

**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	:	A-2018-3002437
of wastewater system assets of	:	
Sadsbury Township,	:	
related wastewater service rights,	:	
fair market valuation ratemaking	:	
treatment, deferral of the post-	:	
acquisition improvement costs, and	:	
certain contracts with municipal corporations	:	

RECOMMENDED DECISION

Before
Darlene Davis Heep
Administrative Law Judge

I. **INTRODUCTION**

Pennsylvania-American Water Company (“PAWC”) is seeking Commission approval for the acquisition of the wastewater system assets of Sadsbury Township (“Sadsbury”) and related wastewater service rights and contracts. The parties reached a settlement that allows the acquisition and establishes a ratemaking rate base of \$8.3 million. This decision recommends that the Commission adopt the proposed Settlement without modification.

II. **HISTORY OF THE PROCEEDING**

On June 19, 2018, PAWC filed an Application, pursuant to Section 1102(a) of the Pennsylvania Public Utility Code (“Code”), 66 Pa. C.S. § 1102(a), and Section 1329 of the Code,

66 Pa. C.S. § 1329, requesting that the Commission (1) issue Certificates of Public Convenience to PAWC for the transfer to PAWC, by sale, of substantially all of the assets, properties and rights of Sadsbury (the "Transaction") related to Sadsbury's wastewater collection system (the "System") and (2) set the fair market value of the acquisition for rate-base ratemaking purposes.

Notice of the Application was published in the *Pennsylvania Bulletin* on June 30, 2018. 48 Pa.B. 3929. The Notice included a July 16, 2018 deadline for filing protests and petitions to intervene.

The Office of Consumer Advocate (OCA) filed a Protest and Public Statement on June 20, 2018.

Counsel for the Commission's Bureau of Investigation and Enforcement (I&E) filed a Notice of Appearance on June 20, 2018.

Sadsbury Township filed a Petition to Intervene on June 29, 2018. The Petition to Intervene was unopposed and granted in the Prehearing Order dated August 1, 2018.

PAWC filed a Petition for Protective Order on July 10, 2018. PAWC also filed a Stipulation of the Parties Regarding Objections and Preservation of Issues. On July 11, 2018, PAWC filed the Joint Petitioners'¹ Stipulation Regarding Discovery Rule Modifications. There were no objections to the Petition for Protective Order and the Protective Order was issued on July 12, 2018.

On July 18, 2018, a hearing notice was issued scheduling an evidentiary hearing for this matter for August 22 and 23, 2018. A telephonic prehearing conference was held on July 25, 2018. Having resolved some issues, the August 22, 2018, hearing date was cancelled at the request of the Joint Petitioners.

¹ PAWC, I&E, OCA, and Sadsbury Township collectively, shall be referred to as the "Joint Petitioners" in this Recommended Decision.

On August 22, 2018, the Joint Petitioners advised the presiding Administrative Law Judge (ALJ) that they had reached an agreement in principle to resolve this matter and the hearing scheduled for August 23, 2018, was cancelled. The ALJ directed the Joint Petitioners to file a Petition for Settlement and Statements in Support on or before September 14, 2018.

On September 14, 2018, a Joint Petition for Approval of Settlement of All Issues and Statements in Support and a Joint Stipulation for Admission of Evidence were filed. On October 3, 2018, an order was signed admitting the following Statements and Exhibits:

A. Pennsylvania-American Water Company Statements and Exhibits

1. Direct

a. PAWC Statement No. 1 – Direct Testimony of Keith E. Gabage, and Exhibit KEG-1 (this Exhibit is the Application, which was previously filed with the Secretary of the Pennsylvania Public Utility Commission;

b. PAWC Statement No. 2 – Direct Testimony of Michael J. Guntrum and Exhibits MJG-1 through MJG-2;

c. PAWC Statement No. 3 – Direct Testimony of John R. Cox;
and

d. PAWC Statement No. 4 – Direct Testimony of Jerome C. Weinert, ASA, PE, CDP, and Exhibit JCW-1.

2. Rebuttal

a. PAWC Statement No. 1-R – Rebuttal Testimony of Keith E. Gabage; and

b. PAWC Statement No. 4-R – Rebuttal Testimony of Jerome C. Weinert, ASA, PE, CDP.

B. Sadsbury Township Statements and Exhibits

1. Direct

a. Sadsbury Statement No. 1 – Direct Testimony of Adrienne M. Vicari, PE, and Exhibit AMV No. I.

