

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

In re: Application and related filings of Pennsylvania- :
American Water Company under Sections 507, 1102(a), :
and 1329 of the Pennsylvania Public Utility Code, 66 Pa. :
C.S. §§ 507, 1102(a), 1329, for approval of its acquisition :
of wastewater system assets of Township of Sadsbury, : Docket No. A-2018-_____ *et al.*
related wastewater service rights, fair market valuation :
ratemaking treatment, accrual and deferral of certain post- :
acquisition improvement costs, and certain contracts with :
municipal corporations :

**DIRECT TESTIMONY OF
JOHN R. COX ON BEHALF OF
PENNSYLVANIA-AMERICAN WATER COMPANY**

Date: June 1, 2018

PAWC Statement No. 3

**DIRECT TESTIMONY OF
JOHN R. COX**

INTRODUCTION

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Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS FOR THE RECORD.

A. John R. Cox, 800 West Hersheypark Drive, Hershey, PA 17033.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by American Water Works Service Company (“Service Company”) as Director of Rates and Regulations - Pennsylvania.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE.

A. I am a 1985 graduate of Shippensburg University of Pennsylvania with a Bachelor of Science degree in Business Administration, with a major in accounting. In 1999, I received my Master’s Degree in Business Management from Lebanon Valley College. I have also completed the continuing education program sponsored by the National Association of Regulatory Utility Commissioners (“NARUC”) and the University of Utah.

I have been employed by Pennsylvania-American Water Company (“PAWC”) or the Service Company since June 1986. From 1986 through June 1988, I served as a staff accountant in the Accounting Department. In July 1988, I was transferred to the Rate Department, and, in July 1989, I was promoted to Senior Rate Analyst. In 1991, I was promoted to accounting supervisor and held that position until December 2000 when I was promoted to Fleet and Materials Management Superintendent. In July 2004, I was

1 promoted to the position of Senior Financial Analyst assigned to the Finance Department.

2 In 2007, I was promoted to the position of Manager of Rates and Regulations, and in

3 2016, I was promoted to my current position of Director of Rates and Regulations.

4
5 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY BEFORE THE**
6 **PENNSYLVANIA PUBLIC UTILITY COMMISSION (THE “COMMISSION” OR**
7 **“PUC”)?**

8 **A.** Yes. I have presented testimony on accounting and rate matters before this Commission
9 on numerous occasions. I have also prepared water rate applications that were presented
10 to the Maryland Public Service Commission and the Virginia State Corporation
11 Commission by subsidiaries of the American Water Works Company that operate in those
12 states.

13
14 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

15 **A.** My testimony first addresses the financial fitness of PAWC to acquire and operate the
16 wastewater collection system (“System”) currently owned and operated by Sadsbury
17 Township (“Sadsbury”), which PAWC has agreed to purchase (“Transaction”). Second, my
18 testimony addresses: (a) the identification of ratemaking rate base as required in 66 Pa.
19 C.S § 1329 for PAWC’s acquisition of the System; (b) an estimate of the range of
20 transaction and closing costs incurred by PAWC; (c) an overview of the rate provisions
21 contained in the Asset Purchase Agreement (“APA”) for PAWC’s acquisition of the
22 System; (d) the benefits of the Transaction; and, (e) a statement regarding PAWC’s

1 intentions with respect to accrual of certain post-acquisition improvement costs and
2 deferral of related depreciation.

3
4 **TRANSACTION IS IN THE PUBLIC INTEREST**

5 **Q. WHAT, IF ANY, BENEFIT DO YOU SEE TO SADBURY'S CUSTOMERS AS A**
6 **RESULT OF THE TRANSACTION?**

7 A. The System's customers will be served by a large, financially sound company that has the
8 capability to finance necessary capital additions. Given its size, access to capital and its
9 recognized strengths in system planning, capital budgeting and construction management,
10 PAWC is well-positioned from a financial perspective to ensure that high quality
11 wastewater service meeting all federal and state requirements is provided to Sadsbury's
12 customers and maintained for PAWC's existing customers.

13
14 **Q. DO YOU ANTICIPATE THE TRANSACTION HARMING PAWC'S FINANCIAL**
15 **STATUS IN ANY MANNER?**

16 A. No, not at all. PAWC does not anticipate that the acquisition of the System will have a
17 negative impact on PAWC's cash flows, credit ratings or access to capital and, therefore,
18 will not deteriorate in any manner PAWC's ability to continue to provide safe, adequate,
19 and reasonable service to its existing customers at just and reasonable rates.

