

**PENNSYLVANIA PUBLIC UTILITY COMMISSION  
HARRISBURG, PENNSYLVANIA 17105-3265**

**Joint Application of Aqua America Inc., Aqua Pennsylvania Inc., Aqua Pennsylvania Wastewater Inc., and Peoples Natural Gas Company LLC for All of the Authority and Necessary Certificates of Public Convenience to Approve a Change in Control of Peoples Natural Gas Company LLC by Way of the Purchase of All of LDC Funding LLC's Membership Interests by Aqua America Inc.**

**PUBLIC MEETING: January 16, 2020  
3006061-OSA**

**Docket No. A-2018-3006061**

**Joint Application of Aqua America Inc., Aqua Pennsylvania Inc., Aqua Pennsylvania Wastewater Inc., and Peoples Natural Gas Company LLC Equitable Division for All of the Authority and Necessary Certificates of Public Convenience to Approve a Change in Control of Peoples Natural Gas Company LLC Equitable Division by Way of the Purchase of All of LDC Funding LLC's Membership Interests by Aqua America Inc.**

**Docket No. A-2018-3006062**

**Joint Application of Aqua America Inc., Aqua Pennsylvania Inc., Aqua Pennsylvania Wastewater Inc., and Peoples Gas Company LLC for All of the Authority and Necessary Certificates of Public Convenience to Approve a Change in Control of Peoples Gas Company LLC by Way of the Purchase of All of LDC Funding LLC's Membership Interests by Aqua America Inc.**

**Docket No. A-2018-3006063**

**STATEMENT OF COMMISSIONER ANDREW G. PLACE**

Before us for consideration and disposition is the Recommended Decision (R.D.) of Administrative Law Judge (ALJ) Mary D. Long, and the relevant Exceptions and Reply Exceptions that have been submitted by various participating parties. This matter concerns the acquisition and transfer of control of Peoples Natural Gas Company LLC, Peoples Natural Gas Company LLC – Equitable Division, and Peoples Gas Company LLC (collectively Peoples, PNG, or Peoples Companies), by Aqua America, Inc. (Aqua America), the parent corporation of Aqua Pennsylvania, Inc. and Aqua Pennsylvania Wastewater, Inc. (collectively Aqua PA). ALJ Long's R.D. has recommended the approval of a non-unanimous settlement petition (Non-Unanimous Settlement) that has been put forward by the Joint Applicants and most of the participating parties in this proceeding. This Non-

Unanimous Settlement is opposed by the Commission's Bureau of Investigation and Enforcement (I&E), and the Office of Small Business Advocate (OSBA).

I do not believe that this acquisition and the accompanying parameters of the Non-Unanimous Settlement provide the substantive net affirmative benefits that are required by statutory law and applicable legal precedent. The proposed transaction also includes a substantial goodwill, or acquisition premium, in the approximate amount of \$2 billion. The Non-Unanimous Settlement terms have attempted to "ring fence" the Pennsylvania regulated operations of Aqua PA and the Peoples Companies from the potential effects of this goodwill acquisition premium. However, goodwill acquisition premiums of such magnitude possess their own and often unpredictable dynamics. Thus, I gravely doubt that the terms of the Non-Unanimous Settlement will be able to timely and adequately safeguard the interests of the regulated operations of Aqua PA and the Peoples Companies and their respective Pennsylvania ratepayers. Consequently, I believe that the proposed transaction is not in the public interest and should not be approved.

#### **A. Absence of Synergistic Cost Savings**

The Joint Applicants have not demonstrated "any quantified cost savings that would occur as a result of the change in ownership"<sup>1</sup> of the Peoples Companies. This is not surprising since Aqua America is a parent corporation of primarily regulated water and wastewater public utilities and the Peoples Companies are primarily engaged in the regulated operations of natural gas distribution services. Consequently, and in accordance with the terms of the Non-Unanimous Settlement, while "there may be some cost savings over time, in the short term the utility subsidiaries will be operated as separate business units and administrative functions will not be combined."<sup>2</sup> Thus, merger synergies are clearly not part of the affirmative net public benefits that would be accrued as a result of the proposed transaction. In recognition of the lack of cost savings, the settling parties have agreed to a comparatively minor, one-year bill credit of \$10 million, shared across all regulated companies, and various other minor shareholder funded contributions to various utility programs. I find these provisions pale in comparison to the financial exposure and potential inefficient capital spending created by the Merger and accompanying Non-Unanimous Settlement, as more fully described below. Thus, "any benefit from a one-time rate credit of \$10 million is eclipsed by the negative effects of the Proposed Transaction" and "while a near-term credit is welcome, there are no longer-term cost savings or rate credits to offset the negative impacts of the Proposed Transaction." Consequently, as "the Proposed Transaction will cost customers much more than they are currently paying, a one-time rate credit is not an affirmative public benefit of the Proposed Transaction."<sup>3</sup>

