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October 10, 2017

Via Electronic Filing

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17105-3265

In re: Docket No. A-2017-2605434
Application of Aqua Pennsylvania Wastewater, Inc. pursuant to Sections 1102 and 1329
of the Public Utility Code for Approval of its Acquisition of the Wastewater System Assets
of Limerick Township

Dear Secretary Chiavetta:

We are counsel to Aqua Pennsylvania Wastewater, Inc. in the above matter and are submitting, via electronic filing with this letter, the Company's Replies to the Exceptions of the Bureau of Investigation and Enforcement and the Office of Consumer Advocate. Copies of the Replies to Exceptions are being served upon the persons and in the manner set forth on the certificate of service attached to them.

Very truly yours,

THOMAS, NIESEN & THOMAS, LLC

By

Thomas T. Niesen

cc: Certificate of Service (w/encl.)
ra-OSA@pa.gov (w/encl.)
Alexander R. Stahl, Esquire (via email, w/encl.)

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

The Honorable Steven K. Haas, Presiding

Application of Aqua Pennsylvania : Docket No. A-2017-2605434
Wastewater, Inc. Pursuant to Sections :
1102 and 1329 of the Public Utility Code :
for Approval of its Acquisition of the :
Wastewater System Assets of Limerick :
Township :

**REPLIES OF
AQUA PENNSYLVANIA WASTEWATER, INC.
TO THE EXCEPTIONS OF THE BUREAU OF INVESTIGATION
AND ENFORCEMENT AND THE OFFICE OF CONSUMER ADVOCATE**

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DATED: October 10, 2017

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I. INTRODUCTION

This proceeding concerns the Application of Aqua Pennsylvania Wastewater, Inc. (“Aqua” or “Company”) pursuant to Sections 1102 and 1329 of the Public Utility Code (“Code”).

The Application asks that the Public Utility Commission (“Commission”) approve Aqua’s acquisition of the wastewater system assets of Limerick Township (“Township”) and allow Aqua to begin to provide wastewater service in Limerick Township.

The Application also asks that the Commission establish \$75,100,000 as the ratemaking rate base of the acquired assets pursuant to Section 1329(c)(2) of the Code.

By Recommended Decision dated September 18, 2017 (“Recommended Decision” or “Rec. Dec.”), Administrative Law Judge Haas concluded, *inter alia*, that the Application should be approved with certain conditions and that the rate base value of the acquired assets should be \$64,373,378.

On October 3, 2017, Aqua, the Bureau of Investigation and Enforcement (“I&E”) and the Office of Consumer Advocate (“OCA”) filed Exceptions to the Recommended Decision. Aqua submits the following Replies to the Exceptions of I&E and the OCA.¹

¹ Pursuant to 52 Pa. Code Section 5.535, Aqua will incorporate into its Replies to Exceptions, by reference and citation, relevant pages of its previously filed Main and Reply Briefs and Exceptions.

II. REPLIES TO EXCEPTIONS

REPLIES TO I&E EXCEPTIONS

Reply to I&E Exception No. 1 – Affirmative Public Benefit

Judge Haas concludes that Aqua has demonstrated sufficient affirmative benefits to warrant approval of the Application.² I&E contends that the Judge erred. It contends that the Application poses identifiable detriments to existing customers.

The Recommended Decision is guided by the Commission's decision in *New Garden*.³ The benefits of regionalization and economies of scale, the experience of Aqua's wastewater professionals, the demonstrated lack of any negative effect on quality or quantity of service to existing Aqua customers and the benefit of long-term cost sharing over a larger customer base support approval of the Application here in the same way as they supported approval of the Applications in *New Garden*⁴ and *Scranton Sewer Authority*.⁵

Guided, again, by *New Garden*, the Recommended Decision addresses Commission concern with potential cross subsidization⁶ by requiring a separate cost of service study which Aqua is willing to provide if the Commission orders it to do so.⁷ Aqua, moreover, acknowledges that the Commission maintains the authority to set rates for Limerick customers.⁸

² Rec. Dec., slip op. at 40 – 47.

³ Rec. Dec., slip op. at 45. *Application of Aqua Pennsylvania Wastewater, Inc.*, Docket No. A-2016-2580061, Opinion and Order entered June 29, 2017.

⁴ Rec. Dec., slip op. at 44 – 47.

⁵ *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*”).

⁶ Rec. Dec., slip op. at 46 and 47.

⁷ See Exceptions of Aqua Pennsylvania Wastewater, Inc. to the Recommended Decision of Administrative Law Judge Steven K. Haas, Exception No. 6.

⁸ Rec. Dec., slip op. at 47. See also Exceptions of Aqua Pennsylvania Wastewater, Inc. to the Recommended Decision of Administrative Law Judge Steven K. Haas, Exception No. 1 and *Scranton Sewer Authority*, cited therein, where the Commission explained that the rate effects of an acquisition are better reserved for a future base rate proceeding.

Aqua presented substantial evidence (not “vague generalizations” as alleged by I&E⁹) addressing the many public benefits of the transaction¹⁰ and summarized the benefits to *existing* Aqua customers as follows:¹¹

Benefits to Existing Customers of Aqua

- Aqua will increase its customer base by approximately 27% as a result of the acquisition. With a larger customer base, future infrastructure investment across the state will be shared at a lower incremental cost per customer for all of Aqua’s customers. Aqua St. No. 1 at 10 and Aqua Exhibit No. 1, Application ¶ 45.f.
- The acquisition, moreover, comes with the expectation of significant future customer growth, which can be accommodated utilizing the current wastewater utility treatment infrastructure. The Township is billing approximately 7,300 EDUs but capacity of 8,400 EDUs has been purchased on the system which represents an approximate 15% increase in billing units. Aqua St. No. 1 at 10 and Aqua St. No. 1R at 6.
- Customer growth will allow for further spreading of the cost of service across even more customers improving economies of scale as the system is integrated into Aqua. Aqua and Aqua PA have a long history of acquiring and operating smaller and mid-size systems. Over the long term, acquisitions have benefitted existing (and acquired) customers as well as the Commonwealth of Pennsylvania. Aqua St. No. 1 at 10 and 11, Aqua St. No. 1R at 6 and Aqua Exhibit No. 1, Application ¶ 45.f.
- Based on extremely conservative assumptions (a continuing rate for Limerick customers of \$70 per month and no further growth in customers beyond Year 10), Aqua’s rate stabilization plan projects a positive rate benefit for existing customers, as early as Year 15/16. With less conservative assumptions (additional customer growth and additional rate increases to Limerick customers within the first ten years), the positive rate benefit easily occurs by Year 10 – within the Year 7/8 time frame. Tr. 22 through 24.

In further support of its exception, I&E emphasizes a sentence from the Final Implementation Order¹² and contends that Limerick is not a system that needs to be acquired.¹³ There, however, is no support in the statutory language for I&E’s attempt to limit the application

⁹ See I&E Exceptions at 8.

¹⁰ Aqua Main Brief, Section II, Findings of Fact Nos. 31 through 45, and Section V.A.3.

¹¹ Aqua Main Brief, Section V.A.3 and Aqua Reply Brief, Section III.A.2.

¹² *Implementation of Section 1329 of the Public Utility Code*, Docket No. M-2016-2543193 (Order entered October 27, 2016).

¹³ I&E Exceptions at 5 – 6 and 8.

of Section 1329 to financially troubled systems or to systems that “need to be acquired.” Section 1329 sets no parameters on what types of systems should be acquired and the Commission’s consolidation policies encourage the acquisition of a portfolio of systems – some may need significant capital investment immediately and some may not.

In conclusion, Judge Haas did not err. As presented at length in our Main and Reply Briefs¹⁴ and discussed above, Aqua demonstrated through a preponderance of the evidence that its acquisition of the Limerick wastewater system and initiation of wastewater service in Limerick Township will affirmatively promote the service, accommodation, convenience, or safety of the public in substantial ways and further the public interest.

I&E Exception No. 1 should be denied.

Reply to I&E Exception No. 2 – Section 507

Judge Haas rejected arguments presented by I&E concerning Section 507 and the assignment of municipal agreements.¹⁵ I&E contends that Judge Haas erred.

The Recommended Decision concludes that the Section 507 issues raised by I&E do not warrant denial of the Application. Instead, consistent with *Scranton Sewer Authority*, Judge Haas directed Aqua, for purposes of administrative completeness and efficiency, to file the APA and all relevant municipal agreements it is assuming under the APA at separate “U” dockets within 20 days of the entry of a final Opinion and Order.

The Recommended Decision is consistent with the Commission’s recent Opinion and Order in *New Garden* where the Commission, in respect to Section 507, explained and held as follows:

¹⁴ Aqua Main Brief, Section II, Findings of Fact Nos. 31 through 45, and Section V.A.3 and Aqua Reply Brief, Section III.A.2.

¹⁵ Rec. Dec., slip op. at 50 and 51.

Aqua is correct that it complied with the filing requirements of Section 507 by submitting the contracts within thirty days prior to the effective date of the contract or agreement. The Company filed copies of the APA, its amendments, and all agreements being assigned or assumed by Aqua in its Application filing. Aqua also acknowledges that the municipal agreements contained as exhibits to the APA will not become effective until after closing of the APA which is well beyond the thirty-day filing period set forth in Section 507. Moreover, the municipal agreements are part of the evidentiary record and we are aware of no Party finding an issue with them or providing an objection to them being assigned or assumed by the Company. Although I&E and the OCA raised objections to provisions of the APA, we ultimately approved the Application as being in the public interest. There was no evidentiary basis upon which to find that the APA, as amended, or the municipal agreements being assigned or assumed by Aqua failed to satisfy the Section 507 standard pertaining to reasonableness, legality or any other matter effecting the validity of the agreement. Thus, we decline to exercise our discretion to modify our decision to find the APA or the agreements as being ineffective.

However, we shall modify the *June 2017 Order* by approving the subject agreements pursuant to 66 Pa. C.S. § 507. We emphasize that our approval of the APA is subject to the additional conditions of approval pursuant to 66 Pa. C.S. § 1329(d)(3)(ii) and set forth in the ordering paragraphs of the *June 2017 Order*. Furthermore, in order to enable the Commission to track future proceedings involving municipal agreements, we will, as a matter of administrative efficiency, direct the Company to file the executed municipal agreements under separate “U” docket numbers.¹⁶

Implementing the foregoing, the Commission, in *New Garden*, included three Ordering Paragraphs addressing Section 507. In Ordering Paragraph 2, the Commission directed the Secretary to issue Section 507 Certificates of Filing for the New Garden APA and amendments.¹⁷ In Ordering Paragraph 3, the Commission directed the Secretary to issue Section 507 Certificates of Filing for two municipal agreements: a Sewage Treatment Agreement/Amendment between the Borough of Kennett Square and New Garden Township and a Bulk Sewage Treatment Agreement between Avondale Borough and New Garden. In Ordering

¹⁶ *Application of Aqua Pennsylvania Wastewater, Inc.*, Docket No. A-2016-2580061, Opinion and Order entered October 5, 2017, slip op. at 24 and 25.

¹⁷ The Office of the Secretary issued the Certificate of Filing for the APA and amendments on October 5, 2017.

Paragraph 4, the Commission directed Aqua to file the Kennett Square and Avondale Borough agreements under separate “U” dockets.¹⁸

The circumstances are the same here as they were in *New Garden*. Aqua included the Limerick APA in its Application. Agreements being assigned are specifically referenced in the APA and were addressed in Paragraph 20 of the Application.¹⁹ The agreements themselves were filed with the Commission as Confidential Exhibit F to the Application.²⁰ The agreements will not become effective until closing which is well beyond the thirty-day filing period set forth in Section 507. No party had an evidentiary issue or objection to the assignment or assumption of the agreements by Aqua. There, thus, is no basis upon which to find that the APA or the municipal agreements being assigned or assumed failed to satisfy the Section 507 standard pertaining to reasonableness, legality or any other matter effecting the validity of the agreement.

Consistent with *New Garden*, Aqua respectfully requests that the Commission include the following directives in its Opinion and Order in this proceeding as paraphrased from Ordering Paragraphs 2, 3 and 4 of *New Garden*:

1. The Commission’s Secretary issue a Certificate of Filing under Section 507 of the Public Utility Code, 66 Pa. C.S. § 507, for the Asset Purchase Agreement Between Limerick Township and Aqua Pennsylvania Wastewater, Inc. filed with the Commission on May 19, 2017.

2. The Commission’s Secretary issue a Certificate of Filing under Section 507 of the Public Utility Code, 66 Pa. C.S. § 507, for the assignment and assumption agreement filed with the Commission on May 19, 2017, for the Agreement between the Borough of Royersford, the Royersford Borough Authority, the Township of Limerick and the Limerick Township Municipal

¹⁸ *Application of Aqua Pennsylvania Wastewater, Inc.*, Docket No. A-2016-2580061, Opinion and Order entered October 5, 2017, slip op. at 26 and 27.

¹⁹ Aqua Exhibit No. 1, Application ¶ 20.

²⁰ Aqua Exhibit No. 1, Confidential Exhibit F. Agreements being assigned to Aqua include an Agreement between the Borough of Royersford, the Royersford Borough Authority, the Township of Limerick and the Limerick Township Municipal Authority Providing for Sewer Service for the Township of Limerick, dated December 4, 1967, and the later Extension of Agreement, dated November 30, 1976. The other agreements to be assigned included with Aqua Exhibit No. 1, Exhibit F, are with private entities, not municipalities, and, therefore, outside any possible filing requirement under Section 507.

Authority Providing for Sewer Service for the Township of Limerick, dated December 4, 1967, and the later Extension of Agreement, dated November 30, 1976.²¹

3. The municipal agreements set forth in Paragraph No. 2 shall be filed under separate "U" docket numbers.

I&E Exception No. 2 should be denied.

REPLY TO OCA EXCEPTIONS

The OCA presents six exceptions to the Recommended Decision. Its Exceptions 1 through 4 concern its proposed adjustments to the HRG and Gannett appraisals. As a threshold matter of Commission jurisdiction and authority, Aqua respectfully states, again, that the OCA's attempt to usurp the role of the UVEs and the purpose of utilizing the UVEs is contrary to clear and unambiguous statutory language, is contrary to the fair market value appraisals of the UVEs and is not supported by competent evidence.²²

With carefully crafted and clear statutory wording phrased in mandatory terms, the General Assembly made it clear that fair market value is determined by taking two separate, independent, and qualified appraisals by the UVEs and averaging those two separate and independent appraisals. The statutory wording must be followed and the OCA's adjustments to the fair market value appraisals must be rejected.

To be clear, as we explained in our Exceptions, we are not suggesting that the Commission is without jurisdiction. The Commission, for example, consistent with the statutory language, could review the appraisals to be sure that they comply with USPAP employing the cost, market and income approaches. We, however, are contending that the Commission's jurisdiction is limited. Thus, where, as here, the presiding administrative law judge has

²¹ By letter dated October 11, 2016, the Borough of Royersford agreed to the assignment of the inter municipal sewer agreement. Aqua Exhibit No. 1, Confidential Exhibit F, Royersford Letter 10-11-2016.

²² Aqua Main Brief, Section V.B, Aqua Reply Brief, Section V.B.1 and Aqua Exception No. 3 to the Recommended Decision of Administrative Law Judge Haas.

determined that the appraisals were performed in compliance with USPAP employing the three approaches²³ the inquiry must end. The Commission has no jurisdiction to consider other approaches or adjustments proposed by other parties.

Gannett's fair market value appraisal is \$80,098,000. 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.

While we offer the following replies to the OCA Exceptions, we submit that the replies are unnecessary inasmuch as the OCA's analysis is contrary to the procedures enacted by the General Assembly and should be rejected on that basis without further consideration. We further submit that the litigation over UVE appraisals which is occurring in this proceeding and which continues with the following Aqua replies to the OCA Exceptions is precisely what the General Assembly intended to avoid in the legislation. Instead, of traditional litigation, the legislation provides for appraisals from two qualified UVEs and an averaging of the two appraisals to account for variations in the approaches of the UVEs and the application of their respective expertise and judgment.

Reply to OCA Exception No. 1 – Removal of Land from the HRG Cost Approach

Judge Haas rejected an OCA adjustment that would have removed land from the HRG reproduction cost analysis and would have reduced the HRG cost approach by \$756,159.²⁴ The OCA contends that Judge Haas erred.

²³ Rec. Dec., Finding of Fact 52.

²⁴ Rec. Dec., slip op. at 37.

Judge Haas explained that, consistent with all other utility plant, he was applying the ENR index to land. He explained 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. He further recognized that, while the ENR index may not be the most appropriate index, he saw no reason why determining the reproduction cost of land to be the land's original cost is more appropriate than the method HRG used.²⁵

Ms. Vicari of HRG explained that, in the absence of a cost trend index, such as ENR, *each* parcel of land would have had to have been separately appraised based on its highest and best use. Separate land appraisals, however, were not performed. HRG chose to use the cost trend index to restate the value of the land in lieu of a separate land appraisal report. HRG's approach reasonably assumes that land values grew roughly along the lines of general inflation of the assets that it hosts further justifying the use of the ENR index.²⁶

The evidence of record and the Recommended Decision support the application of the ENR index to land. The Commission should decline to adopt the OCA's proposed adjustment removing land from the HRG cost approach.

OCA Exception No. 1 should be denied.

Reply to OCA Exception No. 2 – Removal of Future Capital Projects from the HRG Market Approach

Judge Haas rejected an OCA adjustment that would have removed future capital projects from the HRG market approach and, when combined with the OCA's adjustment for customer numbers, would have reduced the HRG market approach result to \$39,775,212.²⁷ The OCA contends that Judge Haas erred.

²⁵ Rec. Dec., slip op. at 37.

²⁶ Aqua St. No. 4R at 9, lines 1 through 10.

²⁷ Rec. Dec., slip op. at 39.

USPAP and the Final Implementation Order *require* consideration of future capital improvements in the Fair Market Value Appraisal.²⁸ The Recommended Decision appropriately recognizes that the listing of Limerick assets prepared by Pennoni Engineers identified \$4,533,000 in capital improvements planned by Limerick.²⁹

Future facilities are an integral part of the acquisition and needed to allow for future growth and additional revenue. 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 the acquiring entity and may be considered as part of the compensation. The failure to recognize future facilities would understate fair market value and the HRG appraisal.³⁰

The evidence of record and the Recommended Decision support the inclusion of future capital projects in the HRG market approach to fair market value. The Commission should decline to adopt the OCA's proposed adjustment removing future capital projects from the HRG market approach.

OCA Exception No. 2 should be denied.

Reply to OCA Exception No. 3 – Removal of Terminal Value from the Gannett Income Approach

Judge Haas rejected OCA adjustments that would have removed the terminal value from the Gannett income approach and used, instead, a DCF valuation using 50-years of discounted net cash flows with no terminal value. The OCA contends that Judge Haas erred. Judge Haas explained that the OCA had not provided sufficient evidence, or the necessary reasoning, to

²⁸ Tr. 61.

²⁹ Rec. Dec., slip op. at 39.

³⁰ Tr. 60 and 61.

determine that Gannett's income approach methods are unreasonable and accepted Gannett's income approach valuation of \$75,204,407.³¹

Terminal Value

The OCA misunderstands the use of "terminal value." 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. Subsequent to time period 13 (year 2030), the growth in annual Debt Free Net Cash Flows is a constant growth rate. The use of a "terminal value" in a DCF analyses is a mathematical shortcut to avoid having to show and/or calculate annual Debt Free Net Cash Flows for hundreds of time periods, or hundreds of years, and is reasonable and is in accordance with accepted valuation practice.³²

50 – Year Model

The OCA does more than disagree with Gannett's use of a terminal value. The OCA also proposes an alternative calculation based on a 50 year modeling approach. The OCA's alternative approach, which, essentially, caps the life of the business to 50 years is not in accordance with accepted valuation practice. By capping the business life to only 50 years, the OCA understates the value indicated by its witness's own model by 10% to 19% under his assumed Township ownership and by 10% to 14% based under his assumed Aqua ownership. It does not represent the valuation of a going concern.³³

³¹ Rec. Dec., slip op, at 34 – 36.

³² Aqua St. No. 3R at 9 through 12 and Schedule 2. In Schedule 2, columns C through G, the "DCF With Capitalization of Terminal Value Model @ 4.37%," or no growth model, from Exhibit Q's Exhibit 8 (Aqua Exhibit No. 1, Exhibit Q, Exhibit 8), produced a value of \$70,519,292 which is only 0.52% higher than the \$70,515,635 value found using the cash flow method advocated by OCA witness Watkins. Similarly, in columns H through L, the "DCF With Capitalization of Terminal Value Model @ 2.37%," or 2% growth model, from Exhibit Q's Exhibit 8 (Aqua Exhibit No. 1, Exhibit Q, Exhibit 8), produced a value of \$107,372,376 which is only 1.08% lower than the \$108,541,335 value found using the cash flow method advocated by Mr. Watkins.

³³ Aqua St. No. 3R at 4.

The OCA attempts to support its 50 year modeling approach by contending that Gannett failed to account for necessary capital investment. Mr. Walker of Gannett explained that the system must be valued as a going concern and cash flows, therefore, need to be considered in perpetuity. Mr. Walker stated the question as follows – does the model reflect the ability for the Limerick system to be valued as a going concern or does it reflect something else – an entity, as OCA witness Watkins suggests, which will have extinguished assets at the end of 50 years?³⁴

The model used by both Gannett and Mr. Watkins appropriately reflects the same 1.5% growth in capital expenditures and depreciation. Over the first fifty years, the model reflects \$77.3 million of capital investment. Over 100 years, the model reflects \$244 million of capital investment. That is how the math of the model works. The capital expenditure shown in the 13th year of the model is \$1.292 million and it almost matches dollar for dollar the depreciation shown on the line above it.³⁵ If the dollars of capital investments being “plowed” back into the system are matching depreciation dollars then the system remains in a “state of good repair,” contrary to the contention of the OCA.³⁶

The evidence of record and the Recommended Decision support Gannett’s use of a terminal value in the income approach. The Commission should decline to adopt the OCA’s proposed adjustment and alternative calculation based on 50 year modeling. The OCA has not shown that the Gannett’s income approach methods are unreasonable.³⁷

OCA Exception No. 3 should be denied.

