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February 1, 2021

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
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Re: Application of Aqua Pennsylvania Wastewater Inc.
pursuant to Sections 507, 1102 and 1329 of the
Public Utility Code for Approval of its Acquisition
of the Wastewater System Assets of the Delaware
County Regional Water Quality Control Authority
Docket No. A-2019-3015173

Dear Secretary Chiavetta:

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

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

Respectfully submitted,

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*303165

CERTIFICATE OF SERVICE

Re: Application of Aqua Pennsylvania Wastewater :
Inc. pursuant to Sections 507, 1102 and 1329 :
of the Public Utility Code for Approval of its : Docket No. A-2019-3015173
Acquisition of the Wastewater System Assets :
of the Delaware County Regional Water Quality :
Control Authority :

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

Dated this 1st day of February 2021.

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*303164

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

In re: Application of Aqua Pennsylvania :
Wastewater Inc. pursuant to Sections 507, 1102 :
and 1329 of the Public Utility Code for : Docket No. A-2019-3015173
Approval of its Acquisition of the Wastewater :
System Assets of the Delaware County :
Regional Water Quality Control Authority :

REPLY EXCEPTIONS OF
THE OFFICE OF CONSUMER ADVOCATE

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I. INTRODUCTION

The Office of Consumer Advocate (OCA) submits this Reply to the Exceptions of Aqua Pennsylvania Wastewater, Inc. (Aqua) and the Delaware County Regional Water Quality Control Authority (DELCORA or Authority). If the Commission approves the Application under Sections 507, 1102 and 1329, the OCA submits that its proposed conditions should be adopted, including the OCA's proposed adjustments to the appraisals.

II. EXCEPTIONS

Reply to DELCORA Exc. Nos. 2, 3 and Aqua Exc. No. 6: The OCA Recommends the PUC Deny the Application because the Harms Outweigh the Benefits. OCA M.B. at 26-28, 37; OCA R.B. at 26-27.

In its Exceptions, DELCORA incorrectly asserts "the Commission should note that although the Bureau of Investigation and Enforcement and the Office of Consumer Advocate critique the proposed irrevocable trust arrangement, both agencies do not outright oppose application approval in this case." DELCORA Exc. at 19-20. Regarding the OCA, this statement is incorrect. The OCA affirmatively opposes the transaction. As stated in its Main Brief:

The OCA recommends that the Commission deny the application, as filed, on the basis that the acquisition as proposed by the Applicant would create significant additional costs and presents significant risks to Pennsylvania ratepayers and would not provide substantial affirmative public benefits.

OCA M.B. at 26. Additionally, the OCA in its Reply Brief stated:

Aqua has not established, under Section 1102 and 1103, that the transaction provides any substantial, affirmative public benefit to the existing Aqua customers. Instead, the record shows that both Aqua's current customers and the DELCORA customers could suffer considerable harm. The OCA submits that the Commission must deny the Application.

OCA R.B. at 26.

As explained more fully in the OCA's testimony and Briefs, the purported benefits identified by Aqua and DELCORA in their Exceptions do not address or outweigh the corresponding harm and risk to existing Aqua wastewater and water customers, and to the DELCORA customers, from the significant additional costs created by the proposed transaction. Aqua Exc. at 27-40; DELCORA Exc. at 22-26. DELCORA's customers will likely experience large rate increases in future Aqua base rate cases after the rate stabilization fund (DELCORA Customer Trust) is depleted. OCA St. 1 at 31; OCA M.B. at 27-28. Additionally, to the extent that DELCORA customers are not paying full cost of service, Aqua's existing water and wastewater customers will bear the difference between the DELCORA rates and the DELCORA cost of service. OCA St. 1SR at 23; OCA M.B. at 37.

Thus, the OCA's primary recommendation is that the Commission should deny the Application as proposed and Aqua Exception No. 6 and DELCORA Exceptions Nos. 2 and 3 should be denied. If, however, the Commission determines to approve the Application, its approval should include the adoption of appropriate and necessary conditions, including those recommended by the OCA to limit ratepayer exposure to the risks of the acquisition and to ensure that ratepayers receive a fair allocation of the benefits of the acquisition.

Reply to Aqua Exc. Nos. 2, 4, 7: If Aqua's Application Is Approved, All of the OCA's Recommended Section 1102 and 1103 Conditions Are Supported by the Record and Should Be Adopted.
OCA M.B. at 23-41; OCA R.B. at 19-28.

Under Sections 1102 and 1103 of the Public Utility Code, the standard for reviewing the benefits of an application is whether the transaction will provide substantial, affirmative benefits to the public. City of York v. Pa. PUC, 295 A.2d 825, 828 (Pa. 1972); 66 Pa. C.S. §§ 1102, 1103. The transaction must affirmatively promote the service, accommodation, convenience or safety of the public in some substantial way; the mere absence of any adverse effect is not sufficient. 295

A.2d at 828. When the “public interest” is considered, the benefits and detriments to all affected parties must be considered. See Middletown Twp. v. Pa. PUC, 482 A.2d 674, 682 (1984).

The ALJs recommended that the Commission deny Aqua’s Application and did not address the conditions proposed by the OCA in the event the Application is granted. R.D. at 19-20. In its Exceptions, Aqua acknowledges that Section 1103 of the Code provides that, in granting a Certificate of Public Convenience, the Commission may impose such conditions as it may deem to be just and reasonable. Further, Aqua contends that it “agreed to many conditions proposed by other parties, notably, several conditions proposed by OCA, and proposed still further conditions for the Commission to consider and impose in approving the Proposed Transaction.” Aqua Exc. at 40-41. Aqua goes on to discuss the OCA’s proposed conditions at length, specifically which conditions it agrees with, and which it does not. Id. at 41.