2. Rebuttal

a. Sadsbury Statement No. 2 – Rebuttal Testimony of Adrienne M. Vicari, PE, to the Direct Testimony of the Office of Consumer Advocate; and

b. Sadsbury Statement No. 3 – Rebuttal Testimony of Adrienne M. Vicari, PE, to the Direct Testimony of the Bureau of Investigation and Enforcement.

C. Bureau of Investigation and Enforcement Statements and Exhibits

1. Direct

a. I&E Statement No. 1 – Direct Testimony of Ethan H. Cline, and I&E Exhibit No. 1.

2. Surrebuttal

a. I&E Statement No. 1-SR – Surrebuttal Testimony of Ethan H. Cline, and I&E Exhibit No. 1-SR.

D. Office of Consumer Advocate Statements and Exhibits

1. Direct

a. OCA Statement No. 1 – Direct Testimony of Ashley E. Everette, and Exhibits AEE-1 through AEE-3; and

b. OCA Statement No. 2 – Direct Testimony of Glenn A. Watkins, and Schedules GAW-1 through GAW-7.

2. Surrebuttal

a. OCA Statement No. 1-SR – Surrebuttal Testimony of Ashley E. Everette; and

b. OCA Statement No. 2-SR – Surrebuttal Testimony of Glenn A. Watkins, and Schedules GAW-1 and GAW-2.

The record closed on October 4, 2018. This Application is ripe for a decision.

III. FINDINGS OF FACT

A. **Parties**

1. PAWC, a subsidiary of American Water Works Company Inc. (“American Water”), is the largest regulated water and wastewater public utility duly organized and existing under the laws of the Commonwealth of Pennsylvania.

2. PAWC furnishes water and wastewater service to the public in a service territory encompassing more than 400 communities in 36 counties, serving a population of over 2,300,000. PAWC St. No. 1 p. 11.

3. As of December 31, 2017, PAWC provided wastewater services to 64,917 customers in Pennsylvania, which includes 59,821 residential customers, 4,875 commercial customers, 182 municipal customers, 35 industrial customers, and 4 bulk customers. PAWC provided water services to 657,710 customers, which includes 605,770 residential customers, 45,022 commercial customers, 525 industrial customers, 2,225 municipal customers, 4,290 fire protection customers and 22 sales for resale customers. PAWC St. No. 1 p. 13.

4. Sadsbury is a Township of the Second Class under the Constitution and laws of the Commonwealth of Pennsylvania. Asset Purchase Agreement (“APA”) p. 1.

5. Sadsbury is located in Chester County, Pennsylvania. APA p. 1.

6. I&E is a Commission bureau that represents the public interest in ratemaking and service matters and enforces compliance with the Pennsylvania Public Utility Code and Commission regulations and Orders. I&E St. No. 1 p. 2.

7. The OCA is a Commonwealth agency created by Act 161 of 1976 to represent the interests of consumers before the Commission. 71 P.S. § 309-2.

B. Sadsbury Wastewater Collection System (The System)

8. As of December 31, 2016, the System provided service to 998 customers, including 950 residential and 48 commercial customer connections. PAWC St. No. 1 p. 12-13.

9. Approximately 240 residential and 11 commercial accounts obtain water from individual groundwater sources not connected to a public water system. PAWC St. No. 1 p. 12-13.

10. The System is interconnected with PAWC's existing Coatesville wastewater system.

11. All sewage collected by the System flows into PAWC's Coatesville system for treatment and disposal. PAWC St. No. 2 pp. 3-4.

12. Sadsbury presently accepts sewage from communities within West Caln Township that are served by PAWC. PAWC St. No. 1 p. 17.

13. The areas served within West Caln Township are already included in PAWC's current certificated service areas and are not a subject of this filing. PAWC St. No. 1 p. 17.²

C. The Transaction and the Asset Purchase Agreement

14. On November 21, 2016, following a meeting between PAWC representatives and representatives of Sadsbury, PAWC sent a "Letter of Interest" to Sadsbury confirming PAWC's interest in discussing the potential acquisition of Sadsbury's wastewater system pursuant to Section 1329 of the Public Utility Code. PAWC St. No. 1 pp. 7-8.

² Areas served by Sadsbury as indicated in the Application includes the Revised Service Area Map and Revised Service Area Metes and Bounds filed by PAWC on 06/20/18 as "Item 4".

15. After several extensions of the Intent Letter, an Asset Purchase Agreement providing for the sale of the System by Sadsbury to PAWC, was executed on May 1, 2018. APA p. 1.

16. The APA included a purchase price of \$9,250,000; however, the signatories agreed to use the fair market valuation process of 66 Pa. C.S. § 1329.

17. The APA signatories also agreed to certain adjustments in the purchase price, based on the results of the fair market valuation process. APA pp. 1 and 3.

D. The Application and the Utility Valuation Expert Appraisals

18. The Application was initially submitted to the Commission on June 1, 2018. Application (Correspondence dated June 1, 2018).

19. On June 7, 2018, the Commission's Bureau of Technical Utility Services ("TUS") notified PAWC in a deficiency letter that it believed the Application did not contain certain information. PAWC Response to Bureau of Technical Utility Service's Deficiency Letter (Correspondence dated June 13, 2018).

20. On June 13, 2018, PAWC responded to TUS's "Deficiency Letter." PAWC Response to Bureau of Technical Utility Service's Deficiency Letter (Correspondence dated June 13, 2018).

21. On June 19, 2018, the Commission acknowledged receipt of the complete Application. Secretarial Letter dated June 19, 2018.

22. Notice of the Application was published in the *Pennsylvania Bulletin* on June 30, 2018. 48 Pa.B. 3929 (June 30, 2018).

23. PAWC's Application is seeking to utilize the process set forth in 66 Pa. C.S. § 1329, to determine the fair market value of the System assets and the ratemaking rate base of those assets. PAWC St. No. 1 p. 4.

24. PAWC and Sadsbury jointly retained the services of Herbert E. MacCombie, Jr., P.E., to complete the Engineer's Assessment of Tangible Assets pursuant to Section 1329. PAWC St. No. 1 p. 8.

25. The Application included the appraisals of PAWC's Utility Valuation Expert ("UVE") and Sadsbury's UVE. Application, Attachment A-5.

26. PAWC retained the services of AUS Consultants, Inc. ("AUS") to complete an appraisal of the System. PAWC St. No. 1 p. 8.

27. AUS is registered as a utility valuation expert with the PUC. PAWC St. No. 4 p. 7.

28. AUS issued a fair market valuation report dated November 20, 2017. PAWC St. No. 4 p. 6.

29. AUS's fair market value report utilized the cost approach, the income approach, and the market approach. PAWC St. No. 4 pp. 14 and 19; Application Attachment A 7.

30. AUS filed a verification that states the fair market value report was prepared in compliance with the Uniform Standards of Professional Appraisal Practice ("USPAP"). PAWC St. No. 4 pp. 14 and 19; Application Attachment A-7.

31. AUS's fair market value report concluded that the value of the Sadsbury System was \$8,910,000. PAWC St. No. 4 p. 19.

32. Sadsbury retained the services of HRG to complete an appraisal of the System. PAWC St. No. 1 p. 8.

33. HRG is registered as a utility valuation expert with the PUC. Sadsbury St. No. 1 p. 3.

34. HRG issued a fair market valuation of the System as of December 31, 2017. Sadsbury St. No. 1 p. 2.

35. HRG's fair market value report utilized the cost approach, the income approach, and the market approach. Sadsbury St. No. 1 pp. 7 and 11; Application Attachment A-7.

36. HRG filed a verification that states the report was prepared in compliance with USPAP. Sadsbury St. No. 1 pp. 7 and 11; Application Attachment A-7.

37. HRG's fair market value report concluded that the value of the Sadsbury System was \$9,590,000. Sadsbury St. No. 1 p. 11.

38. The Joint Petitioners agree that any issues of non-compliance have been remediated through the as-settled ratemaking rate base value of \$8.3 million. Joint Petition for Settlement.

E. PAWC's Financial Fitness

39. PAWC's financial fitness to own and operate the System is not contested.

40. PAWC had total assets of approximately \$4.62 billion as of December 31, 2017. PAWC St. No. 1 p. 15; PAWC St. No. 3 p. 4.

41. For the year 2017, PAWC had annual revenues of \$661 million, operating income of approximately \$346 million and net income of approximately \$161 million. PAWC St. No. 3 p. 4.

42. In addition to generating positive operating cash flows, PAWC may also obