

**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-2017-2605434
Approval of its Acquisition of the	:	
Wastewater System Assets of Limerick	:	
Township	:	

**RECOMMENDED DECISION**

Before  
Steven K. Haas  
Administrative Law Judge

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## I INTRODUCTION

This decision recommends approval, with an adjustment to the proposed rate base value and with certain conditions, of the application of Aqua Pennsylvania Wastewater, Inc. (Aqua or Applicant) for the acquisition, pursuant to Sections 1102 and 1329 of the Pennsylvania Public Utility Code, of the wastewater system assets of Limerick Township, Pennsylvania.

## II. HISTORY OF THE PROCEEDING

On May 19, 2017, 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 system assets of Limerick Township, (2) the right of Aqua to be able to offer, render, furnish and supply wastewater service to the public in a portion of Limerick Township, and (3) an order approving the acquisition that includes the ratemaking rate base of the Limerick Township 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 May 31, 2017.

Aqua's Application requests that the Commission approve its \$75.1 million purchase of Limerick Township's wastewater system assets and issue Certificates of Public Convenience necessary for it to furnish wastewater service to approximately 5,434 Limerick Township customers. Aqua's Application also asks the Commission to issue an Order establishing the ratemaking rate base of the acquired assets at \$75.1 million.

Notice of the Application was published in the *Pennsylvania Bulletin* on June 10, 2017, 47 Pa.B. 3324. A deadline of June 26, 2017 was established for the filing of protests or petitions to intervene.

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

On June 9, 2017, the Commission's Bureau of Investigation and Enforcement (I&E) filed a Notice of Appearance. On June 9, 2017, the Pennsylvania Office of Consumer Advocate (OCA) filed a Protest to the Application. By electronic mail dated June 9, 2017, the Commission and the parties were informed by the Pennsylvania Office of Small Business Advocate (OSBA) that OSBA would not be participating in this proceeding. On June 21, 2017, Limerick Township filed a Petition to Intervene.

By Prehearing Conference Order dated June 9, 2017, an initial prehearing conference was scheduled for Wednesday, June 28, 2017, at 10:00 a.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 June 26, 2017. Each party filed a Prehearing Memorandum.

The prehearing conference was held as scheduled. The following attorneys were present: Thomas T. Niesen and Alexander R. Stahl on behalf of Aqua; Phillip Kirchner<sup>2</sup> on behalf of I&E; Christine Maloni Hoover and Erin L. Gannon on behalf of the OCA; and Thomas Wyatt on behalf of Limerick Township. The following litigation schedule was adopted during the prehearing conference:

Direct testimony of other parties	July 3, 2017
Rebuttal testimony	July 11, 2017
Surrebuttal testimony	July 18, 2017
Evidentiary hearings (with oral rejoinder)	July 20-12, 2017
Main Briefs	August 11, 2017
Reply Briefs	August 18, 2017

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<sup>2</sup> By notice dated August 3, 2017, the Commission and the parties were notified that Phillip C. Kirchner had withdrawn as counsel to I&E. I&E is represented in this proceeding by Carrie B. Wright.

On July 19, 2017, the OCA filed a Motion to Strike, seeking to exclude certain rebuttal testimony submitted by Aqua. The testimony at issue included testimony 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.

Aqua filed an Answer to OCA's Motion on July 24, 2017. Aqua argued in its Answer that the rebuttal testimony at issue was in direct response to the direct testimony of the OCA's witnesses and, therefore, constitutes appropriate rebuttal testimony. Aqua further argued that the two rebuttal witnesses, Harold Walker, III and Adrienne Vicari, 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 rebuttal testimony.

By Order dated July 26, 2017, I denied the OCA's motion to strike portions of Aqua's rebuttal testimony. I agreed with Aqua that the challenged testimony responded to direct testimony submitted by the OCA's witnesses. I also 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 rebuttal testimony at issue, thereby protecting its due process rights.

The evidentiary hearings were held as scheduled on July 20-21, 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 Adrienne M. Vicari, P.E.)

Aqua Exhibit No. 1 (Application and attached exhibits)

Aqua Exhibit No. 2 (CD of work papers to packer direct testimony)  
Aqua Exhibit No. 3 (CD of digital files for Application Exhibit W)  
Aqua Exhibit No. 4 (CD of confidential and proprietary information)  
Aqua Exhibit No. 5 (letter to Commission dated May 30, 2017)  
Aqua Exhibit No. 6 (CD of supplemental confidential information)  
Aqua Cross Exam Exhibit No. 1 (OCA contract)

**I&E**

Statement No. 1 (direct testimony of Kokou Apetoh)  
Statement No. 1-SR (surrebuttal testimony of Kokou Apetoh)  
Statement No. 2 (direct testimony of Rachel Maurer)  
Statement No. 2-SR (surrebuttal testimony of Rachel Maurer)  
I&E Exhibit No. 1 (attachment to Apetoh direct testimony)  
I&E Exhibit No. 2 (attachment to Maurer direct testimony)

**OCA**

Statement No. 1 (direct testimony of Ashley Everette)  
Statement No. 1-S (surrebuttal testimony of Ashley Everette)  
OCA Statement No. 2 (direct testimony of Glenn Watkins)  
OCA Statement No. 2S (surrebuttal testimony of Glenn Watkins)  
OCA Cross Examination Exhibit No. 1 (Aqua 1<sup>st</sup> Qtr. 2017 DSIC filing)

During the July 20-21, 2017 evidentiary hearing, Aqua raised objections to certain testimony contained in statements offered into evidence by the OCA. In particular, Aqua objected to portions of the direct and surrebuttal testimonies of OCA witnesses Glenn Watkins and 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 the OCA or other parties. In response, the OCA 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.

In overruling Aqua’s objections, I noted the Commission’s Order in Aqua’s prior Section 1329 proceeding<sup>3</sup> involving the assets of New Garden Township wherein the Commission allowed the disputed OCA testimony over a similar objection by Aqua. In that proceeding, the Commission concluded that Section 1329 did not did not preclude the OCA or other parties from challenging the Applicant’s appraisals, stating, “. . . we find that Section 1329 permits the Commission and the parties to develop a record pertaining to the review and analysis of the fair market value appraisals of the UVEs.” *New Garden*, p. 35.

Main Briefs were filed by the parties on August 11, 2017, and Reply Briefs were filed on August 18, 2017. The record closed on August 18, 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. 6).

2. Aqua operates 34 wastewater treatment plants in Pennsylvania, serving approximately 20,000 customers in Adams, Bucks, Carbon, Chester, Clarion, Clearfield, Delaware, Lackawanna, Luzerne, Monroe, Montgomery, Pike, Schuylkill, Venango 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 Limerick 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, p. 5).

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<sup>3</sup> *Application of Aqua Pennsylvania Wastewater, Inc.*, Docket No. A-2016-2580061 (Opinion and Order entered June 29, 2017) (*New Garden*).

5. Aqua PA provides water service to approximately 435,000 customers in Pennsylvania. (Aqua Stmt. No. 1, p. 5).

6. Limerick Township is a second class township in Pennsylvania. (Aqua Stmt. No. 1, p. 5).

7. Limerick Township owns and operates a sanitary wastewater system that provides wastewater service to approximately 5,434 customers within a portion of Limerick Township, Montgomery County, Pennsylvania. (Aqua Stmt. No. 1, p. 5; Aqua Stmt. No. 2, p. 3).

8. The Limerick system includes the Possum Hollow Waste Water Treatment Plant (PHWWTP), the King Road Waste Water Treatment Plant (KRWWTP), and all pipes, pumping stations, manholes and pipelines and billing and collections related assets necessary to operate the system. (Application, ¶19).

9. Aqua and Limerick Township are parties to an Asset Purchase Agreement (APA) dated November 16, 2016, for the purchase by Aqua of the wastewater system assets of Limerick Township. (Application, ¶ 5; Application Ex. C).

10. Aqua will operate the Limerick system as a standalone system from its Southeastern Division office in Bryn Mawr, Pennsylvania, with the two treatment plants being approximately 19 miles from the division office. (Application, ¶¶ 37, 42, 43; Aqua Stmt. No. 2, p. 10).

11. Seven existing Limerick employees will integrate with Aqua and continue to operate the Limerick wastewater system, with management, customer service, regulatory compliance, engineering, financial and ancillary functions being provided from Aqua's division office in Bryn Mawr. (Application, ¶¶ 37, 42; Exs. K1, K2 and K3).



12. Aqua and Aqua PA have 17 operators available, some having both water and wastewater system operator certifications, to be utilized to assist in the operation of the Limerick system, as needed. (Aqua Stmt. No. 2, p. 10).

13. The negotiated purchase price of the assets, based on arms-length negotiations, is \$75,100,000.00. (Application, ¶ 18; Aqua Stmt. No. 1, p. 6).

14. Aqua will use existing short-term credit lines to purchase the wastewater system assets. (Aqua Stmt. No. 1, p. 7).

15. The short-term credit lines will be converted to a mix of long-term debt and equity capital after closing. (Application, ¶ 18; Aqua Stmt. No. 1, p. 7).

16. Under its APA with Limerick Township, Aqua will charge the Limerick Township customers the same rates previously charged by the Township for a period of not less than three years from the date of closing of the transaction. (Aqua Stmt. No. 1, p. 8; Application, ¶ 29).

17. Aqua is currently in good standing with the Pennsylvania Department of Environmental Resources (PA DEP). (Application, ¶ 40).

18. Aqua is unaware of any current environmental compliance issues associated with the Limerick system. (Application, ¶ 39).

19. Aqua is planning capital projects for the Limerick system over the next ten years that will total \$8.3 million. (Aqua Stmt. No. 2, p. 6).

20. Upgrades in the KRWWTTP service territory will total \$5.4 million and include improvements to the treatment plant, collection system and pump stations. (Aqua Stmt. No. 2, p. 7).

21. Upgrades in the PHWWTP service territory will total \$1.32 million and include improvements to the treatment plant, collection system and pump stations. (Aqua Stmt. No. 2, p. 7).

22. In addition, Aqua will undertake capital projects involving IT transition and IT CAPX costs totaling approximately \$1.58 million. (Aqua Stmt. No. 2, p. 8).

23. Aqua is a Class A, Pennsylvania wastewater utility with total assets of \$111 million and annual revenues of \$12 million. (Aqua Stmt. No. 1, p. 7).

24. Aqua PA, a Class A water utility, is the largest subsidiary of Aqua America and had total assets of \$3.9 billion and revenues of \$418 million in 2016. (Aqua Stmt. No. 1, p. 7).

25. In 2016, Aqua PA had operating income of approximately \$213 million, net income of \$173 million and cash flows from operations of \$186 million. (Aqua Stmt. No. 1, p. 7).

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

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

28. Aqua will finance the acquisition of the Limerick Township wastewater system using its existing short term credit facility. (Aqua Stmt. No. 1, p. 7).

29. Aqua will likely convert this short-term funding to a mix of long-term debt and equity capital after closing. (Aqua Stmt. No. 1, p. 7).

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

31. 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. 6).

32. Aqua and Limerick Township agreed to use the process set forth in Section 1329 to determine the fair market value of the Limerick Township wastewater assets and the ratemaking rate base of those assets. (Application, ¶ 46).

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

34. Limerick Township selected Herbert, Rowland & Grubic, Inc. (HRG) to perform an appraisal of its wastewater system assets. (Aqua Stmt. No. 1, pp. 11-12).

35. Both Gannett and HRG were pre-qualified by the Commission as authorized Utility Valuation Experts (UVE) and are on the list of qualified appraisers maintained by the Commission. (Application, ¶ 52; Aqua Stmt. No. 1, p. 12).

36. Fair market value appraisal reports were prepared by Gannett and HRG and attached to Aqua's Application as Exhibits Q and R. (Application Exs. Q and R).

37. Gannett determined that the fair market value of the Limerick Township wastewater system assets is \$80,097,939.00. (Application ¶ 49; Application Ex. Q).

38. HRG determined that the fair market value of the Limerick Township wastewater system assets is \$76,890,000.00. (Application ¶ 49; Application Ex. R).

39. The average of the two fair market value appraisals is \$78,493,970.00. (Aqua Stmt. No. 1, p. 12).

40. The purchase price of the assets that was negotiated and agreed upon by Aqua and Limerick Township is \$75,100,000.00. (Aqua Stmt. No., p. 12).

41. The ratemaking rate base of the Limerick Township system assets proposed by Aqua is \$75,100,000.00, being the lesser of the average of the two fair market value appraisals and the negotiated purchase price. (Aqua Stmt. No. 1, p. 12; 66 Pa. C.S. ¶ 1329(c)).

42. Under the APA, Aqua is precluded from increasing Limerick Township's current rates to Limerick Township customers for at least three years from the date of closing of the transaction. (Application, Ex. C, ¶ 7.05(b)).

43. As of December 31, 2014, Limerick Township had total assets of \$86,410,047, total liabilities of \$14,455,105 and a net position of \$72,020,417. (Application, Ex. I2).

44. As of December 31, 2015, Limerick Township had total assets of \$89,073,776, total liabilities of \$15,902,502, and a net position of \$73,749,678. (Application, Ex. II).

45. The Limerick Township wastewater system has a net book value of \$46,153,867. (Application, Ex. Q; OCA Stmt. No. 1, p. 3).

46. The purchase price of \$75,100,000 is \$28,946,133, or 63%, over the net book value of the system. (OCA Stmt. No. 1, p. 3).

47. 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, p. 15).

48. Approval of Aqua's proposed acquisition of the Limerick Township system would add \$75,100,000 in rate base (plant) and approximately 5,434 customers to the Aqua system. (OCA Stmt. No. 1, p. 15).

49. With approximately 20,440 current customers and wastewater net utility plant of approximately \$73,477,924, Aqua's current average net plant amount per customer is approximately \$3,595. (OCA Stmt. No. 1, p. 15).

50. Approval of Aqua's proposed acquisition of the Limerick Township system would add approximately 5,434 customers and \$75,100,000 of rate base, for an average net plant amount per customer of \$13,820, more than 3 times the amount for the current Aqua system. (OCA Stmt. No. 1, pp. 15-16).

51. The combined system would have an average net plant amount per customer of approximately \$5,892, which is approximately \$2,100 more than the current figure for Aqua's existing customers. (OCA Stmt. No. 1, p. 16).

52. The Gannett and HRG fair market value appraisals were performed in compliance with the Uniform Standards of Professional Appraisal Practice (USPAP) 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 Pennsylvania. Aqua currently provides wastewater service to approximately 20,000 customers in Adams, Bucks, Carbon, Chester, Clarion, Clearfield, Delaware, Lackawanna, Luzerne, Monroe, Montgomery, Pike, Schuylkill, Venango and Wyoming Counties. Aqua operates 34 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>4</sup>

The Limerick Township system includes two service areas, the King Road Wastewater Treatment Plant service area and the Possum Hollow Wastewater Treatment Plant service area. The King Road system is an AeroMod activated sludge biological treatment system that includes two-stage aeration and clarification. Effluent disinfection is achieved with in-line ultra violet units. Sludge handling is accomplished with two aerobic digesters and holding tanks. Treated effluent is discharged to the Schuylkill river. The Possum Hollow system is an AeroMod activated sludge biological treatment system that includes two-stage aeration and clarification. Sludge handling is accomplished by hauling thickened liquid to the Pottstown WWTP for further processing and ultimate disposal. (Aqua Stmt. No. 2, p. 4).

The King Road WWTP has a permitted capacity of 1.70 MGD. The Possum Hollow WWTP has a permitted capacity of 0.70 MGD. (Aqua Stmt. No. 2, p. 4).

Aqua proposes in its Application to acquire the Limerick Township sewer system assets for \$75.1 million. Aqua filed its Application under Sections 1329 and 1102 of the Public Utility Code. Aqua requests that the purchase price of \$75.1 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 Limerick Township. (Application, Ex. C). Under the APA, Aqua may not increase rates to the acquired customers for at least three years following the date of closing of the transaction. (Application, Ex. C, ¶ 7.05(b)).

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<sup>4</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 U. 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 V. 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. \_\_."

Aqua anticipates spending approximately \$8.3 million on capital projects associated with upgrades to the two treatment plants and IT transition costs. (Aqua stmt. No. 2, pp. 7-8).

**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 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<sup>5</sup>, 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>6</sup>

### **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 Limerick Township, (2) the right of Aqua to be able to offer, render, furnish and supply

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<sup>5</sup> *Implementation of Section 1329 of the Public Utility Code*, Docket No. M-2016-2543193 (order entered October 27, 2016) (IO).

<sup>6</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).



wastewater service to the public in portions of Limerick Township, and (3) for an order approving the acquisition that includes the ratemaking rate base of the Limerick Township 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).

As discussed more fully below, I am recommending in this decision that the Application be approved, with certain conditions. I am also recommending that the rate base value of the acquired assets be set at \$64,373,378, rather than the \$75.1 million value proposed by Aqua.

I will first 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 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, Clarion, Clearfield, Delaware, Lackawanna, Luzerne, Monroe, Montgomery, Pike, Schuylkill, Venango 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 Limerick 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. 5). Aqua and Aqua PA, have approximately 600 employees who possess expertise in providing water and wastewater service to their customers. (Aqua Stmt. 1, p. 5). 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. (Aqua Stmt. No. 1, p. 6). No 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 plant assets of \$3.9 billion and annual revenues of \$418 million in 2016. Aqua PA had operating income of approximately \$213 million and net income of \$173 million. Its cash flow from operations was \$186 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 \$111 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. (Aqua Stmt. No. 1, p. 7). As a subsidiary of Aqua PA, Aqua has access to Aqua PA's financing capabilities. (Aqua Stmt. No. 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. No. 1, p. 7). No 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 IO, 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 a 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 implement the Limerick Township sanitary wastewater rates in effect at closing as reflected on Schedule 7.05(a) of the Agreement and inclusive of any approved surcharge or pass-through costs as its effective sanitary sewer rates, provide that such rates shall not be lower than the rates in effect on the execution date of the agreement. The Agreement further provides that Aqua’s Base Rate may not increase until after the third anniversary of the Closing date.

Application, ¶ 29.

The rate provisions set forth in ¶ 29 of the Application are reflected in Section 7.05(b) of the APA, which provides, in relevant part:

Rate Stabilization. After closing, Buyer shall begin charging the Base Rate as Buyer’s rates within the Service Area, which Base Rate the Parties agree may not be increased until after the third anniversary of the Closing Date (the “Stabilization Period”).

Application, Ex. C, ¶ 7.05(b).

Unlike in the New Garden proceeding, Aqua acknowledged in this proceeding that it is proposing a rate stabilization plan and, accordingly, submitted with its application supporting testimony and information. Therefore, the question of whether Aqua’s application includes a rate stabilization plan is not an issue in this case, as it was in the New Garden proceeding. However, the parties have expressed concern about the impact the rate freeze will have on Aqua’s existing customers, who may need to cover any revenue shortfall resulting from the freeze on rates to Limerick’s customers. (See, e.g., Aqua Stmt. No. 1, pp. 13-16).<sup>7</sup>

Aqua acknowledged in this proceeding that the Commission has final authority over the rates charged to utility customers for utility service. Aqua witness William Packer stated in his direct testimony, “[w]hile the APA includes a period of three years over which rates

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<sup>7</sup> This issue is further discussed in the “Affirmative Public Benefits” section of this RD.

are to remain unchanged at seller's rates, there is no provision within the APA that changes the purchase price, or provides for a limitation on rate increases. In addition, I note that the Commission maintains the authority to set rates in APW's next base rate case." (Aqua Stmt. No. 1, p. 6). Mr. Packer further states in his rebuttal testimony, "nothing that Aqua has proposed in this application proceeding is binding on the ratemaking authority of the Commission or limiting the Commission's ability to set rates." (Aqua Stmt. No. 1R, p. 8).

In addressing this concern, the OCA recommends that if the Application is approved by the Commission, conditions should attach to the approval that place the risk of any revenue shortfall from the acquired customers caused by the APA on Aqua's shareholders. Specifically, the OCA recommends the following conditions:

The Commission retains the authority to allocate revenues, if appropriate, to the Limerick Township customers that are inconsistent with the restrictions contained 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 Limerick 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.

Aqua Main Brief, pp. 47-48.

In *New Garden*, Aqua proposed in its application freezing rates to New Garden customers for at least two years and, within the first ten years, limiting future rate increases to those customers so as not to exceed a compounded annual growth rate of 4%. The Commission concluded in its Opinion and Order in that proceeding that the rate commitments contained in the APA did not constitute a rate stabilization plan.<sup>8</sup> However, in addressing similar concerns raised by the other parties about the potential rate impact of the rate commitments on Aqua's existing customers, the Commission imposed the conditions described above. It stated, "Aqua

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<sup>8</sup> This conclusion is the subject of a Petition for Reconsideration filed by I&E in the *New Garden* proceeding on July 14, 2017. To date, a ruling on I&E's Petition has not been issued.

acknowledges that the Commission will ultimately decide the appropriate rates for the customers of the acquired utility in the company's next base rate case proceeding, while Aqua and its shareholders will bear any rate differential during the contract period stipulated in the APA. To be clear, we are adopting the ALJ's recommendation, that if the Application is approved, the following conditions should be imposed on Aqua:

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

*New Garden*, Opinion and Order, pp. 70-71.

I agree with the Commission and the OCA's position on this issue and will recommend that the conditions proposed by the OCA attach to approval of Aqua's application here. It is unknown at this point when Aqua's next general base rate case will be filed or its impact on Aqua's customers. I believe that by attaching these conditions to approval of the Application, the acquired customers will enjoy the benefits of the rate commitments negotiated and memorialized in the APA while assuring that Aqua's existing customers are not unfairly burdened by any revenue shortfalls resulting from those commitments.

### **1. Regulatory Asset Treatment**

Aqua proposes to split the \$75.1 million ratemaking rate base into two parts, an initial rate base of \$60 million and a regulatory asset of \$15.1 million. More specifically, Aqua proposes to amortize the \$15.1 million regulatory asset at a rate of \$2.1 million per year, which would be moved into rate base at the time at which the company files a base rate case. (Aqua

Stmt. No. p. 15). The regulatory asset would not depreciate; rather, depreciation would begin when Aqua amortizes it into rate base.

Both I&E and the OCA disagree with the regulatory asset treatment proposed by Aqua on the basis that it is not consistent with the typical use of a regulatory asset as a ratemaking tool, in that regulatory assets are typically used for expense items, not for deferring utility plant in service. I&E argues, “[r]egulatory assets are used to defer the recognition of an expense that would otherwise have been included on the income statement during a certain timeframe and appears in the deferred debit portion of a balance sheet.” (I&E Main Brief, p. 12). The OCA further argues that Aqua’s proposal to amortize the asset in increments as it decides to file base rate cases means that it would not be possible to know when the asset would be fully amortized and included in rate base, creating uncertainty and unnecessary risk for customers.” (OCA Stmt. No. 1, pp. 5-6). I&E and the OCA aver that the entire ratemaking rate base approved by the Commission should be treated as rate base by Aqua and Aqua should begin depreciating it for accounting purposes immediately upon closing. (I&E Main Brief, p. 14; OCA Main Brief, pp. 49-50).

I agree with I&E and OCA’s position that Aqua’s proposal to split the \$75.1 million ratemaking rate base into an initial rate base of \$60 million and a regulatory asset of \$15.1 million should not be approved at this time. Section 1329(c)(1) is clear in its intent to incorporate the full ratemaking rate base of the selling utility into the rate base of the acquiring utility during the acquiring utility’s next base rate case. There is no provision for the splitting of the full rate base amount. Further, I agree that a regulatory asset typically represents specific incurred costs that a regulatory agency permits a public utility to defer to its balance sheet because recovery will come through future rates, amounts that would otherwise be required to appear on the company's income statement and be charged against current expenses; a circumstance that is not the case in this instance. For these reasons, I recommend that Aqua’s proposal to split the \$75.1 million ratemaking rate base into an initial rate base of \$60 million and a regulatory asset of \$15.1 million be denied.



**F. Rate Base Valuation**

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

An important issue in this proceeding, as was the case in the New Garden proceeding, concerns 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 disagree 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 sole 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 Limerick negotiated a purchase price of \$75,100,000 for the wastewater system. The price was the result of voluntary arm's length negotiations. Aqua and Limerick 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 Gannett to provide a fair market value appraisal in accordance with USPAP, utilizing the cost, market and income approaches. Limerick engaged the services of HRG 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 \$80,098,000 (rounded). HRG's fair market value appraisal is \$76,890,000. The average of the two is \$78,494,000. As directed by the General Assembly in Section 1329(d)(1)(iii), the ratemaking rate base determined pursuant to Section 1329(c)(2) is \$75,100,000, being the lesser of the negotiated purchase price of \$75,100,000 and the average of \$78,494,000.

As required by Section 1329(d)(1)(i), copies of the Fair Market Value Appraisal Reports of Gannett and HRG were attached as Exhibit Q and Exhibit R, respectively, to the Application. Verified Statements of Gannett and of HRG, 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 T1 and Exhibit T2, 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 Limerick wastewater system must include a determination that the ratemaking rate base is \$75,100,000.

Aqua Main Brief, pp. 37-38.

The OCA disagrees with Aqua's interpretation of Section 1329. It argues, *inter alia*, that it would be inconsistent with the Public Utility Code's requirement that rates be just

and reasonable to allow Aqua to submit its valuation proposal, supported by two appraisals, without allowing any review or challenge to its rate base proposal or appraisals. (OCA Main Brief, p. 9). OCA also raised a due process issue, arguing that “[a]s the determination of ratemaking rate base will impact the calculation of revenue requirement, that determination can only be made by giving due notice and an opportunity to challenge the UVE appraisals.” (Aqua Main Brief, p. 10). It argues that since the rate base determination under 1329 will impact future rates for years to come, parties must be given an opportunity to challenge that determination and be heard in a section 1329 proceeding, which includes the submission of testimony related to the appropriateness of the rate base valuation. (Aqua Main Brief, p. 10).

As was noted in my recommended decision in the New Garden proceeding, neither Section 1329 nor the Commission’s IO directly address or answer this question.

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 agree that the Commission and other parties are permitted 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 in Section 1329 proceedings. 66 Pa. C.S. § 308.2(a) (11) 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 that Section 1329

precludes review and analysis by the Commission or other parties of the UVE fair market value appraisals in an effort to ensure that the public interest is protected. I do not believe that the legislature, in enacting Section 1329, intended this result, and I do not recommend such a result here.

This position was confirmed by the Commission in its Opinion and Order in the *New Garden* proceeding. After considering similar arguments by the parties in that proceeding, the Commission reasoned:

There is no language in Section 1329 abrogating or repealing the Commission’s authority under Section 505 to conduct an inquiry into the value of the assets that Aqua seeks to acquire. Likewise, because the application proceeding includes the determination of whether a Certificate should be granted, the Commission retains the authority under Section 1103(b) to “make such inquiries, physical examinations, valuations, and investigations, and may require such plans, specifications, and estimates of cost, as it deems necessary or proper in enabling it to reach a finding or determination.” 66 Pa. C.S. § 1103(b). Section 1329 does not contain any language invalidating the General Assembly’s delegation of authority to the Commission under Section 1103.

*New Garden*, Opinion and Order, p. 34.

The Commission concluded in *New Garden*, “. . . we find that Section 1329 permits the Commission and the Parties to develop a record pertaining to the review and analysis of the fair market value appraisals of the UVEs.” (*New Garden*, Opinion and Order, p. 35). Accordingly, I find it appropriate in this proceeding to allow other parties to question or challenge the fair market value appraisals and the proposed rate base value of the acquired assets, and to submit evidence and develop a record in support of their respective positions.

## **2. 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 UVEs.<sup>9</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, Aqua selected Gannett and Limerick selected HRG to prepare fair market value appraisals of Limerick's sewage collection and treatment system assets. Based on Gannett's appraisal, the fair market value for Limerick's wastewater system is \$80,098,000 (Application, Ex. Q). HRG appraised the fair market value to be \$76,890,000 (Application, Ex. R). Both appraisals were prepared using the Uniform Standards of Professional Appraisal Practices employing the cost, income, and market approaches to value. (Aqua Stmt. No. 1, p. 12). The fair market value average of the two appraisals is \$78,494,000. (Aqua Stmt. No. 1, p. 12; 66 Pa. C.S. § 1329(c)(3)).

On November 16, 2016, Aqua and Limerick Township executed an Asset Purchase Agreement for the sale of the wastewater system assets, properties and rights of the system. The negotiated purchase price is \$75,100,000. Aqua proposes to use \$75,100,000 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).

The OCA recommends that if the Commission approves the proposed acquisition, the value of the rate base to be used in Aqua's next rate case should be \$60,976,180, not \$75,100,000. (OCA Main Brief, p. 7; OCA Stmt. No. 1S, pp. 8-22.). OCA avers that the

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<sup>9</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.

appraisals contain flaws and should be revised. Its position is that once the corrections are made, Gannett's fair market value is \$73,275,485, instead of \$80,098,000, and HRG's fair market value is \$48,676,875, instead of \$76,890,000, thereby bringing the average of the two UVE appraisals to \$60,976,180. (OCA Main Brief, pp. 44-45). The OCA argues, therefore, that the amount Aqua should be allowed to claim as rate base for future ratemaking purposes is \$60,976,180.

As noted, OCA argues that Aqua's proposed rate base is overstated due to errors and flaws in the appraisals, and that the correct rate base value is \$60,976,180 under Section 1329 methodology. (OCA Main Brief, p. 7-8). OCA argues, therefore, that the amount Aqua should be allowed to use for future ratemaking purposes is \$60,976,180, rather than the proposed rate base of \$75,100,000 (OCA Main Brief, p. 7). After careful review, I agree with a number of OCA's appraisal adjustments.

In Gannett's appraisal, the OCA made two adjustments to Gannett's income approach. In HRG's appraisal, the OCA made five adjustments to HRG's income approach, four adjustments to HRG's cost approach, and two adjustments to HRG's market approach. (OCA Main Brief, p. 14). OCA's rationale for these adjustments is discussed below.

Income Approach: OCA made the following adjustments to HRG's income approach: (1) replace the 2.5% discount rate in the discounted cash flow analysis with 6.97% (OCA Main Brief, p. 27); (2) correct the calculation of income tax expense in the discounted cash flow analysis (OCA Main Brief, p. 26); (3) no consideration to be given to the rate base/rate of return analysis (OCA Main Brief, p. 30); (4) remove \$4,000,000 adder for "going value" (OCA Main Brief, p. 31); and (5) remove \$300,000 deduction for erosion of cash flow (OCA Main Brief, p. 31). After these adjustments, OCA recommends that the adjusted income approach valuation should be \$36,560,000 (OCA Main Brief, p.32), compared to HRG's \$77,855,000 original value.

OCA made the following adjustments to Gannett's income approach: (1) use of a 50-year model, without a terminal value, in place of Gannett's 13-year model with a terminal value (OCA Main Brief, p. 41); and (2) use of adjusted discount rates for a municipal utility's

cost of capital and an investor-owned utility’s cost of capital (OCA Main Brief, p. 41). After these adjustments, OCA recommends that the adjusted income approach valuation should be \$54,735,000, compared to Gannett’s \$75,204,407 original value. (OCA Main Brief, p. 45).

Cost Approach: OCA made the following adjustments to HRG’s cost approach: (1) reduction of \$19,195,429 to determine the cost of the collection mains in the same way as the rest of the plant; (2) reduction of \$756,159 to revalue land at original cost in the reproduction cost analysis; (3) reduction of \$4,533,000 to remove the future capital projects; and (4) reduction of \$4,000,000 to remove the “going value” add on. After these adjustments, OCA recommends that the adjusted cost approach valuation should be \$61,565,412, compared to HRG’s \$90,050,000 original value. (OCA Main Brief, p. 22).

Market Approach: OCA made the following adjustments to HRG’s market approach: (1) adjust the customer count to reflect the actual number of customers; and, (2) remove the inclusion of future capital improvements. After these adjustments, OCA states that a more appropriate HRG market approach valuation is \$39,775,212, compared to HRG’s \$62,760,000. (OCA Main Brief, p. 43-44).

The following tables recap the original appraisals (Table 1) and the appraisals with OCA’s recommended adjustments (Table 2).

Table 1 – Original Appraisals

<b>HRG (Aqua Ex. R, p.2)</b>	<b>Value</b>	<b>Gannett (Aqua Ex. Q, p.2)</b>	<b>Value</b>
Income	\$77,855,000	Income	\$75,204,407
Cost	\$90,050,000	Cost	\$86,086,756
Market	\$62,760,000	Market	\$79,002,980
Average	\$76,888,333	Average	\$80,098,047
Recommendation	<b>\$76,890,000</b>	Recommendation	<b>\$80,098,000</b>

Table 2 – Appraisals with OCA’s Recommended Adjustments

<b>HRG (OCA Ex. AEE-1S)</b>	<b>Value</b>	<b>Gannett (OCA Ex. AEE-1S)</b>	<b>Value</b>
Income	\$44,690,000	Income	\$54,735,000
Cost	\$61,565,412	Cost	\$86,086,756
Market	\$39,775,212	Market	\$79,002,980
Average	\$48,676,875	Average	\$73,275,485
<b>Recommendation</b>	<b>\$48,676,875</b>	<b>Recommendation</b>	<b>\$73,275,485</b>

After incorporating the adjustments, Gannett’s appraisal result would be \$73,275,485, and HRG’s appraisal result would be \$48,676,875. The recalculated average for the two appraisals result is \$60,976,180. (OCA Main Brief, p. 15)

Before discussing the merits of OCA’s recommended adjustments, I note one issue with the values recommended by OCA. For HRG’s income approach, OCA recommends that the DCF value of \$36,560,000 be used as the income approach value (OCA Main Brief, p. 32-33). However, OCA’s final recommendation is based on an income approach value of \$44,690,000, rather than \$36,560,000. The following table reflects OCA’s figures, consistent with OCA’s recommendation. These adjustments result in an average for the two appraisals of **\$59,621,180**.

Table 3 – Appraisals with OCA’s Recommended Adjustments, Revised

<b>HRG</b>	<b>Value</b>	<b>Gannett (OCA Ex. AEE-1S)</b>	<b>Value</b>
<b>Income</b>	<b>\$36,560,000</b>	Income	\$54,735,000
Cost	\$61,565,412	Cost	\$86,086,756
Market	\$39,775,212	Market	\$79,002,980
Average	\$45,966,875	Average	\$73,275,485
<b>Recommendation</b>	<b>\$45,966,875</b>	<b>Recommendation</b>	<b>\$73,275,485</b>



The following table (Table 4) outlines the Commission’s accepted adjustments and the final average.

Table 4 – Appraisals with Commission’s accepted Adjustments

<b>HRG</b>	<b>Value</b>	<b>Gannett</b>	<b>Value</b>
Income	\$36,560,000	Income	\$75,204,407
Cost	\$62,321,571	Cost	\$86,086,756
Market	\$47,064,553	Market	\$79,002,980
Average	\$48,648,708	Average	\$80,098,047
Recommendation	<b>\$48,648,708</b>	Recommendation	<b>\$80,098,047</b>

The average of the two valuations is \$64,373,378. No change was made to the weight applied to each approach.

Income Approach Discussion of HRG:

The OCA identified several concerns with HRG’s DCF analysis, summarized below:

- Income tax expenses included as a deduction from net cash flows;
- A discount rate of 2.5% being utilized;
- An add-on of \$4 million incorporated as a “provision for going value”; and
- A deduction of \$300,000 incorporated as a “provision for erosion of cash flow.”

As to the issues of HRG’s treatment and calculation of income tax and selected discount rate of 2.5%, the OCA observed that HRG’s methods do not comport with accepted financial theory or practice. The OCA determined that HRG’s calculated income tax expense contained numerous errors, including: (1) HRG assumed no federal or state income taxes for the first four years of its DCF analysis; (2) HRG used a tax rate of 38.9%, whereas a total incremental tax rate of 41.49% should have been used, based off of the Pennsylvania income tax rate of 9.99% and the Federal income tax rate of 35%; (3) HRG treated capital expenditures as a tax deductible expense, when only the depreciation of those capital expenditures should be tax

deductible, and; (4) HRG's taxable income did not include any deduction for depreciation expense or reflect a deduction for interest expense. The OCA also objected to HRG's selected discount rate of 2.5%, which they maintain is substantially below any level of reasonable opportunity cost confronted by HRG in the ownership and operation of the wastewater system. The OCA notes that it is a generally accepted practice that an appropriate discount rate is a firm's total cost of capital, which, when calculated using HRG's actual capital structure with an appropriate cost of debt and a reasonable cost of equity, results in a total cost of capital of 6.97%. Therefore, The OCA asserts that 6.97% is the value that should be used as the discount rate. OCA Main Brief at 24-27.

I agree with the OCA's suggested adjustments for the calculation of the income tax expense, as well as the use of a more appropriate discount rate of 6.97% that reflects HRG's true cost of capital. The impropriety of the selected 2.5% discount rate is further supported by Gannet Fleming's appraisal, which states that the appropriate IOU discount rate is the current pre-tax overall cost of capital on December 31, 2016 and ranges from 6.63% to 7.99%. (Aqua Ex. Q, at 28).

HRG applied two adders to its Income approach – a “Going-Value” adder of \$4 million and an “Erosion of Cash Flow” deduction of \$370,000 – both of which the OCA objects to being used as part of the DCF calculation. The OCA submits that the “Going-Value” adder should be rejected because it does not relate in any way to expected working capital requirements, net income, or cash flows, and that it conflicts with HRG's own cash flow analysis because HRG used expectations of Limerick's operations for its estimates. As to the “Erosion of Cash Flow” adder, which proposes to deduct an amount to reflect that inflation and the absence of rate increases erode annual cash flows, the OCA recommends that it be rejected as well. The OCA states that the adjustment is unnecessary because HRG's DCF reflects the anticipated cash flows that will be derived from the Limerick operations. The OCA further submits that the valuations already reflect HRG's analysis of expected cash flows and there is no basis to make further adjustment to reflect what HRG perceives to be inadequate cash flows in certain years. For these reasons, the OCA declares that HRG's adders are without merit and should not be considered for any of its appraisals. OCA Main Brief at 31-32.

I agree with the OCA's assertion that the use of the "Going-Value" and "Erosion of Cash Flow" adders is not appropriate and should not be utilized in the appraisals.

In addition to the adjustments to the DCF analysis noted above, the OCA took exception to HRG's Rate Base/Rate of Return analysis, which HRG averaged with its DCF analysis to come up with its recommended valuation under the Income Approach. The OCA believes there are numerous flaws and unreasonable assumptions embedded in HRG's Rate of Return/Rate Base analysis, as outlined below.

- HRG did not use Limerick's actual embedded original cost of rate base in its analysis; rather, it utilized "Cost of Reproduction New" rate base for developing its annual cost of service-based returns, which the OCA claims is a fundamental error because, for regulated utilities, annual revenue requirements are established based on original cost, not the hypothetical cost of reproducing a new system at current construction costs.
- HRG assumed an annual rate of return of 7.5% on the "Cost of Reproduction New" rate base, while providing no support for that number. The OCA maintains that it has demonstrated that 6.97% is an appropriate total cost of capital, in that it is derived from Aqua's actual capital structure.
- The OCA also points out that there is a mismatch between HRG's rate of return of 7.5% and its discount rate of 2.5%, noting that it is universally accepted that for discounting purposes a company's cost of capital is the appropriate discount rate. This means that HRG calculated annual cash flows based on a profit level of 7.5% but only discounted those profits by 2.5%, leading to a substantial overstating of the resulting present value of future cash flows.
- Finally, the OCA finds flaw in HRG's estimated annual depreciation expenses. The OCA avers that depreciation is a non-cash expense that should be included within annual cash flows in HRG's analysis, but because HRG's estimated annual depreciation expenses are based on the "Cost of Reproduction New" plant as opposed to actual depreciation expenses, they

are severely overstated, leading to cash flows being inflated by approximately \$1,723,000 every year.

It is for these reasons that the OCA recommends that no consideration be given to HRG's Rate of Return/Rate Base analysis, and that HRG's overstated value of \$100.69 million be thrown out altogether. (OCA Main Brief at 28-31).

For the foregoing reasons, I agree with the OCA's claim that the Rate of Return/Rate Base analysis be disregarded in its entirety. When taken together with the corrections in the calculation of income taxes, the use of a 6.97% discount rate, and the removal of the "Going-Value" and "Erosion of Cash Flow" adders, I agree with the OCA's conclusion that a value of \$36,560,000 be used as the final recommended amount for HRG's Income Approach valuation.

#### Income Approach Discussion of GF:

GF derived its valuation under the Income Approach based on several DCF averages, conducting two DCF analysis each from both a buyer's and a seller's perspective. While the OCA generally agreed with most of GF's analysis, they did find disagreement in two areas. Specifically, the OCA disagreed with GF's use of a 13-year terminal value, instead suggesting that the DCF valuation be calculated using 50 years of discounted net cash flows with no termination value. Additionally, the OCA suggests using different discount rates that utilize a municipal utility's cost of capital and an IOU's cost of capital. OCA Main Brief at 33.

Aqua takes issue with the OCA's assessment of the terminal value, noting that, within the DCF analyses, the terminal value is simply a point in time in which the growth in annual Debt Free Net Cash Flows changes from multiple growth rates to a constant growth rate, meaning subsequent to the 13-year time period, the growth in annual cash flows is at a constant rate. The use of a terminal value in a DCF analysis is merely a mathematical shortcut to avoid having to calculate annual Debt Free Net Cash Flows for hundreds of years, and is in accordance with accepted valuation practices, Aqua avows. Aqua also takes exception to the OCA's

proposal to use a 50-year modeling approach, noting that this would cap the life of the business at 50 years, which would lead to the understating of the value indicated by the OCA's very own model. Aqua contends that the model used by both GF and the OCA reflects the same 1.5% growth in capital expenditures and depreciation, and that the capital expenditures shown in the 13th year of the model almost exactly matches the depreciation displayed for the same time, meaning the capital investments being put back into the system are matching depreciation and thereby the system remains in a state of good repair, contrary to what the OCA contends. Aqua Reply Brief at 26-28.

Aqua further takes issue with the OCA's objection to GF's discount rates. The OCA developed a discount rate from a seller's perspective using municipal equity capital as well as debt, with which Aqua has several problems, summarized thusly:

- The OCA developed its cost of capital for the Township based on methods used to determine a cost of capital for a portion of the municipality's assets that provide utility service outside its municipal boundaries, a circumstance which isn't relevant to the current proceeding since the Township isn't regulated by the Commission.
- The OCA used the Township's embedded cost of debt and book capitalization ratios, which are only used in rate proceedings; whereas, the marginal cost of debt and market capitalization ratios at the valuation date are in accordance with accepted valuation practices.
- The OCA included the Township's book equity in determining its cost of capital even though the Township, or any other municipal or government entity, can't marginally finance a project with equity; rather, they can only prospectively finance with debt capital, not equity capital, and therefore for market valuation purposes, municipal capital structures should be 100% marginal debt.

As to GF's discount rate from a buyer's perspective, the OCA determined that GF's total cost of capital range was not unreasonable for an IOU; however, the OCA did disagree with GF's use of a market ratios, opting instead to use book capitalization ratios to

determine a discount factor. Aqua contends that book capitalization ratios are only used in rate proceedings and are not in accordance with accepted valuation practice; whereas, market value capitalization ratios at the valuation date, as used by GF, are in accordance with accepted valuation practice used for market valuation purposes. Aqua Reply Brief at 29-30.

I agree with Aqua's position that the OCA's proposed adjustments to GF's Income Approach, including objecting to the use of a 13-year terminal value and the calculation of the discount rates, should be rejected. The OCA has not provided sufficient evidence, or the necessary reasoning, to determine that GF's Income Approach methods are unreasonable, and as such, I shall accept GF's Income Approach valuation of \$75,204,407 as filed.

#### Cost Approach Discussion of HRG:

The first adjustment the OCA made to HRG's cost approach involved the reproduction cost of collection mains. HRG used the ENR Index to calculate the reproduction cost of all utility plant except for non-interceptor collection system mains. For that item, HRG felt the unit costs were not in-line with current industry unit costs for collection system main construction, on the basis that the costs reported in the engineer's report represent expenditures made by Limerick and may not include the cost of main contributed by developers. As such, HRG believed that a representative sample of unit costs taken from regional municipalities would reflect a more realistic measure of the reproduction cost value. (Aqua Ex. R, at 6).

The OCA disagrees with HRG's treatment of this plant item. OCA avers that the engineering study does include contributed mains; that no reasonable basis was presented for treating this plant item differently; that by using an index that treats every type of plant the same, it is likely that the actual reproduction cost for some items will be higher while some will be lower; and that there is no reasonable basis, nor is one provided, to conclude that another utility's costs are more accurate than the costs specifically reported for the Limerick system. As such, if the ENR index is applied uniformly to all types of plant, the reproduction cost is decreased by \$19,195,429. (OCA Main Brief at 16-17).

I agree with the OCA's argument that a reasonable basis for HRG's treatment of this plant item has not been established. Therefore, the ENR Index is being applied similarly across all utility plant.

The second adjustment the OCA made to HRG's cost approach involves the inclusion of land in the reproduction cost analysis. The OCA states that land should not be included in the reproduction cost analysis as land cannot be "reproduced"; and that the index HRG used is used when labor costs are a high proportion of total costs, which is not true of land. Instead, the OCA suggests HRG's reproduction cost value for land should equal HRG's original cost value for land. (OCA Main Brief at 17-18).

I disagree with the OCA's argument. As the OCA previously specified, by using an index that treats every type of plant the same, it is likely that the actual reproduction cost for some items will be higher while some will be lower. While the index used may not be the most appropriate index, I see no reason why determining the reproduction cost of land to be the land's original cost is more appropriate than the method HRG used. Therefore, consistent with all other utility plant, I will apply the ENR index to land.

The third adjustment the OCA made to HRG's cost approach involves HRG's inclusion of future capital projects. The OCA avers that these projects should not increase the appraisal value or market valuation since these projects will be paid for by Aqua post-acquisition; these projects do not add value at the time of acquisition; and that Aqua will be compensated for the capital expenditures through the traditional ratemaking methodology, and including these values in the appraisal value would allow Aqua to double recover for the same costs. (OCA Main Brief at 18-19).

I agree with the OCA. HRG's inclusion of future capital projects is not appropriate, as these future capital projects do not add value to the Limerick system at the time of acquisition.

The fourth adjustment the OCA made to HRG's cost approach involves HRG's inclusion of "Going Value". HRG defines Going Value as "that element of value of an assembled and established plant, doing business and earning money, over one that is not that advanced." (Aqua Ex. R at 27). The OCA disputes the inclusion of this value as it is not logical, is contradictory to HRG's analyses, and contains numerous double counts. Specifically, the OCA claims that Limerick is a regulated monopoly with a captive customer base, and as such, this customer base is known with certainty that there are no costs required to attract customers to this business; that Aqua already contains the resources and expertise required to effectively and efficiently operate the system; that it would be illogical and contradictory for an investor to be willing to pay more for a project or business under the rationale that losses and suboptimal cash flow in the early years should be ignored; and that the calculation of the adder itself contains fundamental flaws. (OCA Main Brief at 22).

I agree with the OCA. HRG's use of "Going Value" is without merit and should not be considered. As such, I removed "Going Value" from the appraisal.

#### Cost Approach discussion of Gannett:

The OCA did not make any adjustments to Gannett's cost approach valuation and I see no reason to suggest any adjustments. As such, the cost approach value that Gannett assigned to the Limerick system is \$86,086,756.

#### Market Approach Discussion of HRG:

The first adjustment the OCA made to HRG's market approach involved the customer count. Per HRG's appraisal report, a sample of recent municipal wastewater acquisitions was used to approximate the value on a per customer basis and then averaged to develop an average cost of \$8,661 per customer. This price was then multiplied by the number of projected Limerick customers over the twenty-year period of the analysis. The total number of connections at the end of the projection period was estimated to be 7,246, resulting in an estimated value based on a cost per customer of \$62,760,000. (Aqua Ex. R at 8).



The OCA disagrees with Limerick's use of the projected customer count. OCA reasoned HRG calculated the average cost per customer of the acquisitions in the sample group using the actual customer count, not a projected count. By applying the actual current cost per customer to a projected future customer count, the resulting market value provides an inflated result. Using Limerick's current customer count (5,434) would result in a market value of \$47,060,000. (OCA Main Brief at 42-43).

I agree with OCA's reasoning that the use of 7,246 customers is not appropriate and the customer count that should be used when performing the calculation is the current, actual customer count for the Limerick system, which is 5,434.

The second adjustment the OCA made to HRG's market approach involved removing the cost of future capital improvements from the purchase prices of comparable systems. OCA contends that, when determining the total purchase price of comparable systems, HRG used the purchase price plus the value of capital improvements required by the agreement of sale. For Limerick, however, HRG only used the purchase price and did not add the \$8.3 million of capital investments that Aqua anticipates making. As such, including the cost of capital improvements distorts the results and has the effect of artificially inflating the market value. (OCA Main Brief at 43).

However, Aqua contends that USPAP and the Final Implementation Order require consideration of capital improvements in the Fair Market Value Appraisal. Further, the listing of Limerick assets prepared by Pennoni engineers identified \$4,533,000 in capital improvements planned by Limerick. Therefore, HRG appropriately considered those dollars in its market approach to fair market value. (Aqua Main Brief at 43).

I agree with Aqua that the calculation made by HRG should include an adder for future capital improvements. The asset list prepared by Pennoni engineers identified capital improvements planned by Limerick; therefore, it is reasonable to consider that, insofar as such improvements are not paid by Limerick, these capital improvements are a real cost to be borne by an acquiring entity and may be considered as part of the compensation.

Market Approach discussion of Gannett:

The OCA did not make any adjustments to Gannett's market approach valuation and I see no reason to suggest any adjustments. As such, the market approach value that Gannett assigned to the Limerick system is \$79,002,980.

After consideration of the arguments of the parties and the adjustments discussed above, I recommend that the appropriate amount Aqua should use as a rate base in its next ratemaking proceeding is \$64,373,378.

**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. Pub. Util. Comm'n.*, 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. Pub. Util. Comm'n.*, 937 A.2d 1040 (Pa. 2007).

As explained below, and in consideration of the Commission's decision and guidance in *New Garden*, I find that Aqua has proven that the transaction is in the public interest and that the public at large, including Aqua's existing customers, will realize affirmative benefits sufficient to warrant approval of its application.

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 Stmt. No. 1, p. 8; Aqua Main Brief, p. 27).

Aqua next argues that Limerick customers will become part of a larger, efficiently operated utility. It also notes that it is planning capital projects in the Limerick system totaling approximately \$8.3 million over the next ten years, which will benefit those customers. (Aqua Stmt. No. 1, p. 9; Aqua Stmt. No. 2, p. 7-8; Aqua Main Brief, p. 28).

Next, Aqua argues that it has three other wastewater treatment plants within 22 miles of the Limerick 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. 28). In addition, Aqua is planning to move its Gilbertsville office to the existing office of Limerick's KRWWTP facility, thereby facilitating cross-training between its water and wastewater operations and reducing office rental expense. (Aqua Stmt. No. 2, p. 10; Aqua Main Brief, p. 28). Aqua argues that the Limerick system will have a decreasing cost profile in the future, with the realization of additional economies of scale and enhanced cost spreading. (Aqua Stmt. No. 1R, pp. 8-9; Aqua Main Brief, p. 28).

Aqua also argues that its existing customers will realize benefits from the transaction. It notes that the acquisition would result in an increase in its customer base of approximately 27%. This would result in future infrastructure investment being spread over more customers at lower incremental costs per customer. (Aqua Stmt. No. 1, p. 10). In addition, Aqua states that it will be able to accommodate anticipated future growth utilizing its current wastewater system infrastructure, resulting in even further spreading of costs and improving economies of scale for its customers. (Aqua Stmt. No. 1, p. 10; Aqua Main Brief, p. 29).

Finally, Aqua states that the transaction will not have an adverse effect on the service Aqua provides to its customers, that Limerick has agreed to sell its wastewater system, and that the public interest will be served by allowing it, rather than Limerick, to provide wastewater service in the Limerick service territory. (Aqua Main Brief, p. 29).

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 Limerick Township. The OCA notes that the Township will receive \$28.9 million, or 63%, more than the net book value of the system. (OCA Stmt. No. 1, p. 3). It further notes that Aqua anticipates spending approximately \$8.3 million for capital improvements to the Limerick system over the next ten years, thereby relieving the Township of the need to make these improvements in the future itself. (Aqua Main Brief, pp. 53-54).

Both the OCA and I&E argue, however, that the Application should be denied because any benefits to the Township are outweighed by detriments that will be experienced by Aqua's existing customers as well as the Limerick customers.

First, both OCA and I&E argue that cross-subsidization by Aqua customers will result from the high level of rate base per Limerick customer compared to Aqua's current system. OCA witness Everette stated:

With 20,440 wastewater customers and wastewater net utility plant of \$73,477,925, Aqua's existing system has an average net plant amount of \$3,595 per customer. By contrast, the acquisition of Limerick will add 5,434 customers and \$75,100,000 of rate base (plant), or an average of \$13,820 per customer. The average rate base cost of each Limerick customer is nearly four times that of an existing Aqua customer.

OCA Stmt. No. 1, p. 16.

The OCA concluded, “[w]hile the number of wastewater customers would increase by 27%, the average rate base of Aqua’s wastewater customers would increase by 60% per customer. (OCA Stmt. No. 1, p. 16) (emphasis in the original). I&E noted, “[t]he rate base per customer of the Limerick System is approximately 3.7 times higher than that of Aqua’s existing system. This disparity is important to note because it is one more factor that points to the subsidization of Limerick by existing customers.” (I&E Stmt. No. 1, p. 17; I&E Main Brief, p. 8). Both parties argue that this subsidization outweighs any benefits to Limerick Township and its customers.

The OCA next argues that Limerick’s existing customers will experience significant rate increases following the three-year rate freeze. Aqua’s witness Everett explained:

Aqua witness Packer states that Aqua desires to raise the rates of Limerick customers, from \$38 per month to \$70 per month, which would nearly double the rates to Limerick customers. Aqua states that the rates would be “targeted” to these levels during years four through ten of Aqua ownership (Exhibit U, Page 14). Mr. Packer’s Exhibits C and D show Aqua’s projection that it intends to increase rates to Limerick customers by \$4,650,000 in the first ten years. This is an increase of 105% over existing revenues.

(OCA Stmt. No. 1, pp. 11-12).

The OCA notes that Aqua witness Packer indicated that in order to shift less costs to Aqua’s existing customers, Limerick customer rates could be increased at an even greater amount. (Tr. p. 22). It concluded that, for the foreseeable future, Limerick customers will experience significant rate increases. (OCA Main Brief, p. 58).

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 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. 9). OCA argues, “[a]lthough Aqua references economies of

scale, the company has not provided any showing of cost reductions or efficiencies that will be produced by the acquisition of the Limerick customers. Simply having more customers does not create economies of scale.” (OCA Main Brief, p. 60). Both argue that Aqua’s overly generalized and unsupported assertions of affirmative benefits are insufficient to justify approval of its Application.

The OCA makes the further argument that Aqua has not demonstrated that it can operate and maintain the Limerick system, and make anticipated improvements, at a lesser cost than Limerick Township. The OCA states, “. . . based on Aqua’s projections, it appears that Aqua’s operating and maintenance expenses would be similar to or greater than those experienced by Limerick. Thus, it is not clear whether there will be any efficiencies in costs to run the system through Aqua’s acquisition.” (OCA Main Brief, pp. 60-61). Similarly, OCA argues that, despite Aqua’s assertions of a declining cost profile because the system does not require ongoing capital improvements, that profile will exist whether the system is owned by the Township or Aqua. (OCA main Brief, p. 61). OCA argues that these purported benefits will be realized by customers regardless of who owns the system. Therefore, they are not benefits that would result solely from approval of Aqua’s application.

As discussed below, I conclude, based on the Commission’s Opinion and Order in *New Garden*, that Aqua has demonstrated sufficient affirmative benefits to warrant approval of the Application.

In the *New Garden* proceeding, Aqua made similar arguments in support of its position that the transaction in that case provided sufficient affirmative public benefits to justify approval of the application. In my recommended decision, I disagreed with Aqua and recommended denial of the application on the basis that, although the transaction provided benefits to *New Garden* Township and its customers, it did not provide benefits to Aqua’s existing customers. To the contrary, I found that the detriments to Aqua’s existing customers were sufficient to overcome any benefits realized. Therefore, I recommended that the application be denied.

In ruling on Aqua’s exceptions on this issue, the Commission disagreed with my recommendation and concluded that Aqua had, in fact, shown sufficient public benefits to support approval of the application. Accordingly, the Commission approved the application.

With the benefit of Commission guidance on the issue of affirmative public benefits from the New Garden proceeding, I find, as explained below, that Aqua has shown sufficient public benefits to support approval of the application in this proceeding.

In *New Garden*, the Commission noted that Aqua had identified the following public benefits in that proceeding in support of its application:

- The acquisition will further the benefits of regionalization and economies of scale in the Pennsylvania wastewater sector.
- The New Garden system will be able to draw upon the experience of wastewater professionals throughout the much larger Aqua organization.
- The acquisition will have no negative effect on the quality or quantity of service provided to existing Aqua customers.

In accepting these benefits as support for approval of the application, the Commission stated, “[t]hese stated benefits are consistent with the Commission’s Policy Statement on Acquisition of Viable Water and Wastewater Systems, 52 Pa. Code §69.721, where we set forth that further consolidation of the water and wastewater industry in Pennsylvania may also result in greater economic and environmental benefits to customers.” (*New Garden*, Opinion and Order, pp. 67-68). Aqua has made similar arguments in this proceeding in support of its application. (Aqua Stmt. No. 1, p. 8; Application, ¶ 45.a; Aqua Main Brief, pp. 27-29). Based on the Commission’s decision in *New Garden*, I find that these benefits support approval of the application in this proceeding.

Aqua also argued in *New Garden* that both Aqua and New Garden customers will benefit by sharing the costs of future infrastructure investments at a lower incremental cost per customer because the acquisition will increase Aqua’s customer base by 11% and will occur in a

service territory where customer growth is expected. (*New Garden*, Aqua Stmt. No. 1, p. 8). The Commission accepted these benefits as support for the application, stating, “. . . these factors demonstrate that this acquisition likely will provide the long-term benefit of cost sharing.” (*New Garden*, Opinion and Order, p. 68). Aqua has argued that these same benefits are present in this proceeding. (Aqua Stmt. No. 1, p. 10; Aqua Stmt. No. 1R, p. 6; Application, ¶ 45.f; Aqua Main Brief, pp. 28-29). Under *New Garden*, these benefits support approval of Aqua’s application in this proceeding.

Aqua argues in this proceeding, as it did in *New Garden*, that approval of the transaction will not have an adverse impact on existing operations. (Application, ¶ 45.a; Aqua Main Brief, p. 29). In *New Garden*, this argument was accepted by the Commission as an affirmative public benefit. The Commission stated in *New Garden*, “. . . it will not be necessary for Aqua to hire additional staff to absorb this system. Although Aqua did identify two near-term capital investments necessary in the New Garden system, Aqua testified that over time the acquired assets will become less costly to operate.” (*New Garden*, Opinion and Order, p. 68). Again, based on the Commission’s decision in *New Garden*, this benefit supports approval of Aqua’s application in this proceeding.

In *New Garden*, the Commission expressed concern about the potential for cross-subsidization of the New Garden customers that might result from the acquisition. It noted the significantly higher average net plant per customer value of the New Garden customers compared to Aqua’s customers in suggesting that the New Garden rates, when reconciled to a rate base/rate of return model, may be much higher than the rates currently in effect for Aqua’s existing customers. (*New Garden*, Opinion and Order, p. 69). In addressing its concern about the rate reconciliation between the two customer groups, the Commission imposed a condition requiring Aqua, in its next base rate proceeding, to prepare and submit a cost-of-service analysis. It directed that, “Aqua shall develop and file a cost-of-service study in its next rate case, pursuant to our regulations, that separates the costs, capital, and operating expenses of providing wastewater service to the new Garden customers as a stand-alone rate group.” (*New Garden*, Opinion and Order, pp. 69-70). In requiring this condition, the Commission stated, “[t]hese conditions will ensure that all Parties and the Commission will be informed of the overall rate



impact that the acquisition will have on Aqua customers and, alternatively, the result of establishing New Garden as a separate rate zone.” (*New Garden*, Opinion and Order, p. 70).

Aqua’s witness William Packer testified during the hearing in this proceeding that Aqua would be willing to provide a separate cost-of-service study in its next rate case. (Tr. pp. 21-22).

Given the similar concerns in this proceeding about subsidization by Aqua’s existing customers of the Limerick customers (OCA Main Brief, pp. 56-58; I&E Main Brief, pp. 6-7), and the Commission’s decision to require a cost-of-service study to address those concerns in *New Garden*, I will likewise recommend in this proceeding that Aqua be required, as a condition of approval of its application, to prepare and submit a cost-of-service study in its next rate case, pursuant to the Commission’s regulations, that separates the costs, capital, and operating expenses of providing wastewater service to the Limerick customers.

The public benefits described above, coupled with the conditions requiring that (1) Aqua provide a cost-of-service study as part of its next rate case, and (2) Aqua’s shareholders bear the risk of any shortfall between revenue from the Limerick customers and the cost of providing service to those customers will assure that the requirements of Chapters 11 and 13 of the Public Utility Code are satisfied.

#### **H. Imposition of Six-Month Statutory Deadline**

The OCA has argued in this proceeding that, while Section 1329(d) establishes a six-month statutory deadline for the Section 1329 determination, it does not require the same six-month time limitation for the Section 1102 determination. It emphasized the compressed litigation timeframe under the six-month deadline and argues that Sections 1102 and 1329 can be reconciled and each given full effect by addressing the Section 1329 issues within the six-month timeframe, followed by consideration of the Section 1102 issues unshackled by the same six-month deadline. (OCA Main Brief, pp11-12).

Aqua responds by arguing that the OCA approach would violate the express language of Section 1329(d)(2), which requires that application proceedings brought under Section 1329 be completed within six months. (Aqua Reply Brief, pp. 16-17). In addition, Aqua notes that this issue was addressed by the Commission in *New Garden* in its ruling on a Petition for Interlocutory Review and Answer to a Material Question filed by I&E on the question of whether the six-month deadline applies to the Section 1102 portion of the proceeding.

As correctly explained by Aqua in its Reply Brief, the Commission ruled that, where the acquiring entity is a certificated public utility, there will be no bifurcation and a decision on the Application must be issued within the statutory six-month deadline. (*New Garden*, Opinion and Order entered February 15, 2017). Accordingly, I agree with Aqua in this proceeding that the Section 1329 and 1102 considerations must both be concluded within the six-month deadline set forth in section 1329(d)(2). This issue was addressed and decided by the Commission in *New Garden*.

#### **I. Revised DSIC Tariff and LTIIIP**

Section 1329(d)(4) authorizes an acquiring utility to begin collecting a Distribution System Improvement Charge (DSIC) from the time a tariff goes into effect until new rates are approved for the purchaser in a base rate case. 66 Pa. C.S. § 1329(d)(4). Where the acquiring utility decides to charge its customers a DSIC prior to its next base rate case, it is required, pursuant to the Commission's IO, to file a revised tariff to reflect the charge, as well as a revised Long Term Infrastructure Improvement Plan (LTIIIP). (IO, p. 27-28). Here, the OCA argues in its Main Brief that if the Limerick customers begin paying a DSIC charge prior to the effective date of rates established in Aqua's next base rate case, the Commission should require, as a condition of approval of the application, that Aqua file the required tariff changes and revised LTIIIP no later than 30 days after entry of the final Commission Order in this proceeding. (OCA Main Brief, p. 51).

In response, Aqua notes that the tariff modifications filed with the Commission in Supplement No. 101 at R-2016-2576069 in accordance with the Supplemental Implementation

Order<sup>10</sup> permit Aqua to apply its DSIC to Limerick customers. It states it will amend its LTIP before charging a DSIC to Limerick customers, but argues that the 30-day filing requirement sought by the OCA is unnecessary. (Aqua Reply Brief, p. 35).

On this issue, the Commission's IO provides as follows:

. . . Section 1329(d)(4) allows a public utility's existing DSIC to be applied immediately to the selling utility's customer's bills. OCA correctly notes and we agree that this is a change from the current practice reflected in the Implementation Order of Act 11, *Re Implementation of Act 11 of 2012*, 299 PUR4th 367 (Pa. PUC 2012) (*Act 11 Implementation Order*) wherein the Commission determined that a DSIC would not be charged to customers acquired through acquisitions until the rates were established by a base rate proceeding including the acquired customers. *Act 11 Implementation Order*, 299 PUR4th at 395. Therefore, a public utility that seeks approval to apply the DSIC to the customers acquired through acquisitions under Section 1329 will have to change its existing tariffs to reflect language consistent with the *Act 11 Implementation Order*. In conjunction, the public utility would also need to amend its LTIP (Long Term Infrastructure Improvement Plan). Similarly, the revenues from those customers will need to be included in the DSIC calculation as well as the costs of the projects.

IO, pp. 27-28.

I do not believe it is necessary to include, as a condition of approval of the application, a requirement that Aqua comply with the directives identified above. The IO sets forth the requirements that acquiring utilities must follow relative to the application of DSIC charges to the acquired customers. It does not include the 30-day time deadline sought by the OCA. Aqua will be expected to fully comply with the requirements set forth in the IO.

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<sup>10</sup> Implementation of Act 11 of 2012, Docket No. M-2012-2293611, Supplemental Implementation Order (September 15, 2016).

**J. 66 Pa. C.S. § 507 Approvals**

66 Pa. C.S. § 507 provides, *inter alia*, that “. . . no contract or agreement between any public utility and any municipal corporation shall be valid unless filed with the commission at least 30 days prior to its effective date.” I&E argues in this proceeding that Aqua’s application should be denied because Aqua has not filed for approval of either the APA or other municipal agreements Aqua will assume as part of its application. It argues that Aqua’s failure to file the various agreements with the Commission is a fatal flaw requiring denial of the Application. (I&E Main Brief, pp. 15-17).

In response, Aqua notes that the Wherefore Clause of its Application requests Commission approval of all such other approvals, certificates, registrations and relief, if any, that may be necessary with respect to the acquisition. It further correctly notes that the Commission, in the *Scranton Sewer Authority* proceeding<sup>11</sup>, approved the municipal agreements and directed Pennsylvania-American Water Company, as a matter of administrative efficiency, to file the executed municipal agreements after closing under separate “U” dockets<sup>12</sup>. (Aqua Reply Brief, pp. 9-10).

Similar to the Commission’s disposition of this issue in *Scranton Sewer Authority*, I will direct Aqua, for purposes of administrative completeness and efficiency, to file the APA and all relevant municipal agreements it is assuming under the APA, with the Commission under separate “U” dockets within 20 days of the entry of a final Opinion and Order in this proceeding. I do not believe this issue warrants denial of the Application.

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<sup>11</sup> *Joint Application of Pennsylvania-American Water Company and the Sewer Authority of the City of Scranton*, Docket No. A-2016-2537209 (Opinion and Order entered October 19, 2016) (*Scranton Sewer Authority*).

<sup>12</sup> *Scranton Sewer Authority*, p. 92.

For all of the forgoing reasons, I recommend that the application of Aqua Pennsylvania Wastewater, Inc. be approved, subject to the conditions described herein and with a ratemaking rate base value for the acquired assets of \$64,373,378.

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 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. Cmwlth. 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. A certificate of public convenience will be issued “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.” 66 Pa. C.S. § 1103(a).
6. 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 to provide the proposed service. 66 Pa. C.S. §§ 1102 and 1103; *Seaboard Tank Lines*, 502 A.2d 762, 764 (Pa. Cmwlth. 1985).
7. Aqua has sufficient staff, facilities and operating skills to provide the proposed service. *Re: Perry Hassman*, 55 Pa. P.U.C. 661 (1982).

8. 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).

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

10. 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).

11. Aqua has proven by a preponderance of the evidence that the acquisition is in the public interest because it will result in affirmative public benefits. *City of York v. Pa. Pub. Util. Comm'n.*, 295 A.2d 825 (Pa. 1972).

12. Aqua's proposed rate base value of \$75,100,000 for the acquired assets is not reasonable or in the public interest. 66 Pa. C.S. § 1103(a).

13. Aqua's proposal to split the Section 1329 rate base into a ratemaking initial rate base component and a regulatory asset component is not reasonable or in the public interest. 66 Pa. C.S. § 1103(a), 1329(c).

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 Limerick Township at Docket No. A-2017-2605434 be approved with certain conditions.

2. That at the time of filing of its next base rate case, Aqua Pennsylvania Wastewater, Inc. shall submit a cost-of-service study or analysis that separates the costs, capital, and operating expenses of providing wastewater service to the customers of Limerick Township as a separate class.

3. That the Commission retains the authority to allocate revenues, if appropriate, to the Limerick Township customers that are in excess of the restrictions outlined in the Asset Purchase Agreement. Aqua Pennsylvania Wastewater, Inc. and its shareholders should bear all risk of a shortfall between revenues it is permitted to recover under its Asset Purchase Agreement with Limerick Township and the costs that Aqua Pennsylvania Wastewater, Inc. incurs with respect to the acquired system. To the extent that Aqua Pennsylvania Wastewater, Inc. 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 its shareholders and not spread to other ratepayers.

4. That the rate base value of the acquired assets for ratemaking purposes shall be \$64,373,378.

5. That the application proceeding at Docket No. A-2017-2605434 be marked closed.

Date: September 18, 2017

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/s/  
Steven K. Haas  
Administrative Law Judge