As discussed above, the filed-for transaction would create significant additional costs and presents significant risks to Pennsylvania ratepayers that are not addressed or outweighed by the purported benefits claimed by Aqua and DELCORA. This makes it imperative that, if the Commission approves the acquisition, conditions be imposed to limit ratepayer exposure to the risks and ensure that ratepayers receive a fair allocation of the benefits. The OCA’s recommended conditions are as follows:

- 1) The 12.55% average rate increase for DELCORA ratepayers that Aqua has estimated could occur in the next Aqua wastewater rate case should be mitigated to avoid rate shock associated with the change in ownership. The DELCORA Customer Trust Fund (or some acceptable alternative) should be used to limit the annual rate increases to DELCORA waste water utility customers under Aqua ownership to no more than 3 percent annually, until the approximated \$200 million projected for funding the DELCORA Customer Trust (or some acceptable alternative) has been fully applied for such rate increase mitigation purposes.
- 2) While the Trust is functioning to limit increases to DELCORA customers, the DELCORA customers should be a separate rate zone. The separate rate zone and its separate cost of service study should remain an obligation at least as long as the Trust provides the rate mitigation.

- 3) At the time of filing its next base rate case, Aqua shall submit a cost of service study that removes all costs and revenues associated with the operations of the DELCORA wastewater system. Aqua shall also provide a separate cost of service study for the DELCORA system at the time of the filing of Aqua's next base rate case.
- 4) While the Trust (or some acceptable alternative) is in place and providing rate mitigation for former DELCORA customers, the DELCORA rate zone will reflect the full cost of service and related revenue requirement for that rate zone and no costs will be shifted outside of that rate zone.
- 5) Consistent with Aqua's proposal, when Aqua modifies its LTIP to include the DELCORA wastewater utility, any DELCORA-related projects reflected in the revised LTIP should be in addition to, and not reprioritize, any capital improvements that Aqua was already committed to undertake for existing customers.
- 6) DELCORA must address convincingly whether it has the legal authority to transfer the wastewater utility assets and related contracts to Aqua.
- 7) DELCORA must provide clarity as to how the DELCORA Rate Stabilization Fund Trust Agreement between DELCORA as Settlor and Univest Bank and Trust Co. As Trustee, with the Effective Date of December 27, 2019 will function to insulate DELCORA wastewater customers from rate increases.
- 8) Aqua and DELCORA should revise the MOU to add details regarding how the Trust proceeds will be properly credited to the former DELCORA customers as set forth in responses to OCA and County discovery.
- 9) The customer assistance payments from the DELCORA Customer Trust on Aqua's billings to DELCORA wastewater utility customers should be separately shown on the bills to help make this part of the public benefit transparent to the DELCORA wastewater utility customers who are receiving the bill assistance.
- 10) The operation of the DELCORA Customer Trust, i.e., the DELCORA Rate Stabilization Fund should be reviewed and monitored in quarterly reports which show how amounts are being applied to reduce the Aqua rate increases to DELCORA wastewater utility customers that would be occurring under Aqua ownership.
- 11) In the period from the date when the acquisition is consummated through the effective date of new rates for the acquired DELCORA wastewater utility customers in Aqua's next base rate case, the impact on income tax expense from repairs deductions claimed by Aqua on DELCORA wastewater utility system assets should be recorded in a regulatory liability account and addressed in Aqua's next base rate case in which rates for the acquired DELCORA wastewater utility customers are addressed.

- 12) The issues being raised by some of the resale customers' resale transfer of the agreements should be resolved before the transaction can close. Those agreements are tied to expected revenues.

OCA M.B. at 40-41; OCA R.B. at 26-27; OCA St. 1 at 11; OCA St. 1 at 28-29.

All of the OCA's recommended conditions are supported by the record and many have been imposed by the Commission in prior Section 1329 proceedings. OCA M.B. at 36-41; OCA St. 1 at 31; OCA St. 1SR at 22-23, 26, 28; McCloskey v. Pa. PUC, 195 A.3d 1062-63, 1064 (Pa. Commw. 2018) (New Garden); Application of Aqua Pennsylvania Wastewater, Inc., A-2019-3008491, Order at 86-87 (Nov. 5, 2019) (Cheltenham). Aqua agreed with most of the OCA's recommended conditions and, below, the OCA responds to Aqua's arguments with regard to the remaining four conditions. Aqua Exc. at 41-42. For the reasons discussed above and in the OCA's Briefs, the OCA submits that the Commission should adopt all of the recommended conditions if it determines to approve the Application.

A. It Is Appropriate to Establish a Separate Rate Zone for DELCORA Customers.

Aqua argues that OCA's recommendation of a separate rate zone is not appropriate because it would be improper to establish a cost allocation methodology for DELCORA rates in this current proceeding. Aqua Exc. at 41. Additionally, Aqua contends the OCA would have the opportunity to address this issue and make any proposal in the context of a future Aqua base rate proceeding. Id. Still, Aqua agrees with the OCA that a separate Cost of Service Study (COSS) will remain an obligation for at least as long as the Trust provides the bill assistance payments. Id.

Regarding the rate zone, Aqua's effort to postpone addressing this issue until the next rate case is improper. OCA witness Smith makes clear in testimony, that although Aqua references economies of scale, the Company has not provided any showing of cost reductions or efficiencies that will be produced by the acquisition of the DELCORA customers. OCA St. 1 at 31; OCA M.B.

at 37. Simply having more customers does not create economies of scale. Stated otherwise, if the DELCORA customers do not pay even their full cost of service, they will not share the costs of infrastructure improvements for other parts of Aqua's service territory. OCA St. 1 at 31; OCA St. 1SR at 28; OCA M.B. at 37. The development of the rates to be established for the acquired DELCORA customers would presumably be informed by the results of the separate COSS. Id.

Having a separate rate zone for the acquired DELCORA customers would therefore facilitate the development of the rates based on the separate COSS and would also facilitate transparency with the Application of the funds from the DELCORA Customer Trust. OCA St. 1SR at 23. Mr. Smith goes on to testify:

The acknowledgement that a separate rate zone for acquired DELCORA customers is needed for the above-stated reasons would not pre-determine the specific rate design for that rate zone. The details of rate development for that separate DELCORA rate zone would then subsequently be addressed in the future Aqua base rate proceedings that included the acquired DELCORA wastewater customers. Consequently, I continue to recommend that establishing a separate rate zone for acquired DELCORA customers be included as a condition to approving the proposed transaction.

Id. Thus, OCA witness Smith recommends while the Trust is functioning to limit increases to DELCORA customers, the DELCORA customers should be a separate rate zone.

As such, if the Commission approves the acquisition, the approval should be conditioned on a requirement that Aqua establish a separate rate zone for the DELCORA system now. OCA St. 1 at 31; OCA St. 1SR at 28. While the Trust (or some acceptable alternative) is in place and providing rate mitigation for former DELCORA customers, the DELCORA rate zone should reflect the full cost of service and related revenue requirement for that rate zone with no costs shifted outside of that rate zone.

B. DELCORA Has Yet to Convincingly Address Whether It Has the Legal Authority to Transfer the Wastewater Utility Assets and Related Contracts to Aqua.

Aqua argues in its Exceptions that DELCORA's testimony "convincingly addressed its legal authority" to transfer the wastewater utility assets and related contracts to Aqua. Aqua Exc. at 42. This confidence is misplaced as the transaction between Aqua and DELCORA remains a contested legal issue. OCA St. 1 at 44; OCA M.B. at 32. Specifically, Delaware County disputed the legality of the Asset Purchase Agreement and Trust in the Court of Common Pleas and several municipal customers filed lawsuits "to assert certain property interests that conflict with DELCORA's representations in the [Asset Purchase Agreement]. R.D. at 16; OCA St. 1 at 44; OCA M.B. at 33. These proceedings are in various stages of litigation and/or resolution. R.D. at 19; Tr. 441-43. The ongoing legal questions will impact the Application and could come into conflict with the Commission's determination in this proceeding. Id.

Explicitly, OCA witness Smith advises that approval of the Application without a resolution of the issues identified in the Petition filed in the Court of Common Pleas could lead to irreparable harm for existing Aqua and DELCORA customers. OCA St. 1 at 44; OCA M.B. at 33. The Court of Common Pleas proceedings encompass the same Asset Purchase Agreement as the instant proceeding and include many of the same parties in the instant case, including Aqua and DELCORA. Id.; R.D. at 19. The ALJs properly concluded that DELCORA must address convincingly whether it has the legal authority to transfer the wastewater utility assets and related contracts to Aqua before the transaction can close.

C. The Trust Agreement Is Not Clear Regarding the Establishment of the Trust and its Exclusive Use for the Benefit of Former DELCORA Wastewater Customers and New Customers in the Former DELCORA Service Territory.

Aqua disagrees with OCA witness Smith's assessment that the Trust and its governing documentation need to be clarified prior to approval of Aqua's Application. Aqua Exc. at 42.

Specifically, Aqua argues the “The Trust Agreement is clear both regarding the establishment of the Trust and its exclusive use for the benefit of former DELCORA wastewater customers and new customers in the former DELCORA service territory.” Aqua Exc. at 42.

As explained in OCA’s Main Brief, viewed in the best light, the DELCORA Customer Trust would reduce the impact of Aqua’s bills by crediting the difference between the PUC approved rates Aqua charges to the former DELCORA customers and the 3% annual cap on increases outlined in the APA. OCA St. 1 at 42; OCA M.B. at 33-34. Significantly, OCA witness Smith points out that the 3% referenced is not stated in a tariff. OCA St. 1 at 42. Moreover, as further explained in OCA’s Main Brief, DELCORA explained that the parties can update the governing Memorandum of Understanding (MOU) to include “checks and balances” of the commitment to the 3% annual increase limit, if the Commission approves Aqua’s proposal to include a customer assistance payment on DELCORA customer bills. Id. at 43; OCA M.B. at 34. Regarding the governing documents, if the Commission does not approve Aqua’s proposal to apply Trust disbursements as customer assistance payments on DELCORA customer bills, DELCORA responded:

DELCORA signed an Asset Purchase Agreement with Aqua. DELCORA has decided to use the proceeds of the sale to be applied to DELCORA customer bills for the benefit of DELCORA customers. If the customer assistance payment cannot be included on DELCORA customer bills, DELCORA will explore different options whereby the Trust assets will be distributed directly to customers, consistent with the signed irrevocable Trust Agreement.

OCA St. 1 at 43. As a result of this ambiguity, OCA witness Smith testified that DELCORA must provide clarity as to how the DELCORA Rate Stabilization Fund Trust Agreement between DELCORA as Settlor and Univest Bank and Trust Co. as Trustee, with the Effective Date of December 27, 2019 will function to insulate DELCORA wastewater customers from rate increases. OCA St. 1 at 41, 67.

D. Aqua Must File Quarterly (Not Annual) Reports Demonstrating How Customer Bill Assistance Payments Are Being Applied on Aqua's Bills to DELCORA Customers.

Aqua asserts that it is willing to file annual reports, but not the quarterly reports that Mr. Smith recommended in his testimony. Aqua Exc. at 42; Aqua M.B. at 56. Aqua's Briefs and Exceptions lack any discussion as to why annual reports are, in its opinion, more appropriate than OCA's recommended quarterly reports. Conversely, through Mr. Smith's testimony, OCA's Main Brief describes in great detail why quarterly reporting is required to ensure that the DELCORA commitment to use the proceeds of the transaction to benefit customers is being achieved. OCA St. 1 at 40, 67; OCA M.B. at 35-36. In response to Aqua, Mr. Smith testified:

To assure that the payments are being properly applied from the inception, I recommend that quarterly reports be required at least for the first full year of DELCORA Customer Trust operation. If it is determined at the end of the first full year of such operation that the Trust is operating as intended without any concerns, problems or issues, the reporting after that point could revert to annual reporting.

OCA St. 1SR at 25. Additionally, the reports should also show how the DELCORA Customer Trust amounts are being applied to reduce the Aqua rate increases to DELCORA wastewater utility customers that will be occurring under Aqua ownership. Id.; OCA M.B. at 36.

As such, and for the reasons discussed above and contained in the OCA's Main Brief and Reply Brief, the OCA submits that Mr. Smith's recommendation of quarterly reports provides the necessary clarity needed into this possible transaction.

Reply to Aqua Exc. No. 8: The OCA's Testimony and Recommended Adjustments Are Reasonable, Appropriate, and Consistent with Ratemaking Principles and Should Be Granted Full Weight by the Commission. OCA M.B. at 10-23; OCA R.B. at 3-19.

A. Section 1329 Does Not Eliminate the Commission's Authority to Determine Rate Base or Prohibit the Consideration of the OCA's Testimony on Fair Market Value.

Aqua argues that the Commission should give the OCA's expert witness's testimony and proposed adjustments less weight than those of the UVEs. Aqua Exc. at 53. The Recommended Decision did not address Aqua's contention.

Aqua's position has been previously rejected by the Commission and it should be rejected in this proceeding as well. Section 1329 creates a valuation process, which begins with two UVEs providing individual appraisals of "fair market value." 66 Pa. C.S. § 1329(a)(3). The statute anticipates that these appraisals will differ and provides for the appraisals to be averaged. 66 Pa. C.S. § 1329(g). The fact that two UVEs, who both must comply with the Uniform Standards of Professional Appraisal Practice (USPAP) and employ the Cost, Market, and Income approaches, may recommend different fair market values establishes that the appraisal process is not simply a "formulaic" mathematical exercise. The UVEs are required to make judgments in each type of analysis and in how much weight is given to each approach. OCA M.B. at 7. Thus, the consumer interest can only be protected if the Commission may consider evidence regarding errors and unsupported adjustments in the UVE appraisals.

Consistent with this position, the Commission has repeatedly considered evidence offered by non-UVE witnesses regarding the reasonableness of the UVE appraisals. Specifically, the Commission has held:

[T]he Commission has already considered and rejected Aqua's position and determined that Section 1329 contains no prohibitions on the ability of parties, or the Commission, to review the UVE appraisals as to their reasonableness and, accordingly, propose, or adopt, adjustments to the UVE appraisals. Specifically, in

the *Limerick Order*, citing to the *New Garden Order*, we rejected Aqua's position in those cases, the position Aqua reiterated in this proceeding. *Limerick Order* at 35-36.

Cheltenham at 39 (citing New Garden at 53; Application of Aqua Pennsylvania Wastewater, Inc., A-2017-2605434, Order at 36 (Nov. 29, 2017) (Limerick)).

The OCA's witness in this proceeding is a well-qualified expert in the area of ratemaking and financial issues related to utilities. OCA M.B. at 3. Mr. Smith is a Senior Regulatory Consultant at Larkin & Associates, PLLC, an accounting and regulatory consulting firm. OCA St. 1 at 1. The firm performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups. Larkin & Associates has extensive experience in the utility regulatory field as expert witnesses in over 400 regulatory proceedings including numerous telephone, water and sewer, gas, and electric matters. Id. Mr. Smith is both a licensed CPA as well as member of the Michigan Bar.¹ The OCA's expert is eminently qualified in utility ratemaking issues and utility regulatory policies, is legally competent, and is a credible expert witnesses in this matter.

Here again, the OCA submits that the Commission should use its expertise to interpret Section 1329 as permitting the review of UVE appraisals. Aqua's argument that the OCA's testimony and adjustments should be given limited weight compared to the UVEs is unreasonable as Mr. Smith is a credible expert testifying before the Commission.

¹ Mr. Smith's extensive education and experience has been summarized and attached to his Direct Testimony (OCA St. 1) as Attachment A.

B. The OCA's Adjustments to the UVE Appraisals Are Supported by the Record.

Aqua argues that the appraisal adjustments recommended by Mr. Smith should not be adopted. Aqua Exc. at 53. The Recommended Decision, however, was silent in regard to the appraisal adjustments recommended by Mr. Smith.

As discussed above, Mr. Smith is highly qualified to review the appraisals and present his critiques. Unlike the UVEs, Mr. Smith employed standard financial and regulatory principles to make recommendations as to how to adjust for assumptions within the UVE appraisals that are unreasonable or inconsistent with utility practice. The analyses of the UVE appraisals conducted by Mr. Smith derived from standard financial and business concepts properly based on his financial and utility ratemaking expertise. OCA M.B. at 2.

For the foregoing reasons, the OCA submits that the Commission should reject Aqua's arguments that the OCA's valuation testimony should be given no weight. The OCA's recommendations regarding errors and unsupported adjustments in the UVE appraisals are fully supported by the record as discussed in the OCA's Main Brief, Reply Brief, and herein.

1. Cost Approach

a. Mr. Smith's Adjustments to the Gannett Fleming Cost Approach Are Reasonable.

As discussed in greater detail in the OCA's Main Brief, OCA witness Smith recommended adjustments to the depreciation rates used in Gannett Fleming's Cost Approach as Aqua will be applying Aqua's depreciation rates approved in the Company's most recent base rate case to the DELCORA system when it includes the DECORA acquisition in base rates. OCA M.B. at 12. Aqua argues that Mr. Smith's recommendation is internally inconsistent as he only recommended applying Aqua's depreciation rates to accounts that would lower the asset value under the Cost Approach and does not apply Aqua's depreciation rates to all plant accounts. Aqua Exc. at 54-55.

Aqua also notes that Mr. Smith did not provide a statistical analysis to support the use of Aqua's depreciation rates for the DELCORA assets. Id. at 55. Finally, according to Aqua, the use of the Company's depreciation rates as part of the cost approach "does not meet a standard of value of fair market value and, thus, is a direct violation of Section 1329 of the Code." Aqua Exc. at 54. As discussed below, these arguments are without merit.

There is no internal inconsistency – OCA witness Smith's position is that Aqua's depreciation rates should be applied to *all* of the sewer utility asset accounts. In Direct Testimony, OCA witness Smith discussed applying Aqua's depreciation rates to plant accounts related DELCORA's operations center, as a specific example. OCA St. 1 at 49-50. The schedules attached to his testimony reflect that Mr. Smith adjusted the largest categories of plant accounts (structures and equipment), to reflect his use of Aqua's depreciation rates. OCA Exh. RCS-2. OCA witness Smith and Aqua witness Walker agree that applying Aqua's Commission-approved depreciation rates to all of the sewer utility asset accounts serves to increase the balance of accumulated depreciation and reduce the asset value under the Cost Approach.² OCA St. 1SR at 16-17; Aqua St. 8R at 8. The specific amount of the adjustment, however, is of no import because it does not alter the OCA's ultimate recommendation regarding the fair market valuation.

The critical issue is that Aqua's UVE applied depreciation rates that are contrary to the reality of Commission-approved depreciation rates that Aqua has indicated it *will* utilize for the acquired DELCORA assets if the acquisition is approved. OCA M.B. at 12; OCA St. 1SR at 16; OCA St. 1 at 12. Aqua's depreciation rates were available at the time of Mr. Walker's appraisal.

² The application to all plant accounts increased the Replacement Cost Accumulated Depreciation used in the Gannett Fleming valuation study from \$392,724,620 to \$414,305,664, or by \$21,581,044. OCA St. 1SR at 16; Aqua St. 8R at 8. This change, in turn, serves to reduce Mr. Walker's Cost Approach valuation by the difference of \$21,581,044. OCA St. 1SR at 17; Aqua St. 8R at 8; Aqua Exh. HW-1R at Exh. 1; OCA M.B. at 13.

OCA St. 1SR at 17-18. Instead of utilizing the depreciation rates that will be applied to the acquired system, however, Mr. Walker substituted subjective determinations and introduced his own depreciation judgment – which resulted in a higher valuation under the Gannett Fleming Cost Approach. OCA St. 1SR at 18.

The OCA further submits that Aqua’s argument that Mr. Smith’s recommendation is in direct violation of Section 1329 is inaccurate. Aqua argues that “[u]nder the standard of value of fair market value, the buyer is not a specific entity but is, rather, a hypothetical or generic entity.” Aqua Exc. at 54 (emphasis omitted). Aqua’s argument, however, has recently been rejected by both ALJ Jones and the Commission. In Cheltenham, the Commission stated as follows regarding the application of the USPAP to Section 1329:

Furthermore, we have already declared in the FSIO, Appendix C, that materials submitted in support of a request for Section 1329 fair market valuation pursuant to the USPAP must conform to applicable Pennsylvania law even if in conflict with USPAP. For purposes of Section 1329, we expressly stated that Pennsylvania law includes the Pennsylvania Constitution, statutes, regulations, court precedent, and administrative rules and orders issued by administrative agencies.

Therefore, we agree with the OCA and the ALJ that the statutory appraisal process is not simply a formulaic mathematical exercise, nor is the Commission acting as some type of USPAP-compliance board. We agree that review of the appraisals provided by Aqua and Cheltenham UVEs shows that there are judgments made in each type of analysis as well as in how much weight is to be given to each approach. We also agree that it would be inconsistent with the requirements of the Code and prior Commission orders to permit Aqua to simply present a rate base number, show that the appraisers chose numbers to fill in all the blanks in the formulas and based solely upon the judgments of the UVEs, and to not permit any review or challenges of those inputs, methods or judgments.

Cheltenham at 39-40. Moreover, in Limerick, the Commission was clear that the USPAP is not the controlling text for Section 1329 valuations involving regulated utilities. Limerick at 58. Simply put, the “standard of fair market value” that Aqua refers to is not controlling law under Section 1329.

The OCA submits that Mr. Smith's recommended adjustment is not a violation of Section 1329, but rather is a reasonable adjustment in compliance with ratemaking principles and Pennsylvania law.

b. Mr. Smith's Adjustments to the ScottMadden Cost Approach Are Reasonable.

As noted *supra*, OCA witness Smith recommended that depreciation rates approved in Aqua's previous base rate case should be applied to the acquired plant, as those are the actual depreciation rates that will be applied to the acquired plant given Aqua's existing status as a regulated public utility. OCA M.B. at 14; OCA St. 1 at 60. Aqua argues that ScottMadden is not bound by Aqua's decisions as the useful lives in ScottMadden's Cost Approach "were based on the System of Accounts for Water and Wastewater – with 200 or more Connections as published by the Public Utility Commission of Texas." Aqua Exc. at 56 (emphasis omitted). Aqua also claims that the Commission found that a service life of 75 years was appropriate for mains in a separate application proceeding. *Id.* Lastly, Aqua claims that Mr. Smith did not present evidence which questions the integrity of ScottMadden's reference material. Aqua Exc. at 57.

The OCA submits that applying depreciation lives to a Pennsylvania wastewater facility derived from a publication by the Public Utility Commission of Texas is inappropriate. OCA St. 1SR at 11. Aqua has Pennsylvania wastewater utility assets and the Pennsylvania PUC has approved depreciation lives for those assets. OCA St. 1SR at 11. The useful lives recommended by Mr. Smith are based on the useful lives provided by Aqua's Wastewater Depreciation Study. *Id.* Simply put, better Pennsylvania-specific information is available and should be used.

As such, and for the reasons discussed above and contained in the OCA's Briefs, the OCA submits that Mr. Smith's recommended adjustment to apply Aqua's Commission-approved depreciation rates to the DELCORA wastewater appraisals should be adopted.

2. Market Approach

a. Mr. Smith's Adjustments to the Gannett Fleming Market Result are Reasonable.

As discussed in the OCA's Main Brief, OCA witness Smith recommends removing the Ex-Ante amounts used in Mr. Walker's Selected Transaction method and using only the median of the Ex-Post amounts because the Ex-Ante amounts are essentially initial estimates (as opposed to the actual transaction).³ OCA M.B. at 16; OCA St. 1 at 58. Aqua argues that the use of Ex-Post amounts should be rejected. Aqua Exc. at 57. According to Aqua, Commission-determined rate base value does not change the price bid and paid by a buyer. Id. at 58. Aqua also argues that the metrics used in the Selected Transaction method are time period sensitive. Lastly, Aqua argues that Mr. Walker verified his Market Approach results by using a merger of two Connecticut Investor Owned Utilities (IOUs) with another Connecticut water company as a check. Id.

The OCA submits that fair market appraisals under Section 1329 should not be used for the purpose of validating the purchase price, but should be used to establish the fair market value in compliance with Section 1329. For completed transactions, the actual results are known. OCA St. 1SR at 19. Using the purchase price, and not accounting for the fact that there is a Commission-approved ratemaking rate base, is inappropriate in the context of a Section 1329 Fair Market Valuation. The OCA submits that when the actual fair market value which will be placed into ratemaking rate base under Section 1329 is known, it should be used rather than using inaccurate estimates from historical transactions. Id.

Aqua claimed that the use of ex-post, Commission-determined ratemaking rate base values in the Selected Transaction method was rejected by ALJ Jones and the Commission in the

³ The OCA further notes that the purchase prices used by Mr. Walker do not reflect the purchase prices involved in the actual transactions. OCA St. 1 at 58; OCA Ex. RCS-4.

Cheltenham proceeding. Aqua Exc. at 57. The OCA notes, however, that ALJ Jones properly recommended an additional jurisdictional exception in regard to the UVEs' use of purchase prices as opposed to Commission-approved ratemaking rate base for Section 1329 acquisitions in the Market Approach in the Cheltenham proceeding.⁴ Aqua's argument that using a Commission-determined ratemaking rate base as a market comparable would represent a hypothetical assumption does not recognize the fact that a Market Approach input that is in excess of fair market value will produce a result that is in excess of fair market value. Moreover, ratemaking rate base is not hypothetical, it is a rate base determined and approved by the Commission in each Section 1329 case and is the amount the Commission has determined represents fair market value.

Section 1329 of the Public Utility Code provides the basis for fair market value acquisitions of municipal systems, and using the ratemaking rate base as determined by the Commission ensures that the value used in Section 1329 appraisals is not in excess of the fair market value determined by the Commission. Aqua's logic creates an unreasonable situation in which purchase prices that are in excess of Commission-approved ratemaking rate bases are used in the Market Approach instead of the actual ratemaking rate bases with the dual effect of increasing the instant appraisal valuation, and potentially leading to an increase in Commission-approved ratemaking rate base in future acquisitions.

Additionally, Aqua incorrectly stated in its Exceptions as follows:

A Commission determined ratemaking rate base value for an entity does not change the price bid and paid by a buyer.

Aqua Exc. at 58. To the contrary, the Commission-approved ratemaking rate base for an entity in previous Section 1329 acquisitions has affected the price paid by a buyer. See Application of

⁴ See Application of Aqua Pennsylvania Wastewater, Inc., A-2019-3008491, R.D. at 38-39 (Aug. 1, 2019).

Pennsylvania-American Water Co., Inc., A-2017-2606103, Order (Oct. 26, 2017) (McKeesport); Application of Pennsylvania-American Water Co., Inc., A-2018-3002437, Order (Oct. 25, 2018) (Sadsbury); Application of Pennsylvania-American Water Co., Inc., A-2018-3004933, Order (Oct. 3, 2019) (Exeter). The OCA submits that it is inappropriate to use the proposed purchase prices agreed to in asset purchase agreements for systems acquired under Section 1329 as a substitute for the Commission-approved ratemaking rate base of the system.

Aqua also argues that there is no justification for using the Commission-approved ratemaking rate base for the McKeesport and Limerick Section 1329 acquisitions instead of the purchase price, because Mr. Walker's method relied on and reflected information that was known at the time the winning purchase price was given and the metrics are time-period sensitive. Aqua Exc. at 58. The OCA submits that the Commission-approved ratemaking rate base is the determination of fair market value under Section 1329 of the Public Utility Code. The Commission-approved ratemaking rate base for the McKeesport acquisition was known at the time when Mr. Walker was performing his appraisal. Nevertheless, Mr. Walker instead relied on the purchase price for the system. As such, Aqua's claim that the metrics are time-period sensitive is without merit. Moreover, in regard to the Limerick Section 1329 acquisition, the OCA submits that there is no reasonable justification or basis for using the higher purchase price (in excess of \$10,000,000 over the ratemaking rate base) when analyzing the Limerick acquisition in the context of a Market Approach appraisal under Section 1329 instead of the fair market value approved by the Commission in a Section 1329 proceeding.

Lastly, Aqua noted that Gannett Fleming relied on a "planned merger" of SJW Group and Connecticut Water Service, Inc. through a stock purchase as a check and verification of the indicated value for the Cheltenham system. Aqua Exc. at 58. Aqua stated as follows:

Although the acquisition is not directly applicable to the Wastewater System, it does provide a range of indicated value for the Wastewater System which Gannett relied on as a check.

Aqua Exc. at 58, note 111. Gannett Fleming's appraisal further states that "Connecticut Water is a fully integrated company while the Wastewater System is not." Application Exh. Q at 47. The OCA notes, however, that this acquisition was withdrawn over a year prior to Mr. Walker's appraisal.⁵ The OCA submits that a withdrawn acquisition that has not been approved is not a reliable check on the fair market value of the DELCORA system.

b. Mr. Smith's Adjustments to the ScottMadden Market Result are Reasonable.

Aqua argued that, in regard to the ScottMadden Market Approach, Mr. Smith's criticism of the comparable sales method is illogical and contrary to reference materials. Aqua Exc. at 59. Aqua also argued as follows:

Any homeowner, for example, would, obviously, want to know the recent sales history of other homes on their block – comparable sales, in other words – before putting their home up for sale. It is no different for utility fair market valuation.

Aqua Exc. at 59.

This reasoning is without merit. The OCA generally agrees that in a competitive market, the purchase price would be used in the appraisal. While the use of the "purchase price" may be appropriate in an open and competitive market, however, it is not a reasonable substitute for Commission oversight within a regulatory framework. Comparable acquisitions used in the

⁵ See Application of SJW Group and Connecticut Water Service, Inc. for Approval of Change of Control, Docket No. 18-07-10, Docket Closing (Dec. 3, 2018).
<http://www.dpuc.state.ct.us/dockcurr.nsf/8e6fc37a54110e3e852576190052b64d/04df1735665331998525837f0063a58a>

Market Approach analysis must be limited to the valuation permitted by Section 1329 in order to not overstate the fair market value.

As discussed in detail in the OCA's Main Brief, Mr. D'Ascendis' comparable sales result produced indicated values of \$811,451,586 and \$1,276,340,191, respectively. OCA M.B. at 17-18. The OCA's primary concern with Mr. D'Ascendis' Comparable Sales Method is that it lacks demonstrated reliability and use in actual transactions, especially when applied to valuing a wastewater utility system that has unique characteristics and which is subject to cost-based utility regulation. OCA St. 1SR at 14.

The OCA submits that the Comparable Sales Method's production of an indicated result that DELCORA wastewater system is worth over a billion dollars more than the agreed upon purchase price in this proceeding illustrates the serious shortcomings of this method, and weighs against its use in the Commonwealth in valuing utilities in the context of a regulated public utility framework. OCA M.B. at 17. Attempting to apply a value per connection from one utility onto another utility, from water utilities onto a wastewater utility, from combination water/wastewater utilities onto a wastewater utility, or from a group of utilities that serves primarily end-use customers onto a utility that has a substantial wholesale customer base is not conceptually sound and is almost assured to produce valuation results that are highly abnormal and unreliable, as is the case here. OCA St. 1SR at 14.

3. Income Approach

a. Mr. Smith's Adjustments to the Gannett Fleming Income Approach Are Reasonable.

Aqua criticizes Mr. Smith for recommending the use of net plant value from time period 24 (Year 2044) as the terminal value for the DELCORA plant. Aqua Exc. at 62. Aqua also argues

that Mr. Walker presented an evidentiary analysis demonstrating that net plant value is not a good proxy or measure for future market value. Aqua Exc. at 63.

As explained in the OCA's Main Brief, the assumptions used by Mr. Walker are not consistent with ratemaking principles and are flawed. OCA M.B. at 22. Mr. Smith noted that the approach to quantifying the terminal value should recognize that the wastewater assets are for a regulated public utility, not an unregulated business. OCA St. 1 at 54. Mr. Smith further testified as follows:

[R]ate regulated public utilities have traditionally been distinguishable and distinguished from business enterprises that operate in competitive markets and without price regulation. Because of the monopoly nature and cost regulation, the approach to determining a terminal value for a rate regulated public utility is therefore different than for a business that is not a monopoly and is not subject to cost-based rate regulation. The utility valuation must consider the present value of the net income derived from the utility asset. The utility asset at the end of the valuation period is represented by its remaining net book value (plant less accumulated depreciation), which would generally be recoverable unless there were some type of disallowance for imprudence, unreasonableness, etc. As I explained above, applying traditional concepts of cost-based utility regulation indicate that an approach to terminal value for a rate regulated public utility should focus on the remaining amount of net plant, not on a perpetual capitalization of prospective earnings.

OCA St. 1SR at 19.

The OCA submits that the valuation results for each proposed transaction should be evaluated based on the specific information contained in each application. The traditional concepts of cost-based utility regulation indicate that an approach to terminal value for a rate-regulated public utility should focus on the remaining amount of net plant, not on a perpetual capitalization of prospective earnings. OCA St. 1SR at 19. If a firm is expected to earn a return on its investment at its cost of capital and also recover its depreciation expense, the present value of that future cash flow is exactly equal to the present value of its investment. Id. at 13. Therefore, it is reasonable

to base the terminal value for a rate-regulated monopoly utility on the remaining amount of net plant.

As such, OCA witness Smith adjusted Gannett Fleming's Income Approach as follows:

As shown on Exhibit RCS-3, pages 2 and 3, I have recalculated the valuation of the terminal value using the amount of Net Plant less Accumulated Deferred Income Taxes (ADIT) remaining at the end of Year 24. Exhibit RCS-3, page 2, shows the calculations under municipal ownership, with an indicated value result of \$346,369,318. Page 3 shows the calculations under IOU ownership with an indicated value result of \$263,757,613. The two indicated value results are averaged, as shown on Exhibit RCS-3, page 1, for an adjusted Income Approach value of \$305,063,465. The difference in the indicated value of \$82,690,835 results from the different approach to calculating the "terminal" value for a regulated public utility, which is different than the "terminal" value calculation for a non-regulated business.

OCA St. 1 at 54-55. The adjusted Income Approach value of \$305,063,465 is \$82,690,835 lower than Mr. Walker's proposed amount of \$387,754,301 and should be adopted. Id. at 55.

b. Mr. Smith's Adjustments to the ScottMadden Income Approach Are Reasonable.

As discussed in the OCA's Main Brief, Mr. Smith adjusted Mr. D'Ascendis' Income Approach by recalculating the valuation of the terminal value using the amount of Net Plant less Accumulated Deferred Income Taxes (ADIT) projected to be remaining at the end of 2049. OCA M.B. at 21; OCA St. 1 at 61. Aqua argues that Mr. Smith "provided no theoretical or academic support for the use of projected net plant less ADIT as the terminal value for a going concern." Aqua Exc. at 64. Aqua further notes that Mr. D'Ascendis provided citations to valuation literature to support his calculation of terminal value. Id.

Contrary to Aqua's assertions, Mr. Smith's testimony provided both theoretical and academic support regarding the use of projected net plant less ADIT as the terminal value. Mr. Smith testified as follows:

Rate regulated public utilities have traditionally been distinguishable and distinguished from business enterprises that operate in competitive markets and without price regulation. Two attributes of a public utility business are important distinguishing factors. The first is the special public importance or necessity of the types of services supplied by the utility. The second is the possession of utility plants having technical characteristics leading to monopoly or at least to ineffective forms of competition.² As put simply by Clemens: “Necessity and monopoly are almost prerequisites of public utility status.”³ Because of the monopoly nature and cost regulation, the approach to determining a terminal value for a rate regulated public utility is therefore different than for a business that is not a monopoly and is not subject to cost-based rate regulation.

For a rate regulated public utility, a valuation method, is “any method used to place a value on an asset.”⁴ The valuation under the income approach is “based on the present value of net income expected to be derived from the asset.”⁵ It is therefore crucial for a rate regulated public utility that the value under the income approach is based on the net income expected to be derived from the asset. Thus, the utility valuation must consider the present value of the net income derived from the utility asset. The utility asset at the end of the valuation period is represented by its remaining net book value (plant less accumulated depreciation), which would generally be recoverable unless there were some type of disallowance for imprudence, unreasonableness, etc. For an investor-owned public utility that is subject to federal income taxes, the rate base would also typically include a deduction for accumulated deferred income taxes. The recovery of the remaining undepreciated net book value of the prudently incurred utility plant, possibly less the related Accumulated Deferred Income Taxes (“ADIT”), would therefore constitute the terminal value, that would need to be discounted.

For a rate regulated public utility, it has long been recognized that amounts representing capitalized earnings should not be included in a rate base.⁶ The value of plant for a rate regulated public utility cannot be determined by capitalization of prospective earnings, in the manner of commercial property used in a competitive enterprise free from regulation.⁷ Similarly, it has been observed that a utility regulatory commission should not arrive at a fair value rate base by capitalizing earnings under the utility’s existing rates.⁸ These traditional concepts of cost-based utility regulation indicate that an approach to terminal value for a rate regulated public utility should focus on the remaining amount of net plant, not on a perpetual capitalization of prospective earnings.

OCA St. 1SR at 11-13. Additionally, Mr. Smith testified as follows:

As a matter of arithmetic, as well as financial theory, if a firm is expected to earn a return on its investment at its cost of capital and also recover its depreciation expense, the present value of that future cash flow is exactly equal to the present value of its investment. Therefore, a more appropriate terminal value (before discounting) in the twentieth year is the net plant in service (and net of ADIT if

available) at that point in time. This net investment amount is then discounted back to the present value to determine the ultimate terminal value in present value terms.

² See, e.g., Bonbright, Principles of Public Utility Rates, Columbia University Press, 1969 edition at 8.

³ See, Eli W. Clemens, Economics and Public Utilities (New York, 1950) at 25.

⁴ See, e.g., Edison Electric Institute, Glossary of Electric Utility Terms.

⁵ Id.

⁶ See, e.g., 32 Public Utility Reports 3rd p.43 and PUR 3rd Valuation §31.

⁷ Id. Also see, Re: New York Teleph. Co. (1954) 5 PUR 3rd 33.

⁸ Id. Also see, Re: Western Carolina Teleph. Co. (1962) 45 PUR 3rd120.

OCA St. 1SR at 13-14.

Aqua's assertion that Mr. Smith provided no theoretical or academic support is without merit. Moreover, the OCA submits that Mr. D'Ascendis mere citation to literature supporting his calculation of terminal value does not justify his terminal value calculation in the context of Section 1329 acquisitions in a rate-regulated market. For the reasons discussed in the OCA's Main Brief and *supra*, Mr. Smith's recommended adjustment to the ScottMadden Income Approach should be adopted.

C. Conclusion

OCA witness Smith concluded that under Section 1329, the \$276.5 million purchase price proposed by Aqua should be used as the Fair Market Value for the DELCORA wastewater utility assets because that amount is below the average adjusted result of the ScottMadden and Gannett Fleming valuations. OCA M.B. at 22-23; OCA Table I at Col. G, Ln. 15; OCA St. 1SR at 15; OCA Exh. RCS-1 at Col. G, Ln. 15. The Section 1329 Fair Market Value analyses conducted by Mr. Walker and Mr. D'Ascendis, however, contain flaws. The OCA submits that the OCA's adjustments to the UVE appraisals discussed *supra* are reasonable and should be adopted by the Commission. The OCA's recommended adjustments to the UVE appraisals are as follows:

Aqua Pennsylvania Wastewater, Inc.
Acquisition of Delaware County Regional Water Quality Control Authority Assets
Results of OCA Appraisal Adjustments

OCA Exhibit RCS-1
Docket No. A-2019-3015173
Page 1 of 1

Line No.	Valuation Method	Appraisers' Results			Results with OCA Adjustments				
		(A)	(B)	(C)	(D)	(E)	(F)	(G)	
		Gannett Fleming			OCA	Gannett Fleming			
		Individual Results	Weight	Weighted Result	Adjustment	Individual Results	Weight	Weighted Result	
1	Cost Approach	\$ 399,664,113	33.0000%	\$ 131,889,157	(100,465,415)	\$ 299,198,698	33.0000%	\$ 98,735,570	RCS-2
2	Income Approach	\$ 387,754,301	33.0000%	\$ 127,958,919	(82,690,835)	\$ 305,063,466	33.0000%	\$ 100,670,944	RCS-3
3	Market Approach	\$ 438,337,696	34.0000%	\$ 149,034,817	(15,591,769)	\$ 422,745,927	34.0000%	\$ 143,733,615	RCS-4
4	Total			\$ 408,882,893				\$ 343,140,129	
5	Conclusion			\$ 408,883,000				\$ 343,140,000	
		ScottMadden			OCA	ScottMadden			Exhibit
		Individual Results	Weight	Weighted Result	Adjustment	Individual Results	Weight	Weighted Result	Reference
6	Cost Approach	\$ 292,413,993	45.0000%	\$ 131,586,297	(35,019,728)	\$ 257,394,266	45.0000%	\$ 115,827,420	RCS-5
7	Income Approach	\$ 291,863,370	50.0000%	\$ 145,931,685	(128,738,064)	\$ 163,125,306	50.0000%	\$ 81,562,653	RCS-6
8	Market Approach	\$ 613,520,480	5.0000%	\$ 30,676,024	(197,931,116)	\$ 415,589,365	5.0000%	\$ 20,779,468	RCS-7
9	Total			\$ 308,194,006				\$ 218,169,541	
10	Conclusion			\$ 308,194,000				\$ 218,170,000	
		Summary of Results							
					OCA Adjusted Results				
11		Gannett Fleming			\$ 343,140,000				
12		ScottMadden			\$ 218,170,000				
13		Average			\$ 280,655,000				
14	Purchase Price	\$ 276,500,000			\$ 276,500,000				
15	Lesser of Purchase Price and Fair Market Value	\$ 276,500,000			\$ 276,500,000				

Notes and Source:

Lines 1-5, Cols. A through C: Exhibit Q, Gannett Fleming Fair Market Value Appraisal report, Exhibit 19
Lines 6-10, Cols. A through C: Exhibit R, ScottMadden Fair Market Value Appraisal report, page 12

OCA Table I. As such, Aqua's Exception No. 8 should be rejected.

III. CONCLUSION

For the reasons stated above and in the OCA's Main Brief and Reply Brief, the OCA submits that the proposed transaction should not be approved. If the Commission determines to approve the Application under Sections 507, 1102 and 1329, however, the Office of Consumer Advocate's recommended conditions should be adopted, including the OCA's proposed adjustments to the appraisals.

Respectfully Submitted,

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