#### **B. Goodwill Acquisition Premium**

The goodwill acquisition premium of \$2 billion associated with the acquisition of the Peoples Companies presents the most serious challenge to the future viability of the proposed transaction and the financial stability of Aqua America. It also presents a challenge for the regulated operations of Aqua PA and Peoples and their respective ratepayers in Pennsylvania. The Non-Unanimous Settlement contains a number of terms and conditions intended to "ring fence" and safeguard the regulated operations of these public utilities from the potential effects of this substantial goodwill

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<sup>1</sup> OCA St. No. 2, Direct Testimony of Ralph C. Smith, at 27 (non-proprietary text, emphasis in the original).

<sup>2</sup> R.D. at 41.

<sup>3</sup> OSBA Exceptions at 29.

acquisition premium. However, these safeguards are not absolute and are not able to comprehensively address the risks that this \$2 billion premium presents.

The goodwill acquisition premium at issue will be recorded in the accounts of the parent corporation Aqua America. However, credible testimony in the record indicated the following:

Large amounts of Goodwill — which are intangible assets that *do not earn a return* and which are not amortized — can present a challenge for the acquiring company's management in a number of respects. Goodwill is *not used or useful* in the provision of utility service. Having large amounts of such assets on the books also requires the acquiring company to finance those assets by having long term capital sources such as debt and equity on the liabilities and shareholder equity side of its balance sheet. Impairments of Goodwill can result in large losses and can lead to recorded amounts of equity capital. The reason is that when a company records a Goodwill impairment, it is basically telling the market that the value of the acquired assets has fallen below what the company generally paid for them.

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In summary, Goodwill can represent a large amount of a company's net worth, and acquisitions can involve the purchase of estimated future earnings streams that are difficult to estimate accurately and result in purchase premium amounts for Goodwill that may turn out over time to have been estimated inaccurately.<sup>4</sup>

The same testimony states that the "amount of Goodwill that is expected to be recorded for this transaction of approximately \$2 billion would appear to dwarf amounts of Goodwill previously recorded by Aqua America and its subsidiaries." It further indicates that the "presence of a very large amount of Goodwill on the books of the acquiring Company may be expected to impact decision making by creating pressures on management to attempt to generate other means of improving earnings *to achieve a return on and of the recorded Goodwill amounts*," and contains numerous examples where goodwill premiums in a number of acquisition transactions became impaired.<sup>5</sup>

It is commonly understood and accepted that when goodwill acquisition premiums that are recorded at the acquiring holding company level become impaired, the negative financial consequences of such impairment can and will affect the subsidiaries of the holding company. For example, the incremental cost rates for borrowing long-term debt (including borrowing to refinance existing debt) will invariably be higher both for the parent holding company and its subsidiaries. Any impairment of the goodwill recorded at the Aqua America level will inevitably increase the cost of capital for Aqua PA and the Peoples Companies regulated operations in Pennsylvania with inimical effects for their respective ratepayers, or could place pressure on Aqua America's management to cut operations and management costs of its operating utility companies — potentially threatening the long-term adequacy, safety and reliability of service. While the Non-Unanimous Settlement does contain provisions for maintaining or improving various utility services, these provisions lack any penalties for non-performance, and thus appear ineffective in practice.<sup>6</sup>

<sup>4</sup> OCA St. No. 2, Direct Testimony of Ralph C. Smith, at 43, 45-46 (non-proprietary text, emphasis added).

<sup>5</sup> OCA St. No. 2, Direct Testimony of Ralph C. Smith, at 46-48, 49-50, (non-proprietary text, emphasis added), and Attachment RCS-5 (non-proprietary).

<sup>6</sup> The Commission has general authority to require utilities to provide safe, reliable and adequate service. 66 Pa. Code § 1501. The Merger and Non-Unanimous Settlement do not modify that authority. However, all of these provisions, absent

Furthermore, there are no assurances that the financial “ring fencing” under the Non-Unanimous Settlement would be able to prevent such an occurrence.

First, the Non-Unanimous Settlement terms may not be permanent. For example, certain cross-financing arrangements, debt guarantees, or asset pledges, cannot take place “without prior Commission approval.”<sup>7</sup> Such “prior Commission approval” can be sought and obtained especially if potential goodwill impairment at the Aqua America level will create negative financial implications for the regulated operations of Aqua PA and Peoples in Pennsylvania. Such an outcome would confirm the premise that these regulated operations and their respective ratepayers have assumed the rather large risk of the presently proposed transaction without any commensurate affirmative net benefits.

Second, the Non-Unanimous Settlement “ring fencing” conditions are not comprehensive. Aqua America will be entitled to receive dividend payments from the regulated operations of Aqua PA and Peoples in the ordinary course of business where such dividends will be generated either through the net income of these regulated public utility subsidiaries and/or through their individual borrowing.<sup>8</sup> It will be difficult both for the Non-Unanimous Settlement parties (other than the Joint Applicants) and the Commission to monitor and ascertain whether such dividend payments will be at a level consistent with the net income of Aqua PA’s and Peoples’ regulated operations, or constitute in part “a return on and of the recorded Goodwill amounts.” The Commission could potentially intervene only if the incentive to generate such dividends at the regulated public utility subsidiary level would lead to a reduction in operation and maintenance expenses with a subsequent, noticeable and reported reduction in the adequacy, reliability, and safety of the provided services under Section 1501 of the Public Utility Code. 66 Pa. C.S. § 1501.

Finally, it should be noted that the goodwill acquisition premium of approximately \$2 billion is more than 80% in excess of the base purchase price of \$2.275 billion for the proposed transaction.

### **C. Goodwin and Tombaugh System Rehabilitation**

I have serious concerns regarding the inclusion of the commitments of the Peoples Companies for the full rehabilitation of the Goodwin and Tombaugh Gathering Systems (G&T System) in this Non-Unanimous Settlement.<sup>9</sup> In 2013, the Commission approved a full settlement (2013 Settlement) which included directives for action on these two gathering systems.<sup>10</sup> The 2013 Settlement included

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clear voluntary penalties, merely maintain the status quo. Thus, there are no affirmative benefits from the service quality provisions in the Non-Unanimous Settlement.

<sup>7</sup> Docket Nos. A-2018-3006061 *et al.*, Joint Petition for Approval of Non-Unanimous, Complete Settlement Among Most Parties, filed June 26, 2019, ¶ 49, at 10.

<sup>8</sup> See, e.g., *Securities Certificate of Aqua Pennsylvania, Inc. with respect to the issuance of debt in principal amount not to exceed \$125 million*, Docket No. S-2019-3012500, Order entered October 24, 2019 at 2 (issuance of long-term debt and payment of \$5.5 million dividend to Aqua America).

<sup>9</sup> The Goodwin and Tombaugh Gathering Systems total approximately 379 miles of natural gas gathering pipeline and appurtenant facilities in Greene and Washington Counties. There are approximately 1,602 end-use gas customers served from these lines who are utility customers.

<sup>10</sup> *Joint Application of Peoples Natural Gas Company LLC, Peoples TWP LLC, and Equitable Gas Company LLC for all of the authority and the necessary certificates of public convenience (1) to transfer all of the issued and outstanding limited liability company membership interest of Equitable Gas company LLC to PNG Companies LLC (2) to merge Equitable Gas Company LLC with Peoples Natural Gas Company LLC (3) to transfer certain storage and transmission assets of Peoples Natural Gas Company LLC to affiliates of EQT Corporation (4) to transfer certain assets between Equitable Gas Company, LLC and affiliates of EQT Corporation (5) for approval of certain ownership changes associated with the transaction (6) for approval of certain associated gas capacity and supply agreements, and (7) for approval of certain*

\$5 million for the investigation of the condition of the systems including repairing leaks and preparing an assessment. After the completion of the required assessment, the 2013 Settlement directed that Peoples and PNG Gathering meet with the public advocates, including the Commission's Gas Safety Division, to discuss options including presenting a plan to the Commission. The required periodic updates were filed in accordance with the 2013 Settlement. The last update indicated that Peoples is prepared to discuss the matter with the public advocates and to develop a plan to be filed with the Commission.

The disposition of the G&T System issues presented here in the Aqua America and Peoples Companies Non-Unanimous Settlement is not supported by I&E and the OSBA. Specifically, OSBA submits that the issues concerning the rehabilitation of these gathering systems do not belong in this proceeding. Additionally, the record in this case does not demonstrate that complete replacement of the G&T System is cost effective. Full replacement will result in an estimated net present value cost to ratepayers of \$91.7 million (before the one-time \$13 million rate credit). The Commission has already provided specific directives regarding these lines, and under that earlier docket, a previous methodology was put in place. Further, the record here does not indicate that all parties involved in the 2013 Settlement were provided service of this instant non-unanimous settlement. I believe this may raise due process issues with respect to a finding that Peoples has already complied with the 2013 Settlement in the context of the present transaction.

