process by any predisposition of cost allocation issues. Act 11 of 2012 contemplates that a “public interest” determination regarding a claim for a combined water and wastewater revenue requirement will be made in the base rate case in which the claim is made. At best, the OCA’s request for a prescriptive cost allocation is premature.

The Joint Applicants have clearly carried their burden of proof in this proceeding to demonstrate by a preponderance of the evidence that the Transaction will result in an affirmative public benefit of a substantial nature. OCA's alleged detriments to PAWC's current customers are unfounded. All of PAWC's customers will benefit in the long-term from the addition of 31,000 wastewater customers. The addition of these customers will bring additional wastewater system operational expertise to PAWC and allow the sharing of costs among a larger customer base.

The Joint Applicants have endeavored in these replies to exceptions to present a reasonable alternative to the Recommended Decision's recommendation that the Joint Application be denied on the basis of the Variance Adjustment. The Commission should instead condition approval of the Transaction upon the Joint Applicants' making of a compliance filing within 20 days of final order entry which amends the APA to remove the Variance Adjustment.

Elimination of the Variance Adjustment should help to limit opposition by the statutory advocates and thereby expedite Commission approval (preferably at the September 15, 2016 Public Meeting or, at the latest, at the October 6, 2016 Public Meeting in order to avoid dire financial consequences for the City of Scranton). This approach to the Variance Adjustment will also limit the number of possible appellate issues, if any.

IV. 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 their exceptions, deny the exceptions of OCA, reverse the Recommended Decision issued in this matter on August 24, 2016, and order that:

(i) The Joint Application, as amended, be approved subject to the condition that Joint Applicants make, within 10 days of final order entry, a compliance filing containing an

amendment to the APA which removes the Variance Adjustment from the APA consistent with **Appendix A** to these replies to exceptions (“APA Compliance Filing”);

(ii) Upon the APA Compliance Filing, 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) Upon the APA Compliance Filing, 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;

(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 the APA Compliance Filing and 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).

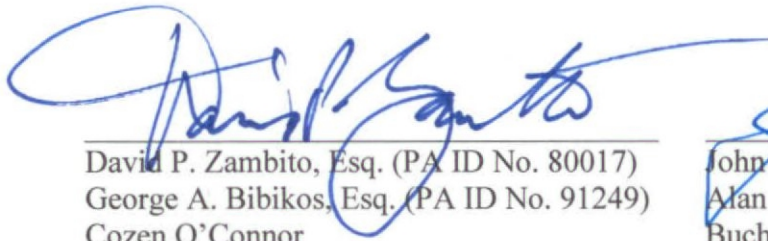
(v) All other approvals required by the Pennsylvania Public Utility Code to carry out the Transaction be granted;

(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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Dated: September 8, 2016

APPENDIX A

"**Transfer Taxes**" has the meaning specified in Section 3.04.

"**Transferred Personnel**" has the meaning specified in Section 7.04(a).

"**Transition Plan**" has the meaning specified in Section 7.06(d).

"**Trustees**" has the meaning specified in Section 2.07(a).

"**UCC Search**" has the meaning specified in Section 6.03.

"**Union**" means Teamsters Union Local 229.

"**Union Personnel**" means Personnel who are members of the Union.

~~"**Variance Adjustment**" has the meaning specified in Section 7.07(d).~~

"**WARN Act**" has the meaning specified in Section 4.13(d)(i).

"**Wastewater Treatment Plant**" means the wastewater treatment plant owned and operated by the Seller located at Cedar Avenue and Breck Street, Scranton, PA, with a permitted average flow capacity of 20 million gallons per day, as authorized by PaDEP Water Quality Management Part II Permit No. 3510401.

"**Water System**" has the meaning specified in the Preamble of this Agreement.

"**Withdrawal Liability**" has the meaning specified in Section 2.07(a).

"**Withdrawal Liability Escrow Account**" has the meaning specified in Section 3.01(c).

"**Withdrawal Liability Escrow Amount**" has the meaning specified in Section 2.07(b).

"**Withdrawal Liability Escrow Release Date**" has the meaning specified in Section 2.07(c).

