

**BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

In re: Application of Aqua Pennsylvania	:	
Wastewater, Inc. Pursuant to Sections 1102	:	
and 1329 of the Public Utility Code for	:	A-2016-2580061
Approval of its Acquisition of the	:	
Wastewater System Assets of New Garden	:	
Township	:	

**RECOMMENDED DECISION**

Before  
Steven K. Haas  
Administrative Law Judge

## **TABLE OF CONTENTS**

I	INTRODUCTION .....	1
II.	HISTORY OF THE PROCEEDING .....	1
III.	FINDINGS OF FACT.....	7
IV.	DISCUSSION .....	14
A.	Overview of Proposed Transaction.....	14
B.	Overview of 66 Pa. C.S. § 1329.....	16
C.	Burden of Proof and Legal Standards .....	18
D.	Applicant’s Fitness.....	19
E.	Rate Stabilization Plan.....	21
F.	Rate Base Valuation.....	28
	1. Ability to Challenge Fair Market Value Appraisals .....	28
	2. Files in Electronic Working Format .....	33
	3. Approval of Rate Base Value .....	34
G.	Public Interest / Affirmative Public Benefits.....	40
V.	CONCLUSIONS OF LAW .....	46
VI.	ORDER .....	48

## I INTRODUCTION

This Recommended Decision recommends denial of Aqua Pennsylvania Wastewater, Inc's. (Aqua or Applicant) Application because Aqua failed to prove by a preponderance of the evidence that the proposed transaction is in the public interest or that it creates sufficient affirmative public benefits to justify approval.

## II. HISTORY OF THE PROCEEDING

On December 15, 2016 Aqua filed an Application with the Pennsylvania Public Utility Commission (Commission), pursuant to Sections 1102 and 1329 of the Public Utility Code,<sup>1</sup> for approval of (1) the acquisition of the wastewater systems assets of New Garden Township and the New Garden Township Sewer Authority (together, New Garden), ( 2) the right of Aqua to be able to offer, render, furnish and supply wastewater service to the public in portions of New Garden and Kennett Townships, Chester County, and (3) for an order approving the acquisition that includes the ratemaking rate base of the New Garden wastewater system assets pursuant to Section 1329(c)(2) of the Public Utility Code (Application). Receipt of the completed Application was acknowledged by the Commission by Secretarial Letter dated December 30, 2016.

Aqua's Application requests that the Commission approve its \$29.5 million purchase of New Garden's wastewater system assets and issue Certificates of Public Convenience necessary for it to furnish wastewater service to approximately 2,106 New Garden customers. Aqua's Application also asks the Commission to issue an Order establishing the ratemaking rate base of the acquired assets at \$29.5 million.

Notice of the Application was published in the *Pennsylvania Bulletin* on January 7, 2017, 47 Pa.B. 78. A deadline of January 23, 2017 was established for the filing of protests or petitions to intervene.

---

<sup>1</sup> 66 Pa. C.S. § 1102 (Section 1102); 66 Pa. C.S. § 1329 (Section 1329).

On January 10, 2017, the Commission's Bureau of Investigation and Enforcement (I&E) filed a Protest to the Application. On January 17, 2017, the Pennsylvania Office of Consumer Advocate (OCA) filed a Protest to the Application. On January 18, 2017, Petitions to Intervene were filed on behalf of New Garden Township and the New Garden Township Sewer Authority. On January 19, 2017, I&E filed an Amended Protest. On January 23, 2017, a Notice of Appearance was filed by Sharon E. Webb, Esquire, on behalf of the Pennsylvania Office of Small Business Advocate (OSBA).

By Prehearing Conference Order dated January 12, 2017, an initial prehearing conference was scheduled for Wednesday, January 25, 2017, at 1:30 p.m. in Harrisburg, Pennsylvania. This order also described certain procedural requirements associated with participation in the proceeding and directed the filing of Prehearing Memoranda by January 23, 2017. Each party filed a Prehearing Memorandum.

On January 17, 2017, I&E filed a Motion to Bifurcate Proceedings. In its Motion, I&E noted the six-month time deadline associated with the Section 1329 part of the proceeding and requested that the Section 1102 part of the proceeding be bifurcated from the Section 1329 proceeding and that the two parts of the Application be adjudicated on separate timelines, with the 1102 part not constrained by the six-month deadline associated with the Section 1329 part. Aqua filed an Answer opposing I&E's Motion to Bifurcate. By Order dated January 27, 2017, I denied I&E's Motion to Bifurcate.

The prehearing conference was held as scheduled. The following attorneys were present: Thomas T. Niesen and Alexander R. Stahl on behalf of Aqua; Carrie B. Wright and Gina L. Miller on behalf of I&E; Christine Maloni Hoover (via telephone) on behalf of the OCA; Elizabeth Rose Triscari on behalf of the OSBA; and Alex Baumler on behalf of New Garden Township. The following litigation schedule was adopted during the prehearing conference:

Direct testimony of other parties	January 31, 2017
Rebuttal testimony	February 7, 2017
Surrebuttal testimony	February 14, 2017
Evidentiary hearings (with oral rejoinder)	February 16-17, 2017
Main Briefs	March 6, 2017
Reply Briefs	March 16, 2017

On January 30, 2017, I&E filed a Petition for Expedited Interlocutory Review, Stay of Proceedings, and Answer to Material Questions. In its Petition, I&E sought Commission review of and answer to the following questions:

1. Does Section 1329 of the Public Utility Code enable an acquiring public utility to impose a six-month time limitation upon the Commission's consideration of an Application for a Certificate of Public Convenience under Section 1102 where no such time limitation previously existed?
2. Does Section 1329 of the Public Utility Code bar the Bureau of Investigation and Enforcement from developing a record for the Commission regarding whether the valuation proposed by an Applicant is appropriate?

I&E requested that the Commission answer both questions in the negative.

A brief in support of I&E's Petition was filed by the OCA on February 6, 2017. A brief in opposition to I&E's Petition was filed by Aqua on February 6, 2017. Also on February 6, 2017, a Notice of Appearance for the purpose of filing *amicus curiae* briefs was filed by David P. Zambito, George A. Bibikos and Susan Marsh Simms on behalf of Pennsylvania American Water Company (PAWC). PAWC filed an *amicus curiae* brief in opposition to I&E's Petition on the same date.

In an Opinion and Order entered February 15, 2017, the Commission rephrased I&E's first question to read as follows:

Does Section 1329 of the Public Utility Code impose a six-month time limitation upon the Commission's consideration of an Application by an acquiring public utility for a Certificate of Public Convenience under Section 1102 where no such time limitation previously existed and the purchaser is an existing, certificated public utility?

The Commission answered its rephrased version of I&E's first question in the affirmative, arguing that its Section 1329 Final Implementation Order<sup>2</sup> (IO) does not contemplate an extended consideration period for applications filed by existing, certificated public utilities. The Commission declined to answer I&E's second question, concluding that I&E failed to satisfy the standards for interlocutory review on that issue.

On February 15, 2017, the OCA filed a Motion to Strike, seeking to exclude certain rebuttal testimony submitted by Aqua. The testimony at issue included evidence supporting the two appraisals submitted by Aqua with its Application. The OCA argued that this information should have been included in Aqua's case in chief. At the February 16, 2017 hearing in this matter, I directed Aqua to file a written response to OCA's Motion by February 21, 2017, and indicated that I would attempt to issue a ruling on the motion by February 23, 2017.

Aqua filed its Answer to OCA's Motion on February 21, 2017. Aqua argued in its Answer that the rebuttal testimony at issue was in direct response to the direct testimony of the OCA's witness and, therefore, constitutes appropriate rebuttal testimony. Aqua further argued that the two rebuttal witnesses, Harold Walker, III and Jerome C. Weinert, were both identified in Aqua's Prehearing Memorandum as potential witnesses, and that the OCA had an opportunity to submit surrebuttal testimony in response to the disputed rebuttal testimony, and to cross examine both witnesses on their testimony.

---

<sup>2</sup> Implementation of Section 1329 of the Public Utility Code; Docket No. M-2016-2543193 (Entered October 27, 2016)

The evidentiary hearing was held as scheduled on February 16, 2017. At the hearing, testimony and exhibits were entered into the record and cross examination was conducted. The following statements and exhibits were admitted into the record:

**Aqua**

Statement No. 1 (direct testimony of William Packer)  
Statement No. 1-R (rebuttal testimony of William Packer)  
Statement No. 2 (direct testimony of Mark Bubel, Sr.)  
Statement No. 3-R (rebuttal testimony of Harold Walker, III)  
Statement No. 4-R (rebuttal testimony of Jerome C. Weinert)  
Aqua Exhibit No. 1 (Application and attached exhibits)  
Aqua Exhibit No. 2 (1/9/17 e-mail)  
Aqua Exhibit No. 3 (confidential, proprietary Excel files)

**I&E**

Statement No. 1 (direct testimony of Joseph Kubas)  
Statement No. 1-SR (surrebuttal testimony of Joseph Kubas)

**OCA**

Statement No. 1 (direct testimony of Ashley Everette)  
Statement No. 1-S (surrebuttal testimony of Ashley Everette)  
OCA Cross Examination Exhibit No. 1 (Aqua 1<sup>st</sup> Qtr. 2017 DSIC filing)

**OSBA**

Statement No. 1 (direct testimony of Brian Kalcic)  
Statement No. 1-S (surrebuttal testimony of Brian Kalcic).

Subsequently, on February 24, 2017, the OCA filed a Motion to Admit Supplemental Evidence. The OCA sought to introduce four discovery responses received from Aqua. No party raised an objection to OCA's Motion. Accordingly, by Order dated February 28, 2017, the following additional OCA exhibits were admitted into the record: OCA Exhibit No. AEE-2; OCA Exhibit No. AEE-3; OCA Exhibit No. AEE-4 and OCA Exhibit No. AEE-5.

During the February 16, 2017 evidentiary hearing, Aqua raised an objection to certain testimony contained in statements offered into evidence by I&E and the OCA. In

particular, Aqua objected to portions of the direct and surrebuttal testimonies of I&E witness Joseph Kubas and OCA witness Ashley Everette, concerning the appropriateness of the fair market value appraisals of the Utility Valuation Experts (UVE) included as part of Aqua's Application. Aqua argued that Section 1329 provides the sole mechanism for determining the fair market value and rate base of the assets to be acquired and does not allow for a challenge to these determinations by I&E or other parties. I&E and the OCA, on the other hand, argued that the Commission is not precluded by Section 1329 from analyzing and challenging the appropriateness of the fair market value and rate base determinations offered by the Applicant.

I overruled Aqua's objection to the disputed I&E and OCA testimony. I noted that the Commission had an opportunity to decide this issue in its review of I&E's Petition for Answers to Material Questions, but chose not to do so. I pointed out that I was not convinced by the language of Section 1329 that it was the legislature's intention to completely strip the Commission or other parties of the ability to review and challenge the fair market value and rate base determination offered by Applicants. I indicated that I was unwilling to exclude such evidence at that point in the proceeding.

On February 24, 2017, I issued an order denying OCA's Motion to Strike portions of Aqua's rebuttal testimony. I again noted that it was uncertain from the language of Section 1329 whether other parties were permitted to offer evidence challenging the fair market and rate base values proposed by applicants and, accordingly, I was unwilling to exclude such evidence offered by I&E and the OCA in response to Aqua's objections during the hearing. Similarly, I was unwilling to grant the OCA's motion to strike portions of Aqua's rebuttal testimony on that issue. I noted that surrebuttal testimony was due a week after rebuttal testimony and that parties had the opportunity to cross examine Aqua's witnesses at the hearing. I concluded that the OCA had sufficient time to prepare and submit surrebuttal testimony and to cross examine Aqua's witnesses on the testimony at issue, thereby protecting its due process rights.

Main Briefs were filed by the parties on March 6, 2017, and Reply Briefs were filed on March 16, 2017. PAWC filed both a Main Brief and a Reply Brief as *Amicus Curiae*.



The record closed on March 16, 2017, upon receipt of the parties' Reply Briefs. The matter is now ready for decision.

### III. FINDINGS OF FACT

1. Aqua is a certificated public utility that provides wastewater service to the public in portions of Pennsylvania. Aqua Stmt. No. 1, p.7; Application, p. 3.

2. Aqua operates 31 wastewater treatment plants in Pennsylvania, serving approximately 20,000 customers in Adams, Bucks, Carbon, Chester, Clearfield, Delaware, Lackawanna, Luzerne, Monroe, Montgomery, Pike, Schuylkill and Wyoming Counties. Aqua Stmt. No. 2, p. 3.

3. Aqua operates 17 wastewater systems in its Southeast Division that are in close proximity to New Garden Township. Aqua Stmt. No. 2, p.3.

4. Aqua is a subsidiary of Aqua Pennsylvania, Inc. (Aqua PA), which is the second largest investor-owned water utility in Pennsylvania. Aqua Stmt. No. 1, pp. 4-5.

5. Aqua PA provides water service to approximately 435,000 customers in Pennsylvania. Aqua Stmt. No. 1, pp. 4-5.

6. New Garden Township is a second class township in Pennsylvania. Aqua Stmt. No. 1, p. 5.

7. New Garden Township Sewer Authority is a Pennsylvania municipal authority established under the Municipal Authorities Act of 1945. Aqua Stmt. No. 1, p. 5.

8. New Garden Township and the New Garden Township Sewer Authority each own portions of a community wastewater system that provides wastewater service to approximately 2,100 customers in Pennsylvania. Aqua Stmt. No. 1, p.5; Aqua Stmt. No. 2, p. 3.

9. The New Garden system includes three separate areas: the East End Service Area; the South End Service Area; and the Avondale Service Area. Aqua Stmt. No. 1, p.5; Aqua Stmt. No. 2, p.3.

10. Aqua, New Garden Township and the New Garden Township Sewer Authority are parties to an Asset Purchase Agreement (APA), along with two amendments dated October 17, 2016 and November 16, 2016, for the purchase by Aqua of the wastewater system assets of the Township and the Authority. Application, ¶18, Application Exs. C1, C2 and C3.

11. Aqua will operate the New Garden system as a standalone system from its Southwestern Division office in Bryn Mawr, PA, which is located approximately 29.5 miles from the New Garden system. Application, p. 10.

12. Aqua will use its current employees to operate the New Garden system with no physical or managerial changes to Aqua being necessary. Application, p. 12.

13. The negotiated purchase price of the assets, based on arms-length negotiations, is \$29,500,000.00. Aqua Stmt. No. 1, p. 6.

14. Aqua will use existing short term credit lines to purchase the wastewater system asset. Aqua Stmt. No. 1, p. 8.

15. Under its APA with New Garden, Aqua is required to charge the New Garden customers the same rates previously charged by the Authority for a period of not less than 730 days from the date of closing of the transaction. Aqua Stmt. No. 1, p. 8; Application, Ex. C1.

16. Also under the APA, for a period of ten years beginning on the date of closing, future rate increases may not exceed a compounded annual growth rate (CAGR) of 4%. Aqua Stmt. No. 1, p. 6; Application ¶26; Application, Ex. C1.

17. Aqua is currently in good standing with the Pennsylvania Department of Environmental Resources (PA DEP). Application, p. 11.

18. The New Garden system currently has an outstanding Notice of Violation with PA DEP, dated July 7, 2015, involving a shortfall in effluent spray disposal capacity at the South End Waste Water Treatment Plant. Aqua Stmt. No. 2, p. 5.

19. Aqua and New Garden are currently working with PA DEP to resolve the shortfall in effluent spray disposal capacity. Aqua Stmt. No. 2, p. 5.

20. Aqua has agreed to complete two post-closing capital improvement projects to the New Garden system. Aqua Stmt. No. 2, p. 27.

21. Aqua agreed to replace a 6 inch diameter AC force main along Route 41 in the Avondale Service Territory in 2018. Aqua Stmt. No. 2, p. 6.

22. The Route 41 force main project is necessary due to the age of the current main and the fact that it has experienced several breaks in recent years. Aqua Stmt. No. 2, p. 6.

23. Aqua agreed to construct and put into service a mechanical treatment system with stream discharge in the South End Service Territory in 2018 or 2019. Aqua Stmt. No. 2, p. 6.

24. The new treatment system will correct for the shortfall in spray irrigation disposal capacity at the South End WWTP, and will bring the New Garden system into compliance with PA DEP requirements. Aqua Stmt. No. 2, p. 6.

25. The total estimated cost for the two capital improvement projects is \$2.5 million. Aqua Stmt. No. 1, p. 6.

26. Aqua is a Class A, Pennsylvania wastewater utility with total assets of \$100 million and annual revenues of \$12 million. Aqua Stmt. No. 1, p. 7.

27. Aqua PA is a Class A water utility that had total assets of \$3.8 billion and revenues of \$415 million in 2015. Aqua Stmt. No. 1, p. 7.

28. In 2015, Aqua PA had operating income of approximately \$208 million, net income of \$172 million and cash flows from operations of \$170 million. Aqua Stmt. No. 1, p. 7.

29. Aqua is a direct subsidiary of Aqua PA and has access to Aqua PA's financing capabilities. Aqua Stmt. No. 1, p. 7.

30. Aqua PA has a Standard and Poor's rating of A+. Aqua Stmt. No. 1, p. 7.

31. Aqua will finance the acquisition of the New Garden wastewater system using its existing short term credit facility. Aqua Stmt. No. 1, p. 8.

32. Aqua will likely convert this short term funding to a mix of long-term debt and equity capital at a later date. Aqua Stmt. No. 1, p. 8.

33. Aqua currently provides wastewater service to approximately 20,000 customers in 13 counties in Pennsylvania. Aqua Stmt. No. 2, p. 3.

34. Aqua's parent, Aqua PA is the second largest investor owned regulated water/wastewater utility operator in Pennsylvania and provides water and wastewater services to approximately 450,000 customers, of which approximately 20,000 are wastewater service customers. Aqua Stmt. No. 1, p. 4.

35. Aqua and Aqua PA have approximately 600 employees with extensive experience providing water and wastewater service to their customers. Aqua Stmt. No. 2, p. 4.

36. Aqua will operate the New Garden system with its current staff of wastewater operators. Aqua Stmt. No. 2, p. 9.

37. There are currently no pending legal proceedings challenging Aqua's ability to provide safe and adequate wastewater service to its customers. Aqua Stmt. No. 1, p. 7.

38. Aqua and New Garden agreed to use the process set forth in Section 1329 to determine the fair market value of the New Garden wastewater assets and the ratemaking rate base of those assets. Application, p. 13.

39. Aqua selected Gannett Fleming Valuation and Rate Consultants, LLC (Gannett) to perform an appraisal of the New Garden wastewater system assets. Aqua Stmt. No. 1, p. 11.

40. New Garden selected AUS Consultants, Inc. (AUS) to perform an appraisal of the New Garden wastewater system assets. Aqua Stmt. No. 1, p. 11.

41. Both Gannett and AUS were pre-qualified by the Commission as authorized Utility Valuation Experts (UVE) and are on the list of qualified appraisers maintained by the Commission. Aqua Stmt. No. 1, p. 11.

42. Fair market value appraisal reports were prepared by Gannett and AUS and attached to Aqua's Application as Exhibits U and V. Application, pp. 13-14; Application Exs. U and V.

43. Gannett determined that the fair market value of the New Garden wastewater system assets is \$33,666,340.00. Application, p. 14; Application Ex. U.

44. AUS determined that the fair market value of the New Garden wastewater system assets is \$30,615,410.00. Application, p. 14; Application Ex. V.

45. The purchase price of the assets that was negotiated and agreed upon by Aqua and New Garden is \$29,500,000.00. Application, p. 14.

46. The ratemaking rate base of the New Garden system assets is \$29,500,000.00, being the lesser of the average of the two fair market value appraisals and the negotiated purchase price. Application, p. 14.

47. Aqua submitted to the Commission an electronic copy of its Application and supporting documentation when the Application was initially filed on December 15, 2016. Aqua Stmt. No. 1R, p. 7.

48. The Commission issued a Secretarial Letter to the parties on December 30, 2016 in which it acknowledged receipt of Aqua's Application and instructed Aqua about further service requirements. Aqua Stmt. No. 1R, p. 7.

49. On January 9, 2017, Aqua attempted to transmit, by electronic mail, Excel files of documentation supporting the two UVE appraisals to I&E and the OCA. Aqua Ex. 2.

50. The Excel files were received by the OCA but were not received by I&E. Aqua Stmt. No. 1R, p. 7.

51. On January 17, 2017, Aqua learned that I&E had not received the e-mail containing the Excel files and delivered a CD copy of those files to I&E. Aqua Stmt. No. 1R, p. 7.

52. On January 25, 2017, Aqua provided to I&E follow up Excel files that addressed certain concerns raised by I&E with the files received on January 17, 2017. I&E Stmt. No. 1, p. 6.

53. Under the APA, Aqua is required to maintain the current rates to New Garden customers for no less than 730 days (two years) from the closing date of the transaction. Application, Ex. C1, p. 13.

54. Under the APA, the compounded annual growth rate (CAGR), inclusive of rates and distribution system improvement charge (DSIC), shall not exceed 4% for the ten year period beginning on the closing date of the transaction. Application, Ex. C1, p. 13.

55. As of December 31, 2014, the New Garden Township Sewer Authority's assets exceeded its liabilities by \$11,151,134, which figure represents the Authority's total net position on that date. Application, Ex. I2.

56. As of December 31, 2015, the New Garden Township Sewer Authority's assets exceeded its liabilities by \$12,347,026, which figure represents the Authority's total net position on that date. Application, Ex. I1.

57. The New Garden wastewater system has a net book value of \$18,567,728. Application, Ex. V; OCA Stmt. No. 1, p. 2.

58. The purchase price of \$29,500,000 is \$10.9 million, or 59%, over the net book value of the system. OCA Stmt. No. 1, p. 2.

59. As of the filing of its December 31, 2015 wastewater Annual Report, Aqua had 19,784 wastewater customers and wastewater net utility plant of \$73,477,924, for an average net plant amount per customer of \$3,714. OCA Stmt. No. 1, pp. 23-24.

60. Acquisition of the New Garden system would add \$29,500,000 in rate base (plant) and approximately 2,106 customers to the Aqua system. OCA Stmt. No. 1, pp. 23-24.

61. The average net plant amount per customer for the New Garden system, at a rate base value of \$29,500,000, is approximately \$14,007, more than 3 times the amount for the current Aqua system. OCA Stmt. No. 1, pp. 23-24.

62. The combined system would have an average net plant amount per customer of approximately \$4,704, which is nearly \$1,000 more than the current figure for Aqua's existing customers. OCA Stmt. No. 1, pp. 23-24; OCA Main Brief, p. 38.

63. The Gannett and AUS fair market value appraisals were performed in compliance with the Uniform Standards of Professional Appraisal Practice using the cost, market and income approaches. Aqua Stmt. No. 1, p. 11.

#### IV. DISCUSSION

##### A. Overview of Proposed Transaction

Aqua is a subsidiary of Aqua Pennsylvania, Inc. (Aqua PA) and is in the business of collecting, transporting, treating and disposing of wastewater for the public in various counties throughout Pennsylvania. Aqua currently provides wastewater service to approximately 20,000 customers in Adams, Bucks, Carbon, Chester, Clearfield, Delaware, Lackawanna, Luzerne, Monroe, Montgomery, Pike, Schuylkill and Wyoming Counties. Aqua operates 31 wastewater treatment plants in Pennsylvania. Aqua and Aqua PA have approximately 600 employees with extensive experience in the provision of water and wastewater service to the public. (Aqua Stmt. No. 2, p. 3).<sup>3</sup>

---

<sup>3</sup> Aqua's Application was admitted into the record in this proceeding as Aqua Exhibit 1. Aqua's Application has a number of exhibits attached to it that are also labeled as exhibits. The direct testimony of Aqua witness William C. Packer Jr. is included with Aqua's Application as Exhibit Y. Mr. Packer's direct testimony was admitted into evidence as Aqua Stmt. No. 1. The direct testimony of Aqua witness Mark J. Bubel, Sr. is included with Aqua's Application as Exhibit Z. Mr. Bubel's direct testimony was admitted into evidence as Aqua Stmt. No. 2. Throughout this decision, references to the direct testimony of Mr. Packer will be cited as Aqua Stmt. No. 1, and references to the direct testimony of Mr. Bubel will be cited as Aqua Stmt. No. 2. References to other parts of Aqua's Application and its exhibits will be referred to as "Application, p. \_\_", "Application, ¶\_\_" or "Application, Ex. \_\_."



The New Garden system includes three service areas, the East End Service Area, served by the East End Wastewater Treatment Plant (East End WWTP), the South End Service Area, served by the South End Wastewater Treatment Plant (South End WWTP), and the Avondale Service Area, served by the Avondale Wastewater Treatment Plant (AWWTP), which is owned by the Borough of Avondale. The East End WWTP and the South End WWTP are treatment pond systems with liquid chlorine disinfection and spray irrigation treated effluent disposal. The East End WWTP has a permitted capacity of 324,000 GPD. New Garden Township has an allocated capacity of 218,250 GPD in the AWWTP's 500,000 GPD plant. The South End WWTP currently has a spray irrigation effluent disposal capacity shortfall of approximately 24,000 GPD. New Garden Township is working with the Pennsylvania Department of Environmental Protection (PA DEP) to correct this shortfall with the approval of a reallocation of nutrient load to effect the approval of a new stream system discharge treatment process that would be located at the site of the South End WWTP. (Aqua Stmt. No. 2, pp. 3-6).

**A summary of the total Collection System Gravity Piping is as follows:**

<b><u>Diameter</u></b>	<b><u>Pipe Material</u></b>	<b><u>Total Lineal Feet</u></b>
6" and 8"	PVC	104,176
10" and 12"	PVC	21,453
6" and 8"	AC	11,244
10" and 12"	AC	13,157

**A summary of the total Collection System Force Main Piping is as follows:**

<b><u>Diameter</u></b>	<b><u>Pipe Material</u></b>	<b><u>Total Lineal Feet</u></b>
4" and less	PVC	33,899
6" and 8"	PVC	20,508
10" and 12"	PVC	1,750
4" and less	AC	1,378
6" and 8"	AC	16,956

(Aqua Stmt. No. 2, pp. 4-5).

Aqua proposes in its Application to acquire the sewer assets of the Township and the Authority for \$29.5 million. Aqua filed its Application under Sections 1329 and 1102 of the Public Utility Code. As the first filing made under Section 1329, Aqua requests that the purchase price of \$29.5 million be approved as the rate base value of the assets to be acquired for

ratemaking purposes, since it is lower than the average of the two appraisals provided with its Application. 66 Pa. C.S. § 1329(c)(2). In addition, Aqua seeks approval of its Asset Purchase Agreement (APA) with the Township and Authority. (Application, Ex. C1, C2 and C3). In the APA, Aqua has agreed not to increase rates for the acquired customers for at least 730 days following the date of closing of the transaction. It has further agreed in the APA to a 4% compound annual growth rate (CAGR) ceiling that would keep rate increases for the first ten years after closing to no more than 4% compounded annually for New Garden customers.

Aqua has agreed to expend approximately \$2.5 million for two projects in the New Garden territory. The first project involves the replacement of a 6 inch diameter AC force main along Route 41 in the Avondale service territory. This project is necessary due to the age of the current line and the fact that it has experienced several breaks in recent years. The second project involves the addition of a mechanical treatment system with stream discharge in the South End service territory to make up for a shortfall in spray irrigation disposal capacity at the South End WWTP. This new treatment system will bring the New Garden system into compliance with PA DEP requirements.

## **B. Overview of 66 Pa. C.S. § 1329**

On April 14, 2016, Governor Wolf signed into law Act 12 of 2016, which amended Chapter 13 of the Pennsylvania Public Utility Code by adding a new section, Section 1329, which became effective on June 13, 2016. 66 Pa.C.S. § 1329. Section 1329 addresses the valuation of assets of municipal-owned water and wastewater systems that are acquired by investor-owned water and wastewater utilities or other entities.

Under prior law at 66 Pa.C.S. § 1311(b), the value of assets to be acquired was defined as the original cost of construction less accumulated depreciation. This calculation often created a disincentive for the sale of municipal systems because systems that were greatly depreciated or were constructed using grants or contributions in aid of construction could have valuations so low that sales of the systems would be less advantageous or could cause financial hardships to the selling municipal corporations or authorities.

Section 1329 attempts to provide a remedy for this situation by establishing an alternative method for valuing water or wastewater system assets for rate making purposes that is more advantageous to the selling municipality and potential purchasers. Section 1329 mitigates the risk that a utility will not be able to fully recover its investment when it acquires a municipal system by enabling the purchasing utility or entity to utilize fair market value as the value of the acquired assets, rather than original construction cost less accumulated depreciation. Section 1329, therefore, allows for enhanced rate base adjustments based on the lesser of fair market value or the negotiated purchase price. It also allows for the deferral of post-acquisition improvement costs that are not recovered through a distribution system improvement charge (DSIC).

Section 1329 establishes a voluntary process whereby the acquiring public utility or entity and the selling municipality or authority may choose to have the fair market value of the acquired assets established through independent appraisals conducted by UVEs. Both the buyer and seller must agree on the fair market valuation procedure in order for it to be utilized. The Commission maintains a list of qualified UVEs from which the buyer and seller each choose an appraiser. The UVEs will each prepare an appraisal of the assets and the average of the two appraisals will be used as the fair market value of the assets. The rate base value of the acquired assets will be the lesser of the fair market value and the negotiated purchase price.

On October 27, 2016, the Commission issued its Section 1329 Final Implementation Order (IO), in which it reviewed the provisions of Section 1329 and detailed the Commission's requirements for compliance with its various subsections. The IO includes, among other things, discussions about the selection and qualification of eligible UVEs, the procedures UVEs must follow in preparing their appraisals, the selection and role of a licensed engineer to conduct a system assessment, and information to be included with the application filing.<sup>4</sup>

---

<sup>4</sup> The Commission's Tentative Implementation Order, entered June 30, 2017, included a sample litigation timeline that the Commission indicated it would use as a guide in order to complete application proceedings within the 6-month deadline set forth at Section 1329(d)((2).

### C. **Burden of Proof and Legal Standards**

Aqua, as the Applicant, has the burden of proof in this proceeding to establish that it is entitled to the relief sought. 66 Pa. C.S. § 332(a). Aqua must establish its case by a preponderance of the evidence. Samuel J. Lansberry, Inc. v. Pa. Pub. Util. Comm’n, 578 A.2d 600 (Pa. Cmwlth. 1990), Alloc. Den., 602 A.2d 863 (Pa. 1992). To meet its burden of proof, Aqua must present evidence more convincing, by even the slightest amount, than that presented by any opposing party. Se-Ling Hosiery v. Margulies, 70 A.2d 854 (Pa. 1950). In this case, Aqua requests that the Commission approve (1) the acquisition of the wastewater systems assets of New Garden Township and the New Garden Township Sewer Authority, (2) the right of Aqua to be able to offer, render, furnish and supply wastewater service to the public in portions of New Garden and Kennett Townships, Chester County, and (3) for an order approving the acquisition that includes the ratemaking rate base of the New Garden wastewater system assets pursuant to Section 1329(c)(2) of the Public Utility Code (“Application”).

Pursuant to 66 Pa. C.S. § 1102, Aqua must demonstrate by a preponderance of the evidence that it is technically, legally and financially fit to provide the proposed service. Seaboard Tank Lines, 502 A.2d 762 (Pa. Cmwlth. 1985); Warminster Township Mun. Auth. v. Pa. Pub. Util. Comm’n, 138 A.2d 240 (Pa. Super. 1958).

In addition to having to demonstrate its technical, legal and financial fitness, Aqua must also demonstrate that the transaction produces affirmative public benefits. In City of York v. Pa. Pub. Util. Comm’n, 295 A.2d 825 (Pa. 1972), the Pennsylvania Supreme Court held that the proponents of a merger or acquisition must show, by a preponderance of the evidence, that the proposed transaction will promote the service, accommodation, convenience or safety of the public in some substantial way.