Additionally, the \$120 million "price cap", is not an actual firm cap<sup>11</sup> on the G&T System rehabilitation costs, but rather the Settlement states that if an agreement cannot be reached [if costs exceed \$120M], Peoples will submit a filing to the Commission for a decision on amounts over \$120 million and that all parties retain their rights to challenge or support such a filing. Accordingly, I do not support the Non-Unanimous Settlement as it relates to the inclusion of the rehabilitation of the G&T System in this proposed transaction.

#### **D. Affirmative Net Public Benefits**

The documented absence of any readily available and quantified merger acquisition synergies presents the major issue whether the transaction produces substantial net affirmative benefits. The continuation of the status quo, the structural separation of the Aqua PA and Peoples regulated operations, and the provision of services to the public in accordance with the provisions of the Public Utility Code and this Commission's regulations do not constitute affirmative net public benefits and cannot be labelled as such. For example, the argument that the Peoples Companies' reversion to "public ownership" constitutes an affirmative net public benefit holds no merit. Specifically, both Aqua PA and the Peoples Companies, as future direct or indirect subsidiaries of Aqua America, will not have any publicly traded common stock securities of their own. Consequently, their potential common equity financing will continue to depend on the issuance of common stock securities at the parent corporation level and the allocation of the relevant proceeds. Furthermore, because of their

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*changes in the tariff of Peoples Natural Gas Company LLC, Docket Nos. A-2013-2353647, A-2013-2353649, A-2013-2353651, Order entered Nov. 14, 2013.*

<sup>11</sup> I&E believes that the \$120 million estimate for full replacement, a cost of approximately \$326,090 per mile (\$120 million /368 miles), contained in the Settlement is artificially low; therefore, ratepayers are likely at risk for much more than what is agreed upon. I&E Exceptions at 8 (non-proprietary data).

public utility status, the regulated operations of Aqua PA and Peoples are already subject to applicable reporting requirements under the regulatory oversight of this Commission.<sup>12</sup>

Similarly, although there may be an incremental benefit (especially in terms of increased levels of public safety), the contemplated acceleration of Peoples' long-term infrastructure improvement plan (LTIIP) will be compensated by the ratepayers of PNG's regulated operations. Moreover, since the PNG regulated operations are already under an existing affirmative obligation to provide adequate, reliable and safe public utility services, the LTIIP acceleration can hardly be named as an affirmative net public benefit, as this acceleration can be achieved absent any merger agreement.

Paragraphs 51 and 52 of the Non-Unanimous Settlement provide that the Peoples Companies and Aqua PA will maintain a debt ratio measured at an annual level of no more than 50% (inclusive of short-term debt, but exclusive of goodwill) for at least five years post-closing. While there may be a benefit to having the parent company not to be overleveraged in terms of the future cost of long-term debt, the record in this case is devoid of providing any foundation establishing this maximum level of debt as the optimal capital structure for these operating utility companies. Given the lower cost of current long-term debt, this provision of the Non-Unanimous Settlement could actually increase the utility cost of service, and thus has no affirmative benefit.

Other provisions of the Non-Unanimous Settlement seek to ameliorate potential negative impacts of the Merger, such as workforce reductions, newly created Goodwill, transaction or transition costs, potential reductions in the acquisition and rehabilitation of troubled Commission regulated water and wastewater systems, tax and accounting impacts, failure to execute on Peoples Unaccounted For Gas Mitigation Plan and existing LTIIP Plan, potential loss of utility employee leadership and experience, potential loss of company headquarters, call centers, collective bargaining agreements, Universal Service and corporate contributions, and need for representation of natural gas expertise on the Board. However, in aggregate the ameliorants do not offset the costs. As noted above, some very minor increases in low income program shareholder contributions are offered for a limited duration, and virtually any service improvement provision articulated in the Non-Unanimous Settlement has no consequence for non-performance.

For the above-referenced reasons, I do not favor the approval of the proposed transaction and the Non-Unanimous Settlement that is before us today.

**Dated: January 16, 2020**

  
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Andrew G. Place, Commissioner

<sup>12</sup> OSBA M.B. – Public Version at 17-18.