"**Withdrawal Liability Payoff Amount**" has the meaning specified in Section 2.07(a).

| Other Defined Terms | Defined in Section: |
|--------------------------------|----------------------------|
| Act 11 | Section 7.09(a)(x) |
| Accounting Referee | Section 3.02(c)(iii) |
| Disputed Amounts | Section 3.02(c)(iii) |
| DOJ | Section 7.06(c) |
| Excluded Intellectual Property | Section 2.02(d) |
| Interim Financial Statements | Section 4.05 |
| Post-Closing Adjustment | Section 3.02(b)(ii) |

reflect the resolution of such Disputed Amounts. The Accounting Referee shall only decide the specific Disputed Amount, and the scope of the disputes to be resolved by such Accounting Referee shall be limited to fixing mathematical errors and determining whether the items in dispute were calculated and determined in accordance with the accounting principles and procedures set forth in this Agreement, and the Accounting Referee's decision for each Disputed Amount must be within the range of values assigned to each such item in the Closing Cash Statement and the Statement of Objections, respectively.

(iv) All fees and costs of the Accounting Referee will be borne pro rata by Buyer and the Seller in proportion to the difference between the Accounting Referee's determination of Post-Closing Adjustment and the Seller's and Buyer's determination of such Post-Closing Adjustment. For example, if the Seller's determination differs by \$20,000 from the Accounting Referee's determination, but Buyer's determination only differs by \$5,000, the Seller will bear 20/25 (or 80%) of such fees and costs and Buyer will bear 5/25 (or 20%) of such fees and costs.

(v) The Accounting Referee shall make a determination as soon as practicable within thirty (30) days (or such other time as the Parties shall agree in writing) after their engagement, and their resolution of the Disputed Amounts and their adjustments to the Closing Cash Statement and the Post-Closing Adjustment shall be conclusive and binding upon the Parties.

(vi) Payment of the Post-Closing Adjustment shall (A) be due (x) within five (5) Business Days following the expiration of the Review Period (if the Seller does not timely deliver a Statement of Objections) or (y) if the Seller timely delivers a Statement of Objections, then within five (5) Business Days following the earlier to occur of (1) written agreement of the Parties with respect to the resolution of all items in dispute, or (2) final resolution by the Accounting Referee; and (B) be paid by wire transfer of immediately available funds to such accounts as are directed in writing by Buyer or the Seller, as the case may be.

(d) Any payments made pursuant to this Section 3.02 shall be treated as an adjustment to the Purchase Price by the Parties for Tax purposes, unless otherwise required by applicable Law.

~~(e) Any payment or distribution to customers of the Variance Adjustment made pursuant to Section 7.07 shall be treated as an adjustment to the Purchase Price by the Parties for Tax purposes and any other purposes under applicable Law, unless otherwise required by applicable Law.~~

Section 3.03. **Allocation of the Purchase Price.** Buyer and the Seller agree that the Purchase Price (which for purposes of this Section 3.03 shall include any liabilities required to be treated as part of the Purchase Price for U.S. federal income Tax purposes), as may be adjusted pursuant to Section 3.02, shall be allocated among the Acquired Assets in accordance with the allocation reflected in a schedule prepared by Buyer in accordance with this Section 3.03 (the "Allocation Schedule") as required by the Code. Within sixty (60) days following the final

customers in the Service Area. However, the Parties acknowledge that Buyer shall have the reasonable discretion to address and agree to base rate increases and changes in rate design for wastewater customers in the Service Area in the context of settlement of the base rate case, subject to PaPUC approval and applicable Law.