In Popowsky v. Pa. Pub. Util. Comm’n, 937 A.2d 1040 (Pa. 2007), the Pennsylvania Supreme Court explained the City of York standard as follows:

In summary, as indicated in City of York, the appropriate legal framework requires a reviewing court to determine whether substantial evidence supports the Commission's finding that a merger will affirmatively promote the service, accommodation, convenience, or safety of the public in some substantial way. In conducting the underlying inquiry, the Commission is not required to secure legally binding commitments or to quantify benefits where this may be impractical, burdensome, or impossible; rather, the PUC properly applies a preponderance of the evidence standard to make factually-based determinations (including predictive ones informed by expert judgment) concerning certification matters.

937 A.2d at 1057.

Even where the Commission finds sufficient public benefit, it has the discretion to impose conditions on its approval that it deems just and reasonable. 66 Pa. C.S. § 1103(a).

I am recommending in this decision that the Application be denied on the basis that the Applicant has failed to prove by a preponderance of the evidence that the proposed transaction is in the public interest because it will not result in sufficient affirmative public benefits to justify its approval. I will address the various legal requirements associated with this application proceeding below.

**D. Applicant's Fitness**

As noted, an Applicant must demonstrate that it possesses the technical, legal and financial fitness to provide the proposed service. It is undisputed in this proceeding that Aqua possesses the necessary fitness. As an existing, certificated Pennsylvania public utility, Aqua enjoys a presumption of fitness in this proceeding. No other party presented evidence challenging the company's fitness to provide the proposed service. Aqua has, nonetheless, presented sufficient record evidence by which to conclude that it possesses the requisite technical, legal and financial fitness to provide the proposed service. I will briefly review some of this evidence below.

With respect to technical fitness, Aqua must demonstrate that it has sufficient staff, facilities and operating skills to provide the proposed service. Re: Perry Hassman, 55 Pa. PUC 661 (1982); Mertz White Ways Tours v. Pa. Pub. Util. Comm'n., 201 A.2d 446 (Pa. Super. 1964). In support of its position that it is technically fit, Aqua presented evidence that it currently provides wastewater service to approximately 20,000 customers in Adams, Bucks, Carbon, Chester, Clearfield, Delaware, Lackawanna, Luzerne, Monroe, Montgomery, Pike, Schuylkill and Wyoming Counties in Pennsylvania. (Aqua Stmt. 2, p. 3). It operates 31 wastewater treatment plants in Pennsylvania, and 17 systems of Aqua's Southeast Division are in proximity to New Garden Township. (Aqua Stmt. 2, p. 3).

Aqua's parent, Aqua PA, is the second largest investor owned regulated water/wastewater utility operating in Pennsylvania. It provides water and wastewater services to approximately 455,000 customers, consisting of 435,000 water customers and 20,000 wastewater customers. (Aqua Stmt. 1, p. 4). Aqua and Aqua PA, have approximately 600 employees who possess expertise in providing water and wastewater service to their customers. (Aqua Stmt. 2, p. 3). No other party presented any evidence challenging Aqua's technical fitness to provide the proposed service. I conclude, based on the record evidence, that Aqua has demonstrated by a preponderance of the evidence that it is technically fit to provide the proposed service.

With respect to legal fitness, Aqua must demonstrate that it obeys the Public Utility Code and the Commission's regulations. Re: Perry Hassman. Aqua is an existing public utility operating under certificates of public convenience issued to it by the Commission. Aqua's witness testified that there are no pending legal proceedings challenging Aqua's ability or propensity to provide safe and adequate service. No other party presented any evidence challenging Aqua's legal fitness to provide the proposed service. I conclude, based on the record evidence, that Aqua has demonstrated by a preponderance of the evidence that it is legally fit to provide the proposed service.

With respect to financial fitness, Aqua must demonstrate that it has sufficient financial resources to provide the proposed service. Re: Perry Hassman. Aqua's witness testified that its parent, Aqua PA, is a Class A Water utility in Pennsylvania with total assets of

\$3.8 billion and annual revenues of \$415 million in 2015. Aqua PA had operating income of approximately \$208 million and net income of \$172 million. Its cash flow from operations was \$170 million. Aqua PA has an A+ rating from Standard and Poor's Rating Service. (Aqua Stmt. 1, p. 7).

Aqua is a Class A wastewater utility in Pennsylvania, with total assets of \$100 million and annual revenues of \$12 million. (Aqua Stmt. 1, p. 7). Aqua included with its Application its financial statements for the year 2015 which show, among other things, net income of nearly \$2 million. (Application, Ex. D). As a subsidiary of Aqua PA, Aqua has access to Aqua PA's financing capabilities. (Aqua Stmt. 1, p. 7). Aqua's witness testified that the company will finance the transaction using existing short term credit lines, which will likely be converted to a mix of long-term debt and equity capital at some point in the future. (Aqua Stmt. 1, p. 8). No other party presented any evidence challenging Aqua's financial fitness to provide the proposed service. I conclude, based on the record evidence, that Aqua has demonstrated by a preponderance of the evidence that it is financially fit to provide the proposed service.

The record evidence demonstrates that Aqua is technically, legally and financially fit to own and operate the assets it would acquire and to provide the proposed service to the public.

**E. Rate Stabilization Plan**

Section 1329(g) defines a rate stabilization plan as, "[a] plan that will hold rates constant or phase rates in over a period of time after the next base rate case." In its Final Implementation Order, the Commission stated, in commenting on this provision:

With regard to an acquiring utility that files a rate stabilization plan . . . we conclude that the rate stabilization plans will be subject to review in each rate case for reasonableness and should not place long term burdens on the acquiring utility's existing ratepayers. As submitted by OCA, we also conclude that if a rate stabilization plan is proposed, the applicant will be required to provide testimony, schedules, and work papers that establish the basis for

the plan and its impact on existing customers who need to cover the revenue requirement that would be shifted to them under the plan.

Final Implementation Order, p. 27; 66 Pa. C.S. § 1329(g).

The requirements in Section 1329(g) are intended to protect against rate commitments built into the transaction that benefit the seller's existing customers, causing revenue shortfalls that may have to be covered by the existing customers of the buyer if future costs attributed to the acquired system are unable to be recovered from the seller's customers because of those commitments.

Paragraph 26 of Aqua's Application provides as follows:

After closing, Aqua will charge the New Garden rate schedules for all customers in the Requested Territory for no less than seven hundred thirty (730) days from the Closing Date. The Agreement further provides that, for the ten year period beginning on the Closing Date, the compounded annual growth rate [CAGR] inclusive of Rates and Distribution System Improvement Charge shall not exceed four percent (4%).

Application, ¶26.

The rate provisions set forth in ¶26 of the Application are reflected in Section 7(b) of the APA, which provides, in relevant part:

Buyer agrees that: (i) the rate schedules, shown in Schedule 7, for all customers in the Service Area shall remain the same as those Rates charged by Seller as of Closing for no less than seven hundred thirty (730) days from the Closing Date (the "Rate Freeze Period") . . . and (ii) the compounded annual growth rate (CAGR) inclusive of Rates and Distribution System Improvement Charge ("DSIP") (as DSIC is defined in Aqua's Tariff) shall not exceed four percent (4%) for the ten year period beginning on the Closing Date. The parties acknowledge and agree that during this ten year period only pass-through costs or charges imposed by the Commonwealth of Pennsylvania, including, but not limited to State



Tax Adjustment Surcharges, may be subject to increase. For purposes of this Section 7.b, “Rates” shall mean and include only customer services charges and consumption charges.

Application, Ex. C1.

Aqua argues that it is not proposing a rate stabilization plan. It correctly notes in its main brief that a rate stabilization plan is not required for every Section 1329 application.

Aqua Main Brief, p. 40. Its witness testified as follows:

No, the Company has not proposed a rate stabilization plan . . . Here, there is no proposal to stabilize rates at this point in time so the Company did not, and was not required to, include a rate stabilization plan. Moreover, the Company’s proposed rate schedule tariff pages contain rates equal to the existing rates of the New Garden Sewer Authority.

Aqua Stmt. 1-R, p. 4.

Aqua states in testimony that it is “. . . proposing neither a constant hold nor a phase in over a period of time after its next base rate case in its application.” (Aqua Stmt. 1R, p. 5). It goes on to argue, “. . . the Company is simply implementing the existing rates of the New Garden Sewer Authority and deferring the rate making determinations until the next base rate case, which is also worth noting, is not date certain.” (Aqua Stmt. 1R, p. 5). Aqua argues in its main brief that the tariff submitted with its application does not propose to leave rates unchanged after its next base rate case, nor does it phase rates in after the next base rate case. It states that the tariff leaves rates unchanged until new rates are approved in the next rate proceeding. (Aqua Main Brief, p. 40).

I&E, the OCA and the OSBA all argue that the commitments set forth in ¶26 of the Application and Section 7(b) of the APA do, in fact, constitute a rate stabilization plan, thereby necessitating the submission, by Aqua, of supporting testimony, schedules and work papers that establish the basis for the plan and its impact on existing customers as required by the Commission’s IO.

The OCA argues that the exact impacts of Aqua's rate freeze and CAGR are not known but, because of their rate commitments, it is likely that the costs of the New Garden system will exceed the revenues that the Company can charge to those customers, thereby shifting the burden to Aqua's existing customers. The OCA's witness testified:

The exact impact of the ratemaking proposals on Aqua's existing customers is unknown, because, as explained previously, Aqua did not provide testimony or schedules outlining the impacts on its existing customers. However, it is likely that costs of the New Garden system will exceed the revenues that the Company may charge under its agreement with New Garden.

The CAGR provision lasts for ten years, and if the provision results in excess revenue requirement being shifted to existing customers, this will place a long-term burden on existing ratepayers. Ten years following the acquisition is an unreasonably long time for existing customers to pay rates that include the costs associated with the New Garden system while New Garden customers pay rates that may be less than their cost of service.

OCA Stmt. 1, pp. 5-6.

As a result of this analysis, the OCA requests that if the Application is approved, including the rate freeze and the CAGR, a condition be imposed that the Commission retain authority to allocate revenues, if appropriate, to the New Garden customers that are in excess of the restrictions set forth in the APA. The OCA further requests that the condition require that Aqua and its shareholders bear the risk of any shortfall between the revenues it is permitted to recover under the APA and the costs Aqua will incur with respect to the New Garden system. (OCA Stmt. 1, p. 6; OCA Main Brief, p. 28).

I&E likewise argues that the rate restrictions contained in Aqua's Application and the APA constitute a rate stabilization plan and that Aqua should have supported the plan with testimony, schedules and work papers. I&E's witness testified that, "[b]ecause Aqua proposes to hold rates constant for a fixed period of time, at least 730 days, and it also proposes a plan to limit New Garden rate increases for a ten-year period following the closing date, it is proposing a

rate stabilization plan.” (I&E Stmt. 1, p. 12). The I&E witness expressed similar concerns to those of the OCA, testifying that:

[W]hen rates are frozen or limited, the revenue shortfall could be substantial. Since future rates are always subject to review, there could be some subsidization of this system by other wastewater customers or over to other water customers in a combined filing. We do not know the revenue requirement for this system in the future and we do not know the plan to eventually merge the wastewater rates in the system with Aqua’s other wastewater rates and how fast after rate cap expires customer rates will increase.

I&E Stmt. 1-SR, p. 14; I&E Main Brief, p. 13.

As a result of I&E’s concerns, it recommends that Aqua’s Application be denied or, in the alternative, that the rate restrictions in the Application and the APA be stricken from the Application.

The OSBA shares the concerns raised by I&E and the OCA. It argues in its main brief:

If the proposed transaction is approved as filed, the plain language of Section 7(b) of the APA provides that New Garden customers will not pay rates outside the limitations set forth in Section 7(b) of the APA. As such, former New Garden customers, now also Aqua customers, would potentially pay less for wastewater services (utility services) than Aqua’s tariffed rates for wastewater service following the company next base rate proceeding in direct contraction [sic] with the Public Utility Code.

OSBA Main Brief, p. 4.

OSBA requests, similar to the other advocates:

. . . as an alternative to rejecting the 4% CAGR provision of the APA, Mr. Kalcic testified that the Commission should direct Aqua to impute revenues to New Garden customers, as necessary, to make up the difference (if any) between (i) the rate increase

otherwise applicable to New Garden and(ii) the rate increase limited by the 4% CAGR commitment. Mr. Kalcic's alternative recommendation would ensure that Aqua shareholders "would bear the cost of any rate differential," as suggested by the Company.

OSBA Main Brief, p. 5.

Each of the advocates argue that the rate restrictions contained in ¶26 of Aqua's Application and Section 7(b) of the APA constitute a rate stabilization plan in support of which Aqua should have submitted testimony, schedules and work papers to explain the impacts of the restrictions. Having not been provided with this supporting information, the advocates argue they are unable to evaluate the reasonableness of the plan and, accordingly, request that either the Application be denied, the restrictions be stricken or that conditions be attached to the approval shifting the risk of any shortfall in revenues collected from the acquired customers to Aqua and its shareholders.

I agree with the advocates that the rate restrictions set forth in the APA constitute a rate stabilization plan as contemplated by Section 1329(g). As noted above, a rate stabilization plan is "[a] plan that will hold rates constant or phase rates in over a period of time after the next base rate case." First, as noted by the OCA in its Main Brief, it is possible that Aqua could file a base rate proceeding that could be concluded within 730 days (2 years) of the closing date of the New Garden system acquisition. If the Application and the APA are approved by the Commission without conditions, New Garden customers would not receive a rate increase, even if costs attributed to that system indicated that a rate increase was necessary. Under this scenario, Aqua's other customers may be burdened with the New Garden portion of the overall increase. I believe that this scenario falls within Section 1329's definition of a rate stabilization plan.

Additionally, Aqua's proposed CAGR provision would limit rate increases to New Garden customers over the ten years following the closing of the transaction to no more than an average of 4% per year. 9Tr. p. 410. I believe that this provision also falls within the definition of a rate stabilization plan. In the event, as addressed by OCA witness Everette on pages 27-28 of her direct testimony, that costs attributed to the New Garden customers exceeded

revenues that could be collected from those customers due to the rate restrictions, the burden would fall on Aqua's existing customers to make up any revenue shortfall. I find this scenario to be analogous to a phase in of rates to the acquired customers following the next base rate case. If the full amount of costs attributable to the acquired customers cannot be recovered from them due to the rate increase limitations of the CAGR, the rates to those customers are, in effect, being phased in over a period of time.

Aqua acknowledged in this proceeding that the Commission has final authority over the rates charged to utility customers for utility service. As the OCA noted in its main brief, Aqua provided a discovery response to the OCA in which it stated, "[t]he Company understands that the PUC has ultimate jurisdiction regarding rates charged to customers to utility service. To the extent that those determinations are in conflict with the provisions of the Asset Purchase Agreement, it is the Company who bears the burden of that risk." (OCA Main Brief, p. 29; OCA Stmt. 1, p. 6). Further, Aqua's witness testified, "[t]he Company understands that PUC ultimately will decide on the appropriate rates to charge for this system in its next base rate case and, if those rates would otherwise violate the Company's commitment in the APA, then the Company shareholders would bear the cost of any rate differential accordingly." (Aqua Stmt. 1, p. 8). Finally, when asked on cross-examination how Aqua would account for a situation where costs attributed to the New Garden system exceed revenue allowed to be recovered from those customers under the APA, Aqua's witness testified, "[t]he company would be preparing a rate design conceivably that we feel would work reasonably within the confines of the purchase agreement but we may not be able to do that. We may have to in some cases shareholders might take part in some of that as well." [sic] (Tr. p. 42).

All parties agree that the rate commitment provisions in the Application and the APA may not trump the Commission's ultimate authority to set and allocate rates. I&E and the OSBA argue that the rate commitments in Section 7(b) of the APA should be stricken from the Application if it is approved by the Commission. The OCA argues if the Application is approved by the Commission, a condition should attach to the approval placing the risk of any revenue shortfall from the acquired customers caused by the APA on Aqua's shareholders.

I find that the rate commitments set forth in the APA constitute a rate stabilization plan and that Aqua should have provided supporting information to determine the impacts of the plan on existing customers. Since supporting information was not provided, it is not possible to fully analyze and assess the potential rate implications of future rate increases on the acquired customers and Aqua's existing customers. In the event the Commission ultimately approves Aqua's application, I recommend that it consider the attachment of the conditions proposed by the OCA, as follows:

The Commission retains the authority to allocate revenues, if appropriate, to the New Garden Township customers that are in excess of the restrictions outlined in the APA.

Aqua and its shareholders should bear all risk of a shortfall between revenues it is permitted to recover under its agreement with New Garden and the costs that the Company will incur with respect to this system. To the extent that Aqua is unwilling or unable to charge costs in excess of the limitations provided in the Asset Purchase Agreement, the excess costs should be borne by shareholders and not spread to other ratepayers.

By attaching these conditions to approval of the Application, the acquired customers would enjoy the benefits of the rate commitments negotiated and memorialized in the APA while assuring that Aqua's existing customers were not unfairly burdened by any revenue shortfalls resulting from those commitments.

**F. Rate Base Valuation**

**1. Ability to Challenge Fair Market Value Appraisals**

An important issue arose in this proceeding concerning the interpretation of Section 1329 related to the appraisals of the two UVEs and the rate base valuation for ratemaking purposes submitted by Applicants with their applications. More specifically, the parties are in disagreement over whether Section 1329 allows for the Commission or other parties to challenge the appropriateness of the fair market value determinations of the UVEs in

their appraisals and, ultimately, the rate base value proposed by the Applicant for those assets for ratemaking purposes.

As noted, Section 1329 provides an alternative method of assigning a rate base value to the acquired assets that provides an incentive to existing utilities or other entities to acquire municipal-owned water and wastewater systems. Under Section 1329, a purchaser may use fair market value calculations in valuing the assets rather than original cost of construction less accumulation depreciation. If the purchaser and the seller both agree to the Section 1329 process, each selects a UVE from a list of appraisers qualified and maintained by the Commission. The UVEs will perform independent appraisals of the system in accordance with Uniform Standards of Professional Appraisal Practice (USPAP), utilizing the cost, market and income approaches. Fair market value is defined as, “[t]he average of the two utility valuation expert appraisals conducted under subsections (a)(2).” Section 1329(c)(2) provides that, “[t]he ratemaking rate base of the selling utility shall be the lesser of the purchase price negotiated by the acquiring public utility or entity and selling utility or the fair market value of the selling utility.”

Aqua argues that the procedures set forth in Section 1329 provide the mechanism for determining the rate base value of the acquired assets and that there is no allowance thereunder for other parties to challenge or question the appropriateness of the rate base value proposed by the applicant. Aqua states:

Aqua and New Garden negotiated a purchase price of \$29,500,000 for the wastewater system. The price was the result of voluntary arm’s length negotiations. Aqua and New Garden are not affiliated with each other. They agreed to use the process presented in Section 1329 to determine the fair market value of the wastewater system and the ratemaking rate base.

Aqua engaged the services of Gannet to provide a fair market value appraisal in accordance with USPAP, utilizing the cost, market and income approaches. New Garden engaged the services of AUS for the same purpose. Both firms were pre-certified as authorized UVEs by the Commission and are on the list of qualified appraisers maintained by the Commission.

Gannett's fair market value appraisal is \$33,666,340. AUS's fair market value appraisal is \$30,615,410. The average is \$32,140,875. As directed by the General Assembly in Section 1329(d)(1)(iii), the ratemaking rate base determined pursuant to Section 1329(c)(2) is \$29,500,000, being the lesser of the negotiated purchase price of \$29,500,000 and the average of \$32,140,875.

As required by Section 1329(d)(1)(i), copies of the Fair Market Value Appraisal Reports of Gannett and AUS were attached as Exhibit U and Exhibit Y, respectively, to the Application. Verified Statements of Gannett and of AUS, verifying that their appraisals determined fair market value in compliance with the USPAP, employing the cost, market and income approaches, were attached to the Application as Exhibit X1 and Exhibit X2, respectively.

Section 1329(d)(3)(i) provides that if the Commission issues an order approving an application under Section 1329, the order "shall include [ ] the ratemaking rate base of the selling utility, as determined under subsection (c)(2)." 66 Pa.C.S. § 1329(d)(3)(i). The express language of Section 1329(d)(3) is clear and unambiguous and phrased in mandatory terms.

The Commission's Order approving Aqua's acquisition of the New Garden wastewater system must include a determination that the ratemaking rate base is \$29,500,000.

Aqua Main Brief, pp. 30-31.<sup>5</sup>

The other parties disagree with Aqua's interpretation of Section 1329. The OCA argues that it would be inconsistent with the Public Utility Code to allow Aqua to submit its valuation proposal, supported by two reports, without allowing any review or challenge to those reports. (OCA Main Brief, p. 8).

I&E argues that Section 1329 contemplates a more thorough review by the Commission of the valuation process than suggested by Aqua. It notes that the UVEs are required to perform their appraisals in compliance with the USPAP, using the cost, market and income approaches. I&E argues that, "[w]ithout parties' ability to investigate the underlying

---

<sup>5</sup> In both its Main Brief and Reply Brief, PAWC supports Aqua's position and argues that Section 1329 does not allow other parties to challenge the appropriateness of the appraisals and rate base valuation proposed by Aqua in its Application.



basis of the UVEs' fair market value appraisals, it will not be possible for the Commission to determine whether the UVEs complied with Section 1329." (I&E Main Brief, p. 22). I&E also argues that the perfunctory review advocated by Aqua is inconsistent with the timeline and procedures set forth in Section 1329. It argues that, without the ability to review an Applicant's proposal as sought by Aqua, an application should theoretically be granted once it has been perfected. Under this scenario, there would be no need for the six-month review required under Section 1329.

I&E further argues that Aqua's interpretation of Section 1329 would have the effect of transferring the duty to protect the public interest from the Commission to the two UVEs. I&E argues that there is no language in Section 1329 requiring the Commission to abdicate its obligation to set just and reasonable rates. (I&E Main Brief, pp. 22-26).

As discussed above, I&E previously requested the Commission, via its Petition for Expedited Interlocutory Review, Stay of Proceedings, and Answer to Material Questions, to answer this question for the parties. Specifically, I&E asked: "Does Section 1329 of the Public Utility Code bar the Bureau of Investigation and Enforcement from developing a record for the Commission regarding whether the valuation proposed by an Applicant is appropriate?" The Commission chose not to answer the question. This is an issue that will likely arise in every Section 1329 application proceeding that comes before the Commission. An ultimate answer to this question will greatly clarify the scope of future proceedings.

I indicated during the hearing that I was not convinced the legislature intended to completely eliminate the Commission's ability to analyze and challenge the UVE appraisals and the rate base value proposed by an Applicant. That remains my position.

Neither Section 1329 nor the Commission's IO address or answer this question of first impression.

Section 1329(a)(3) provides that, "each utility valuation expert shall determine fair market value in compliance with the Uniform Standards of Professional Appraisal Practice,

employing the cost, market and income approaches.” 66 Pa. C.S. § 1329(a)(3). I&E argues in its Main Brief:

Under this standard, any appraisal submitted by a UVE must be consistent with the Uniform Standards of Professional Appraisal Practice and it must utilize the three outlines approaches. Without parties’ ability to investigate the underlying basis of the UVE’s fair market value appraisals, it will not be possible for the Commission to determine whether the UVEs complied with Section 1329.

I&E Main Brief, p. 22.

I agree that, at a minimum, the Commission and other parties should have the ability to fully review and analyze the fair market value appraisals to determine if, in fact, they were prepared in accordance with the requirements of the USPAP and whether the three required approaches were accurately applied to the UVEs’ analyses.

Further, I find nothing in the language of Section 1329 or the Commission’s IO that strips from the Commission its statutory duty to assure the public interest and compliance with the Public Utility Code and Commission regulations. I&E cites in its main brief to 66 Pa. C.S. § 308.2(a) (11), which authorizes the Commission to “[t]ake appropriate enforcement actions, including rate proceedings, service proceedings and application proceedings, necessary to insure compliance with this title, commission regulations and orders.” Additionally, 66 Pa. C.S. § 1103(a) requires that a certificate of convenience shall be granted, “. . . only if the commission shall find or determine that the granting of such certificate is necessary or proper for the service, accommodation, convenience, or safety of the public.” I disagree with Aqua and PAWC that Section 1329 precludes review and analysis by the Commission or other parties of the UVE fair market value appraisals in an effort to insure that the public interest is protected. I do not believe that the legislature, in enacting Section 1329, intended this result, and I will not recommend such a result here.

## **2. Files in Electronic Working Format**

I&E raised another issue in this proceeding concerning the adequacy of the materials submitted by Aqua as part of its Application filing. Specifically, I&E argues that the Application should be denied because Aqua did not submit all supporting documentation for the fair market value appraisals in working electronic format. It refers to the Commission's IO, which provides, "[n]o application will be considered perfected without the filing of all schedules, studies and work papers in a working electronic format and confirmation that all required to be served have the working electronic format." (IO, p. 25). I&E notes that it received the requested files on January 17, 2017, but that they were still not complete and contained inaccuracies. (I&E Main Brief, p. 8). I&E stated it received updated electronic files from Aqua on January 25, 2017 but that, because I&E's testimony was due six days later, on January 31, 2017, it did not have sufficient time to verify the calculations contained in the two appraisals. (I&E Main Brief, p. 9).

Aqua argues first that it understood the request for documentation in working electronic format to mean an electronic copy of the filing, which it provided with the filing of the Application on December 15, 2016. (Aqua Main Brief, p. 36). It further argues it tried to work proactively with I&E to address I&E's concerns, and that it attempted to e-mail to I&E the requested documentation in MS Excel files on January 9, 2017, but an issue with I&E's e-mail system prevented I&E from receiving the files. (Aqua Ex. 2; Aqua Main Brief, p. 37). Aqua states that upon learning that I&E had not received the MS Excel files on January 17, 2017, it delivered a CD copy of the files to I&E. (Aqua Stmt. No. 1R, p. 7). According to Aqua, I&E acknowledged receiving the Excel files on January 17, 2017, and follow up Excel files further addressing I&E's concerns on January 25, 2017. (I&E Stmt. No. 1, pp. 6-10; Aqua Main Brief, p. 37). Aqua argues that I&E's witness acknowledged performing a limited review after January 25, 2017, and that I&E is overstating alleged deficiencies with the files it received. (Aqua Main Brief, p. 38). It asks that the testimony of I&E's witness on this issue be given no weight. (Aqua Main Brief, p. 40).

I first note that, due to the statutory six month time limit for this proceeding contained in Section 1329(d)(2), all parties were constrained by and forced to work within a

greatly compressed litigation schedule. I note further that I&E was the only party to raise the issue of insufficient time to fully analyze the two appraisals. The OCA conducted what appears to be a thorough and comprehensive review and analysis of the application materials and appraisals submitted by Aqua in arguing for a lower rate base value for the acquired assets. OCA's witness thoroughly reviewed and analyzed the appraisals prepared by Gannett and AUS in arriving at OCA's revised rate base value recommendation. The OCA's argument is set forth on pages 6-25 of its main brief.

With respect to the Gannett appraisal, I&E witness Kubas acknowledged having difficulty with only 1 of the 32 books included with the Excel files provided. (Tr. p. 113). With respect to the AUS appraisal, Aqua witness Weinert testified that errors cited by I&E were either residual links from a prior spreadsheet that he imported to begin the New Garden appraisal which were not needed for the New Garden analysis, or included data that was not part of the final appraisal product and, therefore, had no impact of the results of the appraisal. (Aqua Stmt. No. 4R, p. 11; Aqua Main Brief, p. 39).

I&E received Excel files from Aqua on January 17, 2017 and follow up Excel files resolving additional I&E concerns on January 25, 2017. It had six days from that point to prepare its direct testimony, which was due on January 31, 2017. Further, the testimony cited above suggests that the deficiencies expressed by I&E appear to have been relatively limited in scope. For these reasons, I disagree that this issue provides a sufficient basis on which to deny Aqua's Application.

### **3. Approval of Rate Base Value**

As noted, Section 1329 provides, *inter alia*, that when a regulated water or wastewater utility or other entity acquires a municipal water or wastewater system, the parties to the transaction may ask for ratemaking treatment of the acquired assets whereby the value of the assets is established based on fair market value. 66 Pa. C.S. § 1329. As set forth in Section 1329(a) and (b), determination of fair market value is determined by the results of two separate,

independent appraisals conducted by a UVEs.<sup>6</sup> One shall be selected by the selling utility and one shall be selected by the acquiring public utility or entity. 66 Pa. C.S. § 1329(b)(1). Each UVE shall determine fair market value in compliance with the Uniform Standards of Professional Appraisal Practice, employing the cost, market and income approaches. 66 Pa. C.S. § 1329(a)(3). The appraisals are then averaged to determine the fair market value, 66 Pa. C.S. § 1329(g). The lesser of the negotiated purchase price or the fair market value is the value the acquiring utility will use as the rate base for the acquired assets in its next base rate case. 66 Pa. C.S. § 1329(c)(2).

Here, New Garden selected AUS and Aqua selected Gannett to prepare fair market value appraisals of New Garden's sewage collection and treatment system assets. Based on AUS's appraisal, the fair market value for New Garden's wastewater system property, plant, and equipment is \$30,615,410, as of June 30, 2016. (Application, Ex. V). This was determined based on the cost, income, and market approaches to value. Gannett appraised the fair market value to be \$33,666,340, as of September 30, 2016. (Application, Ex. U). Gannett used four methods under the cost, market and income approaches to valuation: original cost new less depreciation method, market multiple discounted cash flow method, capitalization discounted cash flow method, and the market multiples method. The fair market value average of the two appraisals is \$32,140,875. Both UVEs prepared their reports based on the 2016-17 Uniform Standards of Professional Appraisal Practices. (Aqua Stmt. No. 1, p. 11; 66 Pa. C.S. § 1329(c)(3)).

On August 19, 2016, Aqua and New Garden executed an Asset Purchase Agreement for the sale of the wastewater system assets, properties and rights of the system. The negotiated purchase price is \$29,500,000. Aqua proposes to use \$29,500,000 as its rate base in its next base rate case, which is the lesser amount between the purchase price and the fair market value average of the two appraisals. 66 Pa. C.S. § 1329(c)(2).

---

<sup>6</sup> The Commission maintains a list of UVEs to be utilized by the buyer and the seller. To be included on the registry, the UVEs must establish their qualifications, and must have adequate utility valuation and appraisal experience. *See*, Final Implementation Order at Docket No. M-2016-2543193, entered October 27, 2016.

The OCA recommends that if the Commission approves the proposed acquisition, the value of the rate base to be used in Aqua's next ratemaking rate case should be \$28,882,607, not \$29,500,000. (OCA Main Brief, p. 42; OCA Stmt. No. 1S, p. 14.). OCA avers that the appraisal submitted by Gannett contains a number of flaws and should be revised. Its position is that once the corrections are made, Gannett's fair market value is \$27,149,804, instead of \$33,666,340, thereby bringing the average of the two UVE appraisals to \$28,882,607  $((\$27,149,804 + \$30,615,410) / 2)$ . OCA argues, therefore, that the amount Aqua should be allowed to use for future ratemaking purposes is \$28,882,607. As explained below, I am not in complete agreement with the OCA's analysis.

In Gannett's appraisal, the OCA made two adjustments to Gannett's income approach and removed the growth and risk adjustments under Gannett's market approach. I have reviewed OCA's adjustments and agree with removing the growth and risk adjustments made under the market approach, but not with removing the two adjustments under the income approach. I conclude, as explained below, that the overall average of the two appraisals is \$29,990,204.  $((\$30,615,410 + \$29,364,998) / 2)$ .

In the market approach, Gannett gave the wastewater company an indicated value of \$34,385,471, with a weight of 45%, resulting in a weighted value of \$15,473,462. OCA disputes the result, arguing that Gannett incorporated unsupported growth and risk adjustments. OCA avers that the growth and risk adjustments are speculative and should be removed. Once removed, the indicated value is \$25,324,422 and the weighted value at 45% is now \$11,395,989. (OCA Stmt. No. 1, pp. 18-21). I agree that there was not an adequate explanation presented in the appraisal to substantiate growth and risk rates that ranged from 95% to 200%, which increased the value of the property under the market approach. Any such assumption or premise should be more adequately explained.