20
21 **PAWC'S FINANCIAL FITNESS**

22 **Q. PLEASE DISCUSS PAWC'S FINANCIAL FITNESS.**

1 A. PAWC is the Commonwealth’s largest water and wastewater provider, with total assets of
2 \$4.6 billion and annual revenues of \$661 million for 2017. For 2017, PAWC had operating
3 income of approximately \$346 million and net income of approximately \$161 million.
4 These operating results produced cash flows from operations of approximately \$337
5 million.

6 In addition to generating positive operating cash flows, PAWC may also obtain
7 financing as follows:

8 **Line of Credit**

9 PAWC presently has liquidity through a \$400 million line of credit through American
10 Water Capital Corp. (“AWCC”), a wholly owned subsidiary of American Water Works
11 Company, Inc. (“American Water”). PAWC’s strong credit ratings allow PAWC to obtain
12 additional capacity on this line of credit.

13 **Long Term Debt Financing**

14 PAWC carries a corporate credit rating of “A3” from Moody’s Investors Services and an
15 “A” rating from Standard and Poor’s Rating Services. PAWC obtains long-term debt
16 financing through AWCC at favorable interest rates and payment terms. When applicable,
17 PAWC also uses low-cost financing through the Pennsylvania Infrastructure Investment
18 Authority (“PENNVEST”) and the Pennsylvania Economic Development Financing
19 Authority (“PEDFA”).

20 **Equity Investments**

21 PAWC may obtain additional equity investments through American Water based on its
22 strong operating performance.

23

1 **Q. DOES PAWC HAVE THE OVERALL FINANCIAL FITNESS AND ACCESS TO**
2 **CAPITAL TO ACQUIRE SADBURY'S ASSETS?**

3 A. Yes. PAWC has strong operating cash flows and net income and, therefore, a strong
4 balance sheet. PAWC's strong operating and financial performance allows it to obtain
5 competitive interest rates for long-term debt financing and access to equity investments
6 from its parent company. In my opinion, PAWC is a financially-sound business that can
7 financially support the acquisition of the System as well as the ongoing operating and
8 investment commitments that will be required to operate, maintain and improve those
9 assets in serving the public.

10

11 **Q. PLEASE EXPLAIN HOW PAWC INTENDS TO FUND THE ACQUISITION.**

12 A. PAWC will initially fund the Transaction with short-term debt and will later replace it with
13 a combination of long-term debt and equity capital.

14

15 **Q. WHAT IMPACT, IF ANY, DO YOU ANTICIPATE THAT THE ACQUISITION OF**
16 **THE ASSETS WILL HAVE ON PAWC'S CORPORATE CREDIT RATINGS?**

17 A. As stated above, PAWC does not anticipate that the acquisition of the System will have a
18 significant impact on its credit ratings.

19

20 **FAIR MARKET VALUE RATE BASE**

21 **Q. PLEASE STATE THE RATE BASE REQUESTED IN THE APPLICATION**
22 **PURSUANT TO 66 Pa. C.S § 1329.**

1 A. The negotiated purchase price for the acquired assets is \$9,250,000 and the average of the
2 appraisals of the buyer’s Utility Valuation Expert (“UVE”) and the seller’s UVE is
3 \$9,250,000 ($\$8,910,000 \text{ AUS} + \$9,590,000 \text{ HRG} = \$18,500,000/2 = \$9,250,000$).
4 Accordingly, the negotiated purchase price of \$9,250,000 is the fair market value for
5 ratemaking purposes under Section 1329 (*i.e.* the lower of the negotiated purchase price
6 and the average of the UVEs’ appraisals). The fair market value as determined by the
7 Section 1329 process, which, in addition to the transaction and closing costs described
8 below, becomes part of PAWC’s rate base for ratemaking purposes. Note, however, that
9 PAWC reserves its right in future proceedings to make rate base claims related to the
10 acquisition as may otherwise be permitted under the Pennsylvania Public Utility Code.

11

12 **TRANSACTION AND CLOSING COSTS**

13 **Q. PLEASE DESCRIBE THE ESTIMATED TRANSACTION AND CLOSING COSTS**
14 **FOR THE TRANSACTION.**

15 A. As set forth in the Commission’s *Final Implementation Order* at Docket No. M-2016-
16 2543193, transaction and closing costs include the UVE’s appraisal fee and the buyer’s
17 closing costs, including reasonable attorney fees. In accordance with the *Final*
18 *Implementation Order* and traditional ratemaking principles, reasonable transaction and
19 closing costs are not to be decided in this Application proceeding; instead, PAWC must
20 justify the costs by a “preponderance of the evidence” in a future base rate proceeding.

21 As a practical manner, the exact extent of such costs cannot be known at the time
22 of filing the Application and will not be finally known until after closing of the Transaction.
23 The costs depend on a number of variables, including whether this Application is settled

1 or fully-litigated. PAWC will track such costs and incorporate them into rate base in a
2 future base rate proceeding as appropriate. Nevertheless, attached to the Application, as
3 **Appendix A-12** is PAWC's estimate of the anticipated range of transaction and closing
4 costs.

5
6 **APA RATE PROVISIONS**

7 **Q. PLEASE PROVIDE AN OVERVIEW OF THE RATE PROVISIONS OF THE APA.**

8 A. Section 6.7 of the Asset Purchase Agreement ("APA"), dated as of May 1, 2018, contains
9 provisions related to rates. PAWC has committed to adopt, upon closing of the
10 Transaction, Sadsbury's current customer charge and consumption charge then in effect at
11 the time of closing. The current usage rate (consumption charge) utilized by Sadsbury is a
12 rate per thousand gallons. Under PAWC ownership, and set forth in the *pro forma* tariff,
13 attached as **Appendix A-13**, the usage rate per thousand gallons is converted to a usage
14 rate per hundred gallons, thereby corresponding to how all other PAWC customers are
15 billed.

16 The initial rates to be applicable to the former Sadsbury wastewater customers are
17 set forth in the *pro forma* tariff supplement attached as **Appendix A-13** to the Application.
18 System customers will be governed by rates for new Sadsbury Rate Zone "xx." After
19 PAWC closes the Transaction, System customers will be subject to PAWC's prevailing
20 wastewater tariff on file with the Commission with respect to all rates other than the
21 customer charge and consumption charge, including capacity reservation fees,
22 reconnection fees and the like, as well as non-rate related terms and conditions of service.

1 Sadsbury’s customers are currently billed either monthly or quarterly. As PAWC
2 customers, all Sadsbury customers will be billed monthly. For those customers currently
3 connected to the wastewater system assets acquired by the Company, who receive their
4 water from a private well source, an APA dated May 1, 2017 between PAWC and the
5 Township of Sadsbury allows PAWC, at its sole discretion, to meter that source with a
6 PAWC-owned meter and issue wastewater bills based on meter reads from such meter.
7 The Company may also continue to bill the Lincoln Crest Mobile Home Park (“MHP”)
8 through a wastewater meter, owned by PAWC and located on the wastewater line of the
9 MHP until such time as the MHP becomes a water customer of PAWC.

10 I will also note, with the exceptions of those EDUs listed on Schedule 4.1(k)(iii) of
11 the APA, **Appendix A-24-a**, PAWC will charge a capacity reservation fee of \$4,000 per
12 new equivalent dwelling units for the allocation of treatment, pumping, and transmission,
13 truck and interceptor main capacity, commencing with the date of Closing. No capacity
14 fee will be charged for any applicant for wastewater service that meets the criteria of a
15 Bona Fide Service Applicant, as defined in 52 Pa. Code § 65.1 (excluding clause (iii) of
16 that definition) if “wastewater” were substituted for “water.”

17
18 **Q. DO THE RATE PROVISIONS OF THE APA INCLUDE A RATE**
19 **STABILIZATION PLAN AS DEFINED BY SECTION 1329?**

20 **A.** The APA does not set forth or require a “rate stabilization plan” as defined by Section
21 1329(g). Therefore, PAWC is not required under the *Final Implementation Order* at
22 Docket No. M-2016-2543193 to provide testimony, schedules, and work papers in support
23 of a plan.

1 **Q. WHAT, IF ANY, RATE BENEFITS ARE ANTICIPATED TO BE REALIZED BY**
2 **SADBURY CUSTOMERS FROM THE TRANSACTION?**

3 A. In the long-term, the Transaction will help PAWC keep rates reasonable for all of its
4 customers -- including System customers. Through its expertise in wastewater
5 management and the leveraging of economies of scale, PAWC will -- over time -- be able
6 to improve efficiencies and lower or slow the increase in the cost of operating the System.
7 These operational efficiencies -- while they cannot be precisely quantified at this time --
8 will inevitably be realized because of the size of PAWC's water and wastewater operations.

9

10 **Q. WHAT IMPACT, IF ANY, WILL THERE BE ON THE RATES OF PAWC'S**
11 **CURRENT CUSTOMERS AS A RESULT OF THE ACQUISITION OF THE**
12 **SYSTEM?**

13 A. There will be no short-term impact on PAWC's current customers. As explained above,
14 PAWC has committed to adopt Sadsbury's current rates as its base rates. In the future,
15 Sadsbury's wastewater operations would be included in future base rate filings similar to
16 the other operations of PAWC.

17 In the long-term, the acquisition of the System will help PAWC keep rates
18 reasonable for all of its customers by sharing costs across a much larger customer base. I
19 would like to reiterate that nothing contained in the APA, if approved by the Commission,
20 would bind the Commission or other interested parties in future ratemaking proceedings.

21

22

POST-ACQUISITION IMPROVEMENTS

1 **Q. PLEASE STATE YOUR UNDERSTANDING OF SECTION 1329 WITH RESPECT**
2 **TO POST-ACQUISITION IMPROVEMENTS.**

3 **A.** I am advised by counsel that Section 1329(f) allows “an acquiring public utility’s post
4 acquisition improvements that are not included in a distribution system improvement
5 charge [to] accrue allowance for funds used during construction [“AFUDC”] after the date
6 the cost was incurred until the asset has been in service for a period of four years or until
7 the asset is included in the acquiring public utility’s next base rate case, whichever is
8 earlier.” Section 1329(f) also provides that “[d]epreciation on an acquiring public utility’s
9 post acquisition improvements that have not been included in the calculation of a
10 distribution system improvement charge shall be deferred for book and ratemaking
11 purposes.”

12
13 **Q. DOES PAWC INTEND TO ACCRUE AFUDC FOR POSTACQUISITION**
14 **IMPROVEMENTS?**

15 **A.** Yes. As summarized in the Direct Testimony of PAWC Witness Michael J. Guntrum,
16 PAWC’s Sr. Project Engineer, PAWC Statement No. 2, PAWC will be making post-
17 acquisition improvements to the System. As such, PAWC will likely accrue AFUDC
18 consistent with what is permitted under Section 1329. Rate claims related to AFUDC can
19 then be adjudicated in the context of a future PAWC base rate proceeding.

20
21 **Q. DOES PAWC INTEND TO DEFER DEPRECIATION ON NON-DSIC-ELIGIBLE**
22 **POST-ACQUISITION IMPROVEMENTS FOR BOOK AND RATEMAKING**
23 **PURPOSES?**

1 A. Yes. Section 1329(f) permits such deferral of depreciation. The statute appears to allow
2 deferral without specific Commission approval; however, out of an abundance of caution,
3 PAWC is specifically petitioning the Commission, as part of this Application proceeding,
4 for permission to defer the depreciation for book and ratemaking purposes.
5

6 **AUTHENTICATION OF APPLICATION APPENDICES**

7 **Q. ARE YOU FAMILIAR WITH THE APPLICATION FILED BY PAWC IN THIS**
8 **PROCEEDING?**

9 A. Yes, I helped to prepare several of the appendices in support of the Application and I have
10 reviewed the final version of the Application and the appendices.
11

12 **Q. PLEASE IDENTIFY WHICH APPLICATION APPENDICES YOU PREPARED?**

13 A. I prepared the response in **Appendix A-12** which is the Company's estimate of the
14 anticipated range of transaction and closing costs and the *pro forma* tariff supplement
15 attached as **Appendix A-13** to the Application. In addition, I prepared **Appendix C**
16 (audited balance sheet of Sadsbury Township as of December 31, 2016, **Appendix D**
17 (audited balance sheet of PAWC as of December 31, 2017), **Appendix E** (audited income
18 statement of Sadsbury Township for the 12 months ended December 31, 2016), **Appendix**
19 **F** (audited income statement of PAWC for the 12 months ended December 31, 2017),
20 **Appendix G** (*pro forma* balance sheet of PAWC, giving effect to the transfer), **Appendix**
21 **H** (*pro forma* consolidated income statement of PAWC and Sadsbury Township for 12
22 months) and **Appendix K** (estimated annual revenues and Expenses).
23

1 **Q. HOW DID YOU PREPARE APPENDICES A-12, A-13, APPENDICES C**
2 **THROUGH H, AND APPENDIX K?**

3 A. I reviewed the financial information of PAWC, to which I have direct access, and I
4 reviewed the financial and rate information of Sadsbury Township, to which I received
5 access through the Transaction due diligence process.

6

7 **Q. ARE APPENDICES A-12, A-13, APPENDICES C THROUGH H, AND APPENDIX**
8 **K TRUE AND CORRECT TO THE BEST OF YOUR KNOWLEDGE,**
9 **INFORMATION, AND BELIEF?**

10 A. Yes.

11

12

CONCLUSION

13 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

14 A. Yes. However, I reserve the right to supplement my testimony as additional issues and
15 facts arise during the course of the proceeding. Thank you.