~~(d) 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~~During the ten-year period following the Closing subsequent to the first base rate case filed by Buyer after the Effective Date as described in Section 7.07(c) above, subject to PaPUC approval and applicable Law, Buyer shall not propose any Rate Increases to be applicable to wastewater customers in the Service Area that would, taking into account all relevant facts and circumstances at such time, reasonably be expected to result in a 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~~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) (“~~Variance Adjustment~~”). ~~Seller shall review and advise Buyer within 30 days of Seller’s receipt of such statement of any problems or suggested modifications to the calculation of the Variance Adjustment and written statement. The Parties shall timely and in good faith, resolve any problems or suggested modifications to the Variance Adjustment identified by Seller or Buyer. Any dispute regarding the calculation of the Variance Adjustment shall be timely submitted for resolution to the office of a mutually acceptable nationally recognized firm specializing in utility ratemaking, other than consultants of Buyer or Seller or their Affiliates who, acting as experts and not arbitrators, shall resolve the dispute. The dispute shall be resolved within thirty (30) days and the costs of retaining the firm and resolving the dispute shall be shared equally by Buyer and Seller. Buyer shall make an adjustment, without interest or other penalty, to the Purchase Price in the amount of the Variance Adjustment, if any, in accordance with the procedures and timing set forth in Section 7.07(e).~~However, the Parties acknowledge that Buyer shall have the reasonable discretion to address and agree to Rate Increases for wastewater customers in the Service Area in the context of settlement of a particular Rate Increase proceeding, subject to PaPUC approval and applicable Law.

~~(e) 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 in the amount of the Variance Adjustment shall be paid directly to Seller or distributed to Buyer’s then-current wastewater customers in the Service Area. If Seller elects direct payment to itself, Buyer shall make such payment within thirty (30) days without further obligation. 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, Buyer shall at its sole cost and expense, subject to PaPUC approval and applicable Law, timely implement procedures and protocols reasonably acceptable to Seller and then make a one-time equal, flat-rate distribution to all customers then being served by Buyer in the Service Area their proportionate share of the Variance Adjustment as mutually agreed upon by Buyer and Seller. Buyer shall timely certify in writing to Seller when the distribution of the Variance Adjustment has commenced and been completed. 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), Buyer shall pay Seller an amount of \$2,500.00 per day for each day that all or any portion of the Variance Adjustment has been unpaid after 30 days following resolution of the calculation of the Variance Adjustment. The Parties intend that such damages constitute compensation, and not a penalty, and acknowledge and agree that the harm caused by the Buyer's breach of its obligations under this Section would be impossible or very difficult to accurately estimate, and that such damages are a reasonable estimate of the anticipated or actual harm that might arise from Buyer's breach of its obligations under this Section. In the event the PaPUC fails to allow distribution by Buyer to then-current Service area wastewater customers, Buyer shall also timely pay Seller the reasonable costs of (i) hiring a third party to administer and pay the Variance Adjustment to wastewater customers in the Service Area and (ii) establishing the processes and protocols to make such payment as described herein. Notwithstanding anything in this subparagraph to the contrary, Buyer shall have the right to reasonably approve the third party selected by Seller to administer and pay any Variance Adjustment to wastewater customers in the Service Area, but in no event shall such approval be unreasonably delayed, conditioned, withheld or denied.~~

~~(f) The Variance Adjustment shall be calculated in accordance with Schedule 7.07(d).~~

~~(g) If requested by the Seller (not more than once per year), no later than (60) days after such request, Buyer shall provide to the Seller a written statement showing (i) for the 12-month period ending on the most recently completed anniversary of the Closing Date, the projected Variance Adjustment calculated in accordance with Schedule 7.07(d) and (ii) the then-current Annual Variance (as defined in Schedule 7.07(d)). The written statement shall be provided for informational purposes only and shall not trigger an affirmative duty of Buyer to take a specific action, or be deemed to be any agreement or acquiescence of Seller to any of the data and information contained therein. The written statement referenced herein shall be substantially in the form of the Hypothetical Example contained in Schedule 7.07(d), along with reasonable supporting workpapers.~~

(e) ~~(h)~~ At the end of year ten (10) following the Closing Date, if the wastewater base rates for the Service Area are lower by customer class than the Average System Rates for wastewater service charged to Buyer's non-Service Area wastewater customers, Buyer may seek from the PaPUC base rate increases for Service Area wastewater customers that would be effective during years eleven (11) through thirteen (13) following the Closing that would equalize the base rates charged by Buyer to Service Area wastewater customers with Average System Rates effective for Buyer's non-Service Area wastewater customers throughout Pennsylvania. Buyer will attempt to implement the base rate increases over the three-year period in approximately one-third (1/3) increments each year, subject to PaPUC approval and applicable Law. However, the Parties acknowledge that Buyer shall have the reasonable discretion to address and agree to base rate increases for wastewater customers in the Service Area in the context of settlement of a base rate case, subject to PaPUC approval and applicable Law.