In the income approach, OCA made two adjustments to Gannett's valuation. The first adjustment is to remove the result produced by the 7.22% return on equity, and the second adjustment is to disregard the result produced by the 2.66% capitalization rate. By disregarding those two results, OCA adjusted Gannett's indicated value of \$36,297,487 to \$30,877,346. After

applying the 45% weight, the weighted value is now \$13,894,805. (OCA Stmt. No. 1, pp. 12-14). In the income approach there are two common methods to valuation: the capitalization of earning or cash flow method and the discounted cash flow method (DCF). Gannett analyzed both methods and relied on the DCF method to form the basis for the income approach conclusion, as opposed to the results of the capitalization of earnings method. I disagree with OCA's adjustment because it involves the capitalization of earning or cash flow method. I note, however, that there is a mathematical error transcribed from the Excel spreadsheet to the narrative report that affected the results of the DCF method. The correct indicated value under the income approach should be \$35,800,000 (rounded) and not \$36,297,487.<sup>7</sup> After applying a 45% weight, the weighted value is now \$16,110,000.

I note that Gannett made one other error, which was acknowledged in Aqua's response to a Commission data request. Gannett had included property in the cost of assets that amounted to \$20,000 (rounded), which should not have been included. The assets need to be reduced by \$20,000 before all calculations are made. However, the \$20,000 error is not enough to impact the overall figures in a significant way.

The third method used by the UVE's was the cost approach. The cost approach can include the use of the original cost method, the trended original cost method, the reproduction cost method, and the replacement cost method. Using the trended original cost method, AUS determined that New Garden's investment in plant, property and equipment of \$27,146,852 was determined to have a reproduction cost new of \$60,232,051.<sup>8</sup> Based on their experience with other water and wastewater depreciation studies, inspection of New Garden's

---

<sup>7</sup> On Gannett's Exhibit 9, page 3 of the appraisal, the result of the Market Multiple DCF based on an investor owned utility (IOU) ownership indicated a range value of \$31.7 million to \$36.0 million. However, in Gannett's narrative report, they used the figures of \$31.7 million to \$40.0 million. The value range for the Market Multiple DCF based on IOU should be corrected to \$31.7 million to \$36 million. The average of these two numbers is \$33.9 million instead of \$35.9 million. When the adjusted number of \$33.9 million is averaged with the Capitalization DCF based on IOU of \$21 million (average of \$16.5 million and \$25.5 million), the overall IOU ownership valuation is \$27.5 million and not \$28.5 million. The Market Multiple DCF based on MUNI ownership indicates a value of \$44.1 million. The \$44.1 million and \$27.5 million are averaged together with a result of \$35.8 million (rounded). Gannett incorrectly used \$36.3 based on averaging \$44.1 million and \$28.5 million.

<sup>8</sup> The cost indexes used were from the Handy-Whitman Index of Public Utility Construction Costs for the water industry in the northeastern region of the United States, AUS General Plan Indexes, and various United States Bureau of Labor Statistics indexes. (AUS Appraisal, page 2).

sewer property, and analysis of New Garden's sewer system operating performance, AUS made the assessment that New Garden experiences normal depreciation but not any significant functional or economic obsolescence (AUS Appraisal, p. 3). After applying normal age-life depreciation techniques, AUS indicated the value of the sewer system is \$30,615,410. AUS gave it a weight of 100%, therefore the weighted value was \$30,615,410. No adjustments were made to AUS's weighted value.

Gannett used the original cost new less depreciation (OCNLD) method. An OCNLD study established that the original cost new of the sewer system's utility plant in service as of June 30, 2016, was not less than \$27,267,123. It also determined a calculated accrued depreciation reserve of \$8,677,034. After factoring in the accrued depreciation reserve, the OCNLD of the sewer system's utility plant in service was determined to be \$18,580,089 (\$27,267,123 - \$8,677,034). Gannett gave this a weight of 10%, which produced a weighted value of \$1,859,009. No adjustments were made to Gannett's cost approach method. Therefore, the weighted value of \$1,859,009 remained unchanged.

The UVEs have the discretion to apply different weights to their indicated values. It is noted that applied weights used by the UVEs are extremely different, but OCA did not make any adjustments to the weights used, and I do not do so here.

The following tables give a recap of the appraisals as originally submitted (Table 1) and of the appraisals with the Commission's adjustments for Gannett (Table 2).



**Table 1 – Gannett and AUS appraisal recap with no adjustments.**

	<u><b>Gannett</b></u>				<u><b>AUS</b></u>		
	Indicated Value	Weight	Weighted Value		Indicated Value	Weight	Weighted Value
Cost	\$18,590,089	10%	\$1,859,009	Cost	\$30,615,410	100%	\$30,615,410
Income	\$36,297,487	45%	\$16,333,869	Income	\$29,500,000	0%	0
Market	\$34,385,471	45%	\$15,473,462	Market	\$30,090,662	0%	0
<b>Total</b>		100%	<b>\$33,666,340</b>	<b>Total</b>		100%	<b>\$30,615,410</b>

The average of the two evaluations  $((\$33,666,340 + \$30,615,410) / 2)$  is \$32,140,875.

**Table 2 – Gannett and AUS appraisal recap with adjustments.<sup>9</sup>**

	<u><b>Gannett</b></u>				<u><b>AUS</b></u>		
	Indicated Value	Weight	Weighted Value		Indicated Value	Weight	Weighted Value
Cost	\$18,590,089	10%	\$1,859,009	Cost	\$30,615,410	100%	\$30,615,410
Income	\$35,800,000	45%	\$16,110,000	Income	\$29,500,000	0%	\$0
Market	\$25,324,422	45%	\$11,395,989	Market	\$30,090,662	0%	\$0
<b>Total</b>			<b>\$29,364,998</b>	<b>Total</b>		100%	<b>\$30,615,410</b>

The average of the two valuations  $((\$29,364,998 + \$30,615,410) / 2)$  is \$29,990,204.

After consideration of the adjustments reflected in Table 2, I find that the appraisals submitted by the UVEs are just and reasonable and that, if the Application were to be approved, the appropriate amount Aqua should use as a rate base in its next ratemaking proceeding is \$29,500,000.

<sup>9</sup> As addressed above, I removed the growth and risk adjustments to Gannett's market approach, and corrected a math error to Gannett's income approach.

**G. Public Interest / Affirmative Public Benefits**

I now turn to the issue of whether Aqua has proven by a preponderance of the evidence that approval of its Application is in the public interest by demonstrating that the transaction will result in affirmative public benefits. As noted above, Aqua must demonstrate that the transaction produces affirmative public benefits. In City of York v. Pa. Pub. Util. Comm'n, 295 A.2d 825 (Pa. 1972), the Pennsylvania Supreme Court held that the proponents of a merger or acquisition must show, by a preponderance of the evidence, that the proposed transaction will promote the service, accommodation, convenience or safety of the public in some substantial way. When looking at the benefits and detriments of a transaction, the focus of the analysis must be on all affected parties, not merely a particular group or a particular geographic area. Middletown Township v. Pa. P.U.C., 482 A.2d 674 (Pa. Cmwlth. 1984). The primary objective of the law in this regard is to serve the interests of the public. Id. See also Popowski v. Pa. P.U.C., 937 A.2d 1040 (Pa. 2007).

As explained below, I find that, although approval of Aqua's Application may result in affirmative benefits to certain segments of the public, such as New Garden's existing customers, Aqua has failed to prove that the public at large, including Aqua's existing customers, will realize affirmative benefits.

Aqua makes a number of arguments in its main brief in support of its position that approval of its Application will result in affirmative public benefits. It first argues that the transaction will promote the Commission's goals of consolidation and regionalization of systems. It avers that consolidation/regionalization enables the utility industry to realize the benefits of better management practices, economies of scale and greater environmental and economic benefits. (Aqua Main Brief, p. 23).

Aqua next notes that it will undertake two significant capital projects after closing at a total cost of approximately \$2.5 million. The two projects are the Route 41 force main replacement project and the construction of a mechanical treatment system with stream discharge to address capacity issues at the South End WWTP. Aqua notes that it has the financial and

technical ability to complete these projects for the benefit of the New Garden customers. (Aqua Main Brief, p. 24).

Next, Aqua argues that it has four other wastewater treatment plants within 10 miles of the New Garden system and, as a result, it will be able to operate the system without any additional operational or administrative staff, thereby realizing operational efficiencies that will mitigate future rate increases. (Aqua Main Brief, p. 24). In addition, Aqua argues that the increased customer base resulting from the transaction will mean future infrastructure costs will be shared by Aqua's customers at a lower incremental cost, and that expected significant future customer growth will allow for additional long term cost sharing, further diluting the cost of service across more customers. (Aqua Main Brief, p. 24).

Aqua also argues that, following the two capital improvement projects noted above, it does not anticipate any significant investment needs for some unidentified period of time in the future, making the system less costly each year under its ownership, and that the acquisition will not have any adverse effects on the service provided to existing customers, or on the rates of either New Garden customers or Aqua's existing customers. (Aqua Main Brief, p. 25).

Finally, Aqua states that New Garden has agreed to sell its wastewater system and that the public interest will be served by allowing it, rather than New Garden, to provide wastewater service to the New Garden customer. (Aqua Main Brief, p. 25).

I&E and the OCA, on the other hand, argue that Aqua has failed to demonstrate that the proposed transaction will result in affirmative public benefits. They argue that the benefits cited by Aqua are either overly general, with insufficient support in the record, or that the transaction will harm Aqua's existing customers to such an extent that the Application should be denied.

The parties generally agree that the transaction would result in benefits to New Garden Township (Township) and its current customers. With respect to the Township, the

OCA notes that the Township will receive \$10.9 million, or 59%, more than the net book value of the system. (OCA Stmt. No. 1, p. 2). It cites to Aqua's Application wherein, in a Frequently Asked Questions document, the Township identified a number of projects it intends to undertake with the sale proceeds, including, among other things, paying off wastewater system debt, bridge and road construction capital projects, establishing a capital fund for maintenance of Township facilities and for vehicle and equipment purchases, and establishing a tax stabilization fund and a park fund. Additionally, the OCA notes that, under the APA, Aqua will take on the two capital improvement projects identified in the Application and the APA, thereby relieving the Township of any further obligations with respect to those projects. (Aqua Main Brief, pp. 36-37).

With respect to New Garden's current customers, the OCA argues that the New Garden customer rate increase limitations contained in the APA, which it considers a rate stabilization plan, will result in rate benefits to these customers, but at the expense of Aqua's existing wastewater customers, at least for the first ten years following the transaction's closing date. It argues that Aqua's existing customers will be required to subsidize artificially low rates to New Garden's customers. (OCA Main Brief, p. 38).

Both the OCA and I&E argue that the Application should be denied because any benefits to the Township and its current customers are outweighed by detriments that will be experienced by Aqua's existing customers. First, the OCA states that, although the transaction will result in approximately 2,106 additional customers to Aqua, record evidence shows that system costs per customer will actually increase as a result of the acquisition. OCA witness Everett testified that, as a result of the \$29,500,000 purchase price, the average net plant amount per customer, post-acquisition, would increase by \$1,000.00. (OCA Stmt. No. 1, pp. 23-24, OCA Main Brief, p. 38). It further argues, as noted above, that due to the APA's rate limitations, Aqua's existing customers will end up subsidizing the acquired customers, at least for the first ten years after closing. (OCA Main Brief, p. 38).

The OCA and I&E also both argue that Aqua's purported affirmative public benefits are overly general and have not been supported or quantified by Aqua in the record. For example, I&E states, "[t]he Applicant in this proceeding has made unquantified and generalized

assertions that current customers will benefit from the economies of scale, but I&E submits that this is simply insufficient to show any affirmative public benefits.” (I&E Main Brief, p. 14). It states further, “[t]he benefits alleged by Aqua are largely unsubstantiated. This does not equate to the showing of substantial affirmative public benefits as required by the *City of York* standard.” (I&E Main Brief, p. 15).

OCA likewise argues that Aqua’s overly generalized and unsupported assertions of affirmative benefits are insufficient to justify approval of its Application. For example, it argues, [a]lthough Aqua references economies of scale, the Company has not demonstrated that any costs will decrease with the acquisition of the New Garden customers.” (OCA Main Brief, p. 40). It states further, “[t]he Joint Applicants provided no documentation that Aqua can construct, operate and maintain the existing New Garden system and proposed improvements at a lesser cost than New Garden Township . . . .” (OCA Main Brief, p. 41).

I agree with the OCA and I&E that, although New Garden Township and that system’s current customers may realize affirmative benefits from approval of the Application, Aqua has failed to prove that its existing customers will realize any such benefits. In fact, the record evidence supports OCA’s and I&E’s positions that approval of the Application may harm Aqua’s existing customers to the extent that, on balance, approval of the Application is not in the public interest.

As noted by both the OCA and I&E in their respective main briefs, Aqua’s December 31, 2015 wastewater Annual Report shows the company had 19,784 wastewater customers and a wastewater net utility plant value of \$73,477,924. This results in an average net plant amount of \$3,714.00 per customer. By contrast, the acquisition of the New Garden system will add \$29,500,000 of rate base (plant) and 2,106 new customers, for an average net plant amount of \$14,007 per customer. The average cost of each New Garden customer would be nearly 4 times the average cost of existing Aqua customers. (OCA Stmt. No. 1, pp. 23-24; OCA Main Brief, p. 38; I&E Main Brief, p. 15). In addition, Aqua is committed to completing the two infrastructure improvement projects following closing of the transaction at a total estimated cost of \$2.5 million. These facts, coupled with the APA’s rate limitation provisions for the New

Garden customers discussed above, will likely result in Aqua's existing customers having to bear a disproportionate share of revenue requirements in future base rate cases, at least over the ten year period after closing. While this may be a benefit to New Garden's current customers, it certainly does not constitute an affirmative benefit to Aqua's existing customers.

Aqua included with its Application the financial statements for the New Garden Township Sewer Authority for the years 2013/2014 (Application, Ex. I2) and 2014/2015 (Application, Ex. I1). These two exhibits show that the Authority appears to be in solid financial health. As of December 31, 2014, the Authority's assets exceeded its liabilities by \$11,151,134, which figure represents its net position at the end of 2014. The Authority's net position increased during 2014 by \$629,774. (Application, Ex. I2). As of December 31, 2015, the Authority's assets exceeded its liabilities by \$12,347,026, which figure represents its net position at the end of 2015. The Authority's net position increased during 2015 by \$364,237. (Application, Ex. I1). There is no evidence in the record proving that Aqua is capable of making any necessary system upgrades or improvements that the Authority would not be able to make itself. We are not faced here with a situation of an established utility purchasing the assets of a financially troubled system that is unable to make necessary system improvements.

Clearly, Aqua is financially capable of making all necessary upgrades to the New Garden system. Aqua asserts in its main brief as an affirmative public benefit that it has the financial and technical ability to complete the two system infrastructure improvement projects required under the APA. (Aqua Main Brief, p. 24). The record evidence also shows, however, that the Authority itself is financially capable of completing the necessary upgrades. While the public will benefit from completion of the necessary system improvements regardless of who makes them, no added affirmative public benefit would be realized by approval of Aqua's Application and it being the entity that makes the improvements.

I also agree with the OCA and I&E that other benefits suggested by Aqua are overly general in nature and that Aqua has not demonstrated or quantified how they specifically benefit the public in this proceeding.

By way of example, Aqua argues in its main brief that, due to the proximity of existing wastewater treatment plants, it will be able to operate the system without adding any additional operational or administrative staff. Aqua suggests that this may ultimately mitigate future rate increases. (Aqua Main Brief, p. 24). While not having to add any additional staff to operate the New Garden system may be a benefit to Aqua, the company does not explain how this will provide an affirmative benefit to either New Garden or Aqua's existing customers. There is no record evidence showing that Aqua will be able to operate the New Garden system more economically or efficiently than it is currently being operated by New Garden.

Aqua also argues that approval of the Application will promote the goals of system consolidation and regionalization. It makes the general assertion that New Garden is exactly the kind of system that the Commission encourages utilities such as Aqua to acquire. (Aqua Main Brief, p. 23). Aqua provides no additional explanation or support for this position. As noted, record evidence shows that the New Garden Sewer Authority is a financially stable entity that is capable of continuing to operate the system in an efficient and economical manner. There is no record evidence to suggest that this is not the case. It is not a troubled system whose customers will benefit from a takeover by a more financially sound company. Approval of Aqua's Application will undoubtedly benefit New Garden and Aqua, with a purchase price based on fair market value and an enhanced rate base value for the acquired assets. Merely stating that the transaction will promote consolidation and regionalization, however, does not adequately explain how that constitutes an affirmative public benefit to New Garden's and Aqua's existing customers.

Aqua further argues that the New Garden system will experience a decreasing cost profile following completion of the Route 41 main replacement project and the South End WWTP upgrade project. It states that future investment needs will be minimal and that the system will become less costly each year under Aqua's ownership. (Aqua Main Brief, p. 24). Again, however, Aqua provides no further explanation or quantification in support of its assertions about future cost savings. I find it highly speculative to assert that future investment needs associated with the New Garden system will be minimal. There is no way of knowing at this point what those needs may be in the future or what amount of expenditures may be

necessary. Further, if, in fact, it turns out that there are minimal investment needs for the system in the future, this benefit would be realized by New Garden and its customers even if the system remained under New Garden ownership. I do not see this as providing an affirmative public benefit only upon approval of Aqua's application.

Finally, Aqua argues that New Garden has agreed to sell its system and that the public interest will be served by allowing Aqua, rather than New Garden, to provide service and to address regulatory requirements and necessary capital expenditures. (Aqua Main Brief, p. 25). Aqua does not explain how it, rather than New Garden, will be better able to address regulatory requirements or make necessary capital expenditures. As noted, there is no evidence in the record suggesting that New Garden is unable to provide adequate service to its customers or make necessary capital expenditures to the system. The mere fact that New Garden has agreed to sell its system, or that Aqua will be able to provide adequate service and make necessary capital expenditures, offers no support for Aqua's position that affirmative public benefits will be realized by the approval of its Application.

By way of summary, Aqua has shown that approval of its application will provide some affirmative public benefits to New Garden and its customers. Aqua has failed to show, however, that all affected parties, including its existing customers, will realize any affirmative public benefits as a result of approval of Aqua's application. Middletown Township. For these reasons, I am recommending that Aqua's application be denied on the basis that it is not in the public interest.

## V. CONCLUSIONS OF LAW

1. The Commission has jurisdiction over the subject matter of, and the parties to, this application proceeding. 66 Pa. C.S. §§ 1102, 1103 and 1329.
2. Aqua has the burden of proof in this proceeding to establish that it is entitled to the relief it is seeking. 66 Pa. C.S. § 332(a).



3. Aqua must prove its case by a preponderance of the evidence. Samuel J. Lansberry, Inc. v. Pa. Pub. Util. Comm'n., 578 A.2d 600 (Pa. Cmwlt. 1990), alloc. den., 602 A.2d 863 (Pa. 1992).

4. To meet its burden of proof, Aqua must present evidence more convincing, by even the smallest amount, than that presented by any opposing party. Se-Ling Hosiery v. Margulies, 70 A.2d 854 (Pa. 1950).

5. As the party to whom the assets and service obligations would be transferred, Aqua must demonstrate by a preponderance of the evidence that it is technically, legally and financially fit. 66 Pa. C.S. §§ 1102 and 1103; Seaboard Tank Lines, 502 A.2d 762, 764 (Pa. Cmwlt. 1985).

6. Aqua has sufficient staff, facilities and operating skills to provide the proposed service. Re: Perry Hassman, 55 Pa. P.U.C. 661 (1982).

7. Aqua has complied with the Public Utility Code and the Commission's regulations, thereby rendering it legally fit to provide the proposed service. Re: Perry Hassman, 55 Pa. P.U.C. 661 (1982).

8. Aqua has sufficient financial resources to provide the proposed service. Re: Perry Hassman, 55 Pa. P.U.C. 661 (1982).

9. Aqua must demonstrate, by a preponderance of the evidence, that the proposed transaction will also promote the service, accommodation, convenience and safety of the public in some substantial way. City of York v. Pa. Pub. Util. Comm'n., 295 A.2d 825 (Pa. 1972).

10. Aqua has failed to prove by a preponderance of the evidence that the acquisition is in the public interest because it failed to demonstrate that the transaction will result in affirmative public benefits to its existing customers. City of York v. Pa. Pub. Util. Comm'n., 295 A.2d 825 (Pa. 1972).

11. Aqua's application includes a rate stabilization plan. 66 Pa. C.S. § 1329(g).

12. Aqua failed to support its rate stabilization plan with necessary testimony, schedules and work papers showing the basis for the plan and the impact it would have on existing customers. 66 Pa. C.S. § 1329(g); Final Implementation Order, M-2016-2543193 (entered October 27, 2016).

13. Aqua's proposed rate base value of \$29,500,000 for the acquired assets is reasonable. 66 Pa. C.S. § 1329.

## VI. ORDER

THEREFORE,

IT IS RECOMMENDED:

1. That the application of Aqua Pennsylvania Wastewater, Inc. for approval, under 66 Pa. C.S. §§ 1102 and 1329 of the Pennsylvania Public Utility Code, of its acquisition of the wastewater system assets of New Garden Township and the New Garden Township Sewer Authority at Docket No. A-2016-2580061 be denied.

2. That the application proceeding at Docket No. A-2016-2580061 be marked closed.

Date: April 21, 2017

\_\_\_\_\_/s/  
Steven K. Haas  
Administrative Law Judge