³⁴ Tr. 48.

³⁵ OCA St. No. 2, Schedule GAW-7 at 2.

³⁶ Tr. 47 through 50.

³⁷ Rec. Dec., slip op. at 36.

Reply to OCA Exception No. 4 – Discount Rates

Judge Haas rejected an OCA adjustment to the discount rate used by Gannett in its income approach. The OCA contends that Judge Haas erred. Judge Haas explained that the OCA had not provided sufficient evidence, or the necessary reasoning, to determine that Gannett’s income approach methods are unreasonable and accepted Gannett’s income approach valuation of \$75,204,407.³⁸

Viewing the transaction, first, from Limerick’s perspective, the OCA proposes a discount rate using Township “equity” capital as well as debt. This is neither reasonable nor in accordance with accepted valuation practice for five reasons.

First, OCA witness Watkins developed his cost of capital for the Township based on methods used by witnesses who provide testimony before the Commission who are tasked with determining a cost of capital for a portion of a municipality’s assets which provide utility service outside its corporate limits or boundaries. Simply put, only in such cases as when a portion of a municipality’s assets provide utility service outside its corporate limits are municipalities treated as a business enterprise with respect to the cost of capital of those assets providing “outside” service. None of these circumstances is present in the current proceeding since the Township is not regulated by the Commission.³⁹

Second, OCA witness Watkins indicated that he used the Township’s embedded cost of debt or the historical cost of all debt issuances that were outstanding at 12/31/15. An embedded cost of debt, such as that used by Mr. Watkins, is only used in rate proceedings. Whereas the

³⁸ Rec. Dec., slip op. at 35 and 36.

³⁹ Aqua St. No. 3R at 6.

marginal cost of debt at the valuation date is in accordance with accepted valuation practice and used for market valuation purposes.⁴⁰

Third, OCA witness Watkins indicated that he used the Township's book capitalization ratios (i.e., debt and equity ratios calculated from a balance sheet) at 12/31/15. Book capitalization ratios, such as those used by Mr. Watkins, are only used in rate proceedings. Whereas market value capitalization ratios at the valuation date (i.e., 12/31/16) are in accordance with accepted valuation practice and used for market valuation purposes.⁴¹

Fourth, OCA witness Watkins included the Township's book equity in determining his cost of capital even though the Township, or any other municipal or government entity, can never marginally finance a project with equity. That is, the Township, or any other municipality, can only prospectively finance with debt capital, not equity capital. Accordingly, for market valuation purposes, municipal capital structure has to be 100% marginal debt.⁴²

Fifth, use of the Township's cost of capital does not conform to the "hypothetical buyer" or "hypothetical seller" of fair market valuation.⁴³

Viewing the transaction, next, from Aqua's perspective, OCA witness Watkins indicated that he used Aqua's book capitalization ratios (i.e., debt and equity ratios calculated from a balance sheet) to determine a discount factor. Book capitalization ratios, such as those used by Mr. Watkins, are only used in rate proceedings and are not in accordance with accepted valuation practice. Market value capitalization ratios at the valuation date (i.e., 12/31/16) as used by

⁴⁰ Aqua St. No. 3R at 6.

⁴¹ Aqua St. No. 3R at 6 and 7. For example, both the American Society of Appraisers, *ASA Business Valuation Standards*, 2009, and the National Association of Certified Valuation Analysts, *Professional Standards*, 2007, use the same definition: "Weighted Average Cost of Capital (WACC). The cost of capital (discount rate) determined by the weighted average, at market values, of the cost of all financing sources in the business enterprise's capital structure."

⁴² Aqua St. No. 3R at 7. For example, when a municipal or government entity, such as the Commonwealth of Pennsylvania, finances construction of a road or bridge, they only consider the marginal debt cost despite having "equity" reflected on their books (balance sheet).

⁴³ Aqua St. No. 3R at 7.

Gannett, on the other hand, are in accordance with accepted valuation practice used for market valuation purposes.⁴⁴

In sum, the evidence of record and the Recommended Decision support Gannett's discount rates. The Commission should decline to adopt the OCA's proposed adjustment. The OCA has not shown that the Gannett's income approach methods are unreasonable.⁴⁵

OCA Exception No. 4 should be denied.

Reply to OCA Exception No. 5 – Public Interest

Similar to I&E, the OCA claims that Judge Haas erred by concluding that Aqua has demonstrated sufficient affirmative benefits to warrant approval of the Application.⁴⁶

The OCA contends that it was inappropriate for Judge Haas to rely on *New Garden* for guidance as Commission reconsideration of *New Garden* remains pending. Reconsideration, however, is no longer pending.⁴⁷ Judge Haas appropriately relied on *New Garden* to guide his public benefit analysis.

The OCA contends further that Judge Haas did not properly evaluate the benefits of the Application on a stand-alone basis. Aqua submits that the OCA's characterization of Judge Haas's public benefit analysis is inaccurate. The Recommended Decision is based on the record evidence in this proceeding, the specifics of the Limerick transaction and the Commission's guidance in *New Garden*.

Similar to I&E, the OCA also contends that there is no substantial evidence of public benefit. Aqua, however, presented substantial evidence addressing the many public benefits of

⁴⁴ Aqua St. No. 3R at 7 and 8.

⁴⁵ Rec. Dec., slip op. at 36.

⁴⁶ Rec. Dec., slip op. at 40 – 47.

⁴⁷ See *Application of Aqua Pennsylvania Wastewater, Inc.*, Docket No. A-2016-2580061, Opinion and Order entered October 5, 2017.

this transaction.⁴⁸ In contrast to the OCA's claim of "harm," the benefits to *existing* Aqua customers are many and summarized in the reply to I&E Exception 1 which we incorporate herein by reference.⁴⁹

In its discussion of alleged harm, the OCA also references the Company's rate stabilization plan. Contrary to the OCA's contention, Aqua's rate stabilization plan projects a positive rate benefit for existing customers, as early as Year 15/16 based on extremely conservative assumptions (a continuing rate for Limerick customers of \$70 per month and no further growth in customers beyond Year 10). With less conservative assumptions (additional customer growth and additional rate increases to Limerick customers within the first ten years), the positive rate benefit easily occurs by Year 10 – within the Year 7/8 time frame.⁵⁰

We point out, again, as we did in reply to the I&E Exception, that there is simply no basis to contend that Judge Haas erred. Even with the required determination of ratemaking rate base pursuant to Section 1329, Aqua is not proposing any change in the existing rates of either Limerick customers or Aqua's existing customers. The potential rate effects, rather, are reserved for a future base rate proceeding just as they were reserved for a future base rate proceeding in *New Garden* and in *Scranton Sewer Authority*.

In conclusion, Judge Haas did not err. As presented at length in our Main and Reply Briefs⁵¹ and discussed above, Aqua demonstrated through a preponderance of the evidence that its acquisition of the Limerick wastewater system and initiation of wastewater service in Limerick Township will affirmatively promote the service, accommodation, convenience, or safety of the public in substantial ways and further the public interest.

⁴⁸ Aqua Main Brief, Section II, Findings of Fact Nos. 31 through 45, and Section V.A.3.

⁴⁹ Aqua Main Brief, Section V.A.3 and Aqua Reply Brief, Section III.A.2.

⁵⁰ Tr. 22 through 24.

⁵¹ Aqua Main Brief, Section II, Findings of Fact Nos. 31 through 45, and Section V.A.3 and Aqua Reply Brief, Section III.A.2.

OCA Exception No. 5 should be denied.

Reply to OCA Exception No. 6 – Six Month Statutory Deadline

Judge Haas rejected an OCA contention that a Section 1329 application proceeding may be bifurcated and that a decision as to Section 1102 considerations need not be issued within six months. Citing the Commission’s decision in *New Garden*,⁵² Judge Haas explained that the Section 1329 and 1102 considerations must both be concluded within the six-month deadline set forth in Section 1329(d)(2).⁵³ The OCA contends that Judge Haas erred.

The Commission in *New Garden* explained and held as follows:

The language under Section 1329(d)(1) expressly provides that a public utility must submit an “*application*” for a certificate of public convenience to acquire municipally-owned water or wastewater assets under Section 1102 of the Code. If both the buyer and seller agree to proceed under Section 1329, the public utility “shall include as an attachment to its *application*” all of the information contained in Section 1329(d)(1)(i) to (v). Thereafter, the Commission “shall issue a final order on an *application* submitted under this section within six months of the filing date of an application meeting the requirements of subsection (d)(1).” 66 Pa. C.S. § 1329(d)(2) (emphasis added). We find this express language to be clear and unambiguous. It requires that once a utility applicant invokes Section 1329 and provides the information required under Section 1329(d), the Commission must issue an order within six months.

Because the language in Section 1329(d) is phrased in mandatory terms, there would appear to be no discretion to authorize an extension of the deadline period for a Commission decision as it relates to acquiring public utilities. Moreover, the Commission is prevented from inserting or reading into the statute words that do not appear in the text if the existing text makes sense and the implied reading would change the existing meaning or the effect of the actual language. *Pa School Boards Ass’n, Inc. v. Cmwlth., Public School Employees’ Retirement Bd.*, 580 Pa. 610, 621, 863 A.2d 432, 439 (Pa. 2004). If we were to read in words permitting a bifurcation, the six-month deadline under Section 1329(d)(2) would appear to be rendered inapplicable or superfluous. Under a bifurcated process there would be one proceeding under Section 1102 to determine the fitness without a Commission time limitation and a second proceeding to determine valuation under Section 1329 with a six-month time requirement. However, any time constraint under Section 1329 would become

⁵² *Application of Aqua Pennsylvania Wastewater, Inc.*, Docket No. A-2016-2580061, Opinion and Order entered February 15, 2017.

⁵³ Rec. Dec., slip op. at 47 and 48.

ineffectual or irrelevant if another integrated proceeding under Section 1102 could be extended for an indefinite time period.⁵⁴

The express language of the statute is clear and unambiguous and phrased in mandatory terms as set forth above. Section 1329 and 1102 considerations must both be concluded within the statutorily prescribed six month time period.

OCA Exception No. 6 should be denied.

Reply to OCA Exception No. 7 – Tariff Changes and Revised LTIP

Judge Haas rejected OCA proposals that Aqua file tariff changes and a revised Long Term Infrastructure Improvement Plan (“LTIP”) within 30 days following entry of an order. Citing the Final Implementation Order, Judge Haas denied the OCA proposals noting that Aqua will be expected to fully comply with the requirements set forth in that Order.⁵⁵ The OCA contends that Judge Haas erred.

Aqua filed tariff modifications in Supplement No. 101 at R-2016-2576069 enabling it to apply its DSIC to Limerick customers. Aqua, moreover, has acknowledged that it will amend its LTIP before charging DSIC to Limerick customers. The 30 day filing requirement is not necessary and, as recognized by Judge Haas, is not part of the Final Implementation Order.

OCA Exception No. 7 should be denied.

⁵⁴ *New Garden*, Opinion and Order entered February 15, 2017, slip op. at 22-23.

⁵⁵ Rec. Dec., slip op. at 48 and 49.

III. CONCLUSION

The Public Utility Commission should deny the I&E and OCA Exceptions, grant Aqua's Exceptions, modify the Recommended Decision as set forth in Aqua's Exceptions, approve Aqua's Application filed pursuant to Sections 1102 and 1329 of the Public Utility Code, and:

- a. Issue Certificates of Public Convenience under Section 1102:
 - (1) Authorizing Aqua to acquire, by purchase, the wastewater system assets of Limerick; and
 - (2) Authorizing Aqua to begin to offer, render, furnish and supply wastewater service to the public in the Requested Territory.
- b. Authorize Aqua to file tariff revisions, effective upon one day's notice, to:
 - (1) Include within its territory all the Requested Territory;
 - (2) Adopt and apply within the Requested Territory, Limerick's rates as Aqua's Base Rates; and
 - (3) Apply Aqua's *Rules and Regulations* within the Requested Territory.
- c. As part of its Order approving the Application include a determination that the ratemaking rate base of the Limerick system is \$75,100,000 pursuant to Section 1329(c)(2); and
- d. Issue such other approvals, certificates, registrations and relief, if any, under the Public Utility Code as may be appropriate.

Respectfully submitted,

AQUA PENNSYLVANIA WASTEWATER, INC.

By  _____

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Date: October 10, 2017

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

The Honorable Steven K. Haas, Presiding

Application of Aqua Pennsylvania : Docket No. A-2017-2605434
Wastewater, Inc. Pursuant to Sections :
1102 and 1329 of the Public Utility Code :
for Approval of its Acquisition of the :
Wastewater System Assets of Limerick :
Township :

CERTIFICATE OF SERVICE

I hereby certify that I have this 10th day of October 2017, served a true and correct copy of the foregoing Replies of Aqua Pennsylvania Wastewater, Inc. to the Exceptions of the Bureau of Investigation and Enforcement and the Office of Consumer Advocate, upon the persons and in the manner set forth below:

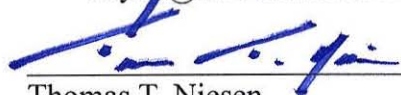
VIA ELECTRONIC AND 1ST CLASS MAIL

The Honorable Steven K. Haas
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