(f) ~~(i)~~ If during years eleven (11) through thirteen (13) wastewater base rates in the Service Area are higher by customer class than the Average System Rates for wastewater service charged to Buyer's other wastewater customers, Buyer shall not seek a base rate increase for the Service Area wastewater customers during this period. However, the Parties acknowledge that Buyer shall have the reasonable discretion to address and agree to base rate increases for wastewater customers in the Service Area in the context of settlement of a base rate case, subject to PaPUC approval and applicable Law.

(g) ~~(j)~~ If at the end of year ten (10) following the Closing Buyer's wastewater customers in the Service Area are not paying the same non-base rates (including the distribution system improvement charge) as Buyer's other customers being served under Average System Rates, Buyer will attempt to bring the non-base rates of customers in the Service Area into conformity with the non-base rates of the other customers being served under Average System Rates by the end of year thirteen (13) following the Closing, subject to PaPUC approval and applicable Law.

(h) ~~(k)~~ After year thirteen (13) following the Closing, the Parties acknowledge that Buyer may, subject to PaPUC restrictions and applicable Law, propose rate adjustments reasonably necessary to make the total rates (inclusive of base rates and non-base rates such as the distribution system improvement charge) for wastewater customers of the Service Area consistent with the total rates (inclusive of base rates and non-base rates such as the distribution system improvement charge) of Buyer's customers who are subject to Average System Rates.

~~(i) Solely for the purposes of any calculation of the projected or actual Variance Adjustment and the provisions of written statements related thereto pursuant to this Section 7.07, the "Closing Date" shall be deemed to have occurred on the date that is the last day of the month in which the Closing actually occurs.~~

Section 7.08. **Operation and Maintenance of the MS4 System.**

(a) General operation and maintenance obligations. Subject to applicable Law, the Seller, the City and the Borough, as the case may be, shall at all times maintain ownership of the MS4 System, the Stormwater System Assets and the City's NPDES Permit.

(b) Community-based Public-Private Partnership Approach for Integration of the MS4 System and the System. Following the Closing, Buyer shall cooperate with the City and the Borough, and use commercially reasonable good faith efforts to evaluate the feasibility of and develop a mutually-acceptable plan for financing, management and operation of the MS4 System in a manner that is consistent with the community-based public-private partnership approach described in Section 6 of Buyer's response to the Request for Best and Final Offers for the Purchase of the Seller's Sewer System and Sewage Treatment Works dated as of October 5, 2015, and in compliance with applicable Law.

Section 7.09. **Additional Agreements.**

(a) From and after the Closing Date and for a period of no less than ten (10) years following the Closing (except, in the case of clause (xi) of this Section 7.09(a), for such shorter

from the PaPUC (i) the issuance of certificates of public convenience to Buyer to provide wastewater services in the Service Area and the acquisition of the System by Buyer, (ii) approval of this Agreement and any other contractual arrangements between Buyer and municipalities for the provision of wastewater services in the Service Area in accordance with Section 507 of the Public Utility Code, 66 Pa. C.S. § 507, (iii) ~~approval to allow Buyer to implement procedures and protocols and then distribute the Variance Adjustment to wastewater customers being served by Buyer in the Service Area as provided in and limited by Section 7.07(e)~~, (iv) approval of Buyer's initial pro forma tariff applicable to Service Area customers, and (v) approval of a tariff supplement incorporating Buyer's Industrial Pretreatment Program applicable to the System into Buyer's tariff to be filed by Buyer during the course of the PaPUC proceeding. The Seller shall assist and cooperate with Buyer in connection with Buyer's performance of its obligations under this Section 7.12(a) in accordance with the Seller's obligations pursuant to Section 9.02 and Section 9.04.

(b) The Parties acknowledge and agree that Buyer shall be primarily responsible for prosecuting the PaPUC proceedings referenced in Section 7.12(a), that Buyer may establish reasonable processes and procedures for prosecuting the PaPUC proceedings to which Seller and its representatives shall be required to comply, and that Seller shall act with due diligence and dispatch in addressing all matters pertinent to the prosecution of the PaPUC proceedings so as to not prejudice the Parties' participation in that proceeding or the potential outcome thereof. Notwithstanding the foregoing, the Parties shall in good faith timely cooperate with each other in developing and implementing procedures and protocols for addressing all aspects of the PaPUC proceedings referenced in Section 7.12(a) including developing case strategy, pre-filing meetings with regulators and stakeholders, preparing all pleadings, responding to discovery, developing testimony, conducting evidentiary hearings, preparing briefs and other pleadings, etc. In the event of a good faith dispute between the Parties regarding strategy, tactics or other aspects of the PaPUC proceeding that cannot in the exercise of good faith and due diligence be resolved timely, Buyer shall have the right in such circumstances to take such action as it reasonably deems necessary consistent with this Agreement.

(c) Nothing contained herein shall preclude, consistent with Section 7.12(b), the filing for reconsideration of or appealing a PaPUC Final Order if the order contains terms or conditions that are not reasonably satisfactory.

(d) Notwithstanding anything to the contrary in this Agreement, in the event the PaPUC issues an order approving the transaction as contemplated by this Section 7.12 and if all other conditions precedent to Closing have been fully satisfied in accordance with the terms of this Agreement, the Parties may elect in their discretion and by mutual agreement to close on the transaction (i) notwithstanding a pending appeal or request for reconsideration with respect to such order or (ii) during the otherwise applicable appeal/reconsideration periods if no party has been aggrieved by the PaPUC order and the Parties reasonably believe there is little likelihood of a successful legal or other challenge to said PaPUC order.

Section 7.13. **Insurance.** To the extent that the Seller (with respect to the System or any Acquired Assets), the System or any Acquired Assets were insured under any occurrence-based insurance policies of the City or the Borough (or with respect to any Acquired Assets, any occurrence-based insurance policies of the Seller) prior to the Closing Date, following the

(a) Except as otherwise set forth herein and subject to Sections 15.13(b) and (c), neither Party hereto shall assign or delegate this Agreement or any rights or obligations hereunder without the prior written consent of the other Parties hereto, and any attempted assignment or delegation without prior written consent shall be void and of no force or effect. Subject to Section 15.13(b), this Agreement shall inure to the benefit of and shall be binding upon the successors and permitted assigns of the Parties hereto.

(b) With respect to any assignment or delegation permitted pursuant to Section 15.13(a) or in connection with any proposed sale, lease, liquidation or transfer of all or substantially all of the System or the Acquired Assets by Buyer, Buyer shall cause such assignee or successor to acknowledge and agree in writing for the benefit of Buyer and the Seller, to fully perform and be liable for all of Buyer's obligations set forth in Article VII, which obligations shall continue to be subject to the Seller's rights and remedies hereunder. ~~In the event of any assignment or delegation by Buyer of its rights and obligations under this Agreement to any Person, Buyer shall be fully liable to the Seller to the extent that such Person fails to pay or assist Seller in distributing to customers the Variance Adjustment as provided under this Agreement, and such assignment or delegation by Buyer to such Person shall in no event relieve Buyer of its obligations pursuant to this Section 15.13(b) in the event of any failure by such Person to pay or assist Seller in distributing to customers the Variance Adjustment in breach of this Agreement.~~

(c) The Parties hereto acknowledge and agree that the limitation on assignment or delegation contained in Section 15.13(a) in no way limits the rights or obligations of the City and the Borough, as the municipalities creating the Seller, under the Municipality Authorities Act. In the event of the termination of the Seller in accordance with the Municipality Authorities Act and other applicable Law following the Closing:

(i) the City and the Borough shall (x) obtain all property of the Seller and succeed to all of the Seller's rights under this Agreement, and (y) assume and be jointly and severally liable for all of the Seller's obligations under this Agreement (including with respect to the System), in each case as if the City and the Borough were originally direct parties hereto;

(ii) the City, or such other Person as may be designated by mutual written agreement of the City and the Borough (the City or such other Person, the "Seller Successor"), is hereby appointed to act as agent for and on behalf of the City and the Borough in connection with, and to facilitate, any and all transactions arising from, in connection with and incident to this Agreement;

(iii) a decision, act, consent or instruction of the Seller Successor shall constitute a decision of the Seller and shall be final, binding and conclusive upon each of the City and the Borough, and Buyer and the Escrow Agent may rely upon any decision, act, consent or instruction of the Seller Successor as being the decision, act, consent or instruction of the Seller, the City and the Borough;

(iv) Buyer and the Escrow Agent are hereby irrevocably relieved from any liability to any Person for any acts done by them in accordance with such decision, act, consent or instruction of the Seller Successor; and

(v) the Seller or the Seller Successor, as the case may be, shall constitute the sole point of contact for purposes of any notices to be given, consents to be obtained or other communications, by Buyer or Buyer's Affiliates pursuant to or in connection with this Agreement or any matters arising out of or relating hereto, and in no event shall Buyer be required or obligated in any way to give notice to, obtain the consent of or otherwise communicate with any Person other than the Seller or the Seller Successor.

Section 15.14. **Governing Law; Jurisdiction.** This Agreement shall be construed and enforced in accordance with, and governed by, the Laws of the Commonwealth of Pennsylvania (without giving effect to the principles of conflicts of laws thereof). The Parties hereto irrevocably agree and consent to the jurisdiction of the United States District Court for the Middle District of Pennsylvania, the Court of Common Pleas of Lackawanna County, Pennsylvania, and the PaPUC for the adjudication of any matters arising under or in connection with this Agreement. Any action initiated shall be filed and litigated (including all discovery proceedings) exclusively in the United States District Court for the Middle District of Pennsylvania, the Court of Common Pleas of Lackawanna County, Pennsylvania and the PaPUC, and each Party irrevocably submits to the jurisdiction of such courts and the PaPUC in any such suit, action or proceeding. Service of process, summons, notice or other document by mail to such Party's address set forth herein shall be effective service of process for any suit, action or other proceeding brought in any such court. EACH PARTY ACKNOWLEDGES AND AGREES THAT ANY CONTROVERSY WHICH MAY ARISE UNDER THIS AGREEMENT OR THE OTHER TRANSACTION DOCUMENTS IS LIKELY TO INVOLVE COMPLICATED AND DIFFICULT ISSUES AND, THEREFORE, EACH SUCH PARTY IRREVOCABLY AND UNCONDITIONALLY WAIVES ANY RIGHT IT MAY HAVE TO A TRIAL BY JURY IN RESPECT OF ANY LEGAL ACTION ARISING OUT OF OR RELATING TO THIS AGREEMENT, THE OTHER TRANSACTION DOCUMENTS OR THE TRANSACTIONS CONTEMPLATED HEREBY OR THEREBY. EACH PARTY TO THIS AGREEMENT CERTIFIES AND ACKNOWLEDGES THAT (A) NO REPRESENTATIVE OF ANY OTHER PARTY HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT SUCH OTHER PARTY WOULD NOT SEEK TO ENFORCE THE FOREGOING WAIVER IN THE EVENT OF A LEGAL ACTION, (B) SUCH PARTY HAS CONSIDERED THE IMPLICATIONS OF THIS WAIVER, (C) SUCH PARTY MAKES THIS WAIVER VOLUNTARILY, AND (D) SUCH PARTY HAS BEEN INDUCED TO ENTER INTO THIS AGREEMENT BY, AMONG OTHER THINGS, THE MUTUAL WAIVERS AND CERTIFICATIONS IN THIS SECTION. Notwithstanding the foregoing, this Section 15.14 shall not apply to the dispute resolution procedures set forth in ~~(i)~~ Section 3.02, which shall be the exclusive manner to resolve any dispute surrounding the determination of the Post-Closing Adjustment, *provided*, that, any dispute arising out of a breach of any of the provisions of Section 3.02 or a Party's failure to pay an amount determined to be due under Section 3.02 (and not out of a disagreement relating to the determination of such amounts) shall be resolved pursuant to this Section 15.14 ~~or (ii) Section 7.07(d), which shall be the exclusive manner to resolve any dispute regarding the calculation of the Variance Adjustment as set forth in Section 7.07(d), provided, that, any dispute arising out of a breach of any of the provisions of Section 7.07(d) (other than a disagreement relating to the calculation of the Variance Adjustment) shall be resolved pursuant to this Section 15.14.~~

SCHEDULE 7.07(d)
CAGR CALCULATION

Schedule 7.07(d)

1. Determine Base Year 0 Wastewater Annual Revenue and Billing Determinants from Scranton System Wastewater Customers at time of Closing Per Seller's Records = Year 0 Revenue Base at time of Closing. Billing determinants shall consist of a proof of revenues schedule for the 12 calendar months prior to Closing that includes, among other things, (i) the number of bills rendered for residential and non-residential customers; and (ii) number of gallons sold by rate block substantially in the format shown in Appendix A to this Schedule 7.07(d).
2. Calculate Wastewater Revenue from Scranton System Wastewater Customers at Year X (based on Year 0 billing determinants and PaPUC approved rates in Year X) = Year X Revenue
3. Multiply Year 0 Revenue Base by Cumulative CAGR for Year X = Year X CAGR Revenue

| Cumulative CAGR by Year | | |
|-------------------------|----------------|--------------------|
| Year | Annual CAGR | Cumulative CAGR |
| 1 | 1.900% | 1.900% |
| 2 | 1.900% | 3.836% |
| 3 | 1.900% | 5.809% |
| 4 | 1.900% | 7.819% |
| 5 | 1.900% | 9.868% |
| 6 | 1.900% | 11.955% |
| 7 | 1.900% | 14.083% |
| 8 | 1.900% | 16.250% |
| 9 | 1.900% | 18.459% |
| 10 | 1.900% | 20.710% |

| Hypothetical Example | | |
|----------------------|---|--|
| Year | Year X Revenues (PUC Approved Rates) | Year X CAGR Revenue (Cumulative CAGR) |
| 0 | | \$ 23,600,000 |
| 1 | \$ 23,600,000 | 24,048,000 |
| 2 | 23,600,000 | 24,505,000 |
| 3 | 24,190,000 | 24,971,000 |
| 4 | 24,780,000 | 25,445,000 |
| 5 | 24,780,000 | 25,929,000 |
| 6 | 26,639,000 | 26,421,000 |
| 7 | 27,305,000 | 26,923,000 |
| 8 | 27,971,000 | 27,435,000 |
| 9 | 27,971,000 | 27,956,000 |
| 10 | 30,069,000 | 28,487,000 |

Non-Binding Assumptions in Hypothetical Example - For Illustrative Purposes Only

1. Year X Revenues Assumes Base Rate Increases of 7.5% in Years 6 and 10
2. Year X Revenues Assumes a DISC of 2.5% in Years 3 and 7 and a DISC of 5% in Years 4 and 8

Appendix A
Schedule 7.07(d)

Sewer Authority of the City of Scranton

Example of billing determinants and proof of revenue

Date : XX/XX/XXXX

| Residential - Bi-Monthly Billing | No. of Bills (EDUs) | Usage In 1,000 gals | Rates | Revenues |
|---|------------------------|------------------------|----------|-------------------|
| Fixed Charge (Customer Charge) | 190,872 | | \$ 39.00 | \$ 7,444,008 |
| Vol. Charge (Per 1,000 gallons) | | <u>1,675,884</u> | 5.00 | <u>8,379,420</u> |
| Total Residential | 190,872 | 1,675,884 | | 15,823,428 |
| Commercial Monthly | | | | |
| <u>Apartments</u> | | | | |
| Fixed Charge (Customer Charge) | 8,448 | | 19.50 | 164,736 |
| Vol. Charge (Per 1,000 gallons) | | <u>94,938</u> | 5.00 | <u>474,690</u> |
| Subtotal | 8,448 | 94,938 | | 639,426 |
| <u>Commercial - Other than Apartments</u> | | | | |
| Fixed Charge (Customer Charge) | 37,560 | | 19.50 | 732,420 |
| Vol. Charge (Per 1,000 gallons) | | | | |
| Rate Blocks (per 1,000 gallons) | | | | |
| Up to 5 | | 61,347 | 5.00 | 306,735 |
| Over 5 | | <u>786,838</u> | 7.75 | <u>6,097,991</u> |
| Subtotal | 37,560 | 848,185 | | 7,137,146 |
| Total Commercial | 46,008 | 943,123 | | 7,776,572 |
| Total Residential and Non Residential | 236,880 | 2,619,007 | | \$ 23,600,000 |

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 Replies to Exceptions of the Joint Applicants, Pennsylvania-American Water Company and The Sewer Authority of the City of Scranton, to the Exceptions of the Office of Consumer Advocate, upon the parties, listed below, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a party).

VIA ELECTRONIC MAIL AND FIRST CLASS MAIL:

Allison C. Kaster, Esquire
Gina L. Lauffer, Esquire
Bureau of Investigation & Enforcement
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor West
P.O. Box 3265
Harrisburg, PA 17105-3265

Christine Maloni Hoover, Esquire
Erin L. Gannon, Esquire
Office of Consumer Advocate
555 Walnut Street
Forum Place, 5th Floor
Harrisburg, PA 17101-1923

Sharon E. Webb, Esquire
Office of Small Business Advocate
Commerce Building, Suite 202
300 North Second Street
Harrisburg, PA 17101-1303

John F. Povilaitis, Esquire
Alan Michael Seltzer, Esquire
Buchanan Ingersoll & Rooney PC
409 North Second Street, Suite 500
Harrisburg, PA 17101

R. Timothy Weston, Esquire
K&L Gates LLP
17 North Second Street, 18th Floor
Harrisburg, PA 17101

DATED: September 8, 2016



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

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

**ANTI-STATIC
MEDIA MAILER**

**PAWC/Scranton Sewer
Joint Applicants Replies to Exceptions
Docket No. A-2016-2537209
(September 8, 2016)**

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UNITED STATES US

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PA PUBLIC UTILITY COMMISSION
COMMONWEALTH KEYSTONE BLDG
400 NORTH STREET, 2ND FLOOR
HARRISBURG PA 17120

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2. Place the label in a waybill pouch and affix it to your shipment so that the barcode portion of the label can be read and scanned.
3. Keep the second page as a receipt for your records. The receipt contains the terms and conditions of shipping and information useful for tracking your package.

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Tendering packages by using this system constitutes your agreement to the service conditions for the transportation of your shipments as found in the applicable FedEx Service Guide, available upon request. FedEx will not be responsible for any claim in excess of the applicable declared value, whether the result of loss, damage, delay, non-delivery, misdelivery, or misinformation, unless you declare a higher value, pay an additional charge, document your actual loss and file a timely claim. Limitations found in the applicable FedEx Service Guide apply. Your right to recover from FedEx for any loss, including intrinsic value of the package, loss of sales, income interest, profit, attorney's fees, costs, and other forms of damage whether direct, incidental, consequential, or special is limited to the greater of 100 USD or the authorized declared value. Recovery cannot exceed actual documented loss. Maximum for items of extraordinary value is 500 USD, e.g. jewelry, precious metals, negotiable instruments and other items listed in our Service Guide. Written claims must be filed within strict time limits, see applicable FedEx Service Guide. FedEx will not be liable for loss or damage to prohibited items in any event or for your acts or omissions, including, without limitation, improper or insufficient packaging, securing, marking or addressing, or the acts or omissions of the recipient or anyone else with an interest in the package. See the applicable FedEx Service Guide for complete terms and conditions. To obtain information regarding how to file a claim or to obtain a Service Guide, please call 1-800-GO-FEDEX (1-800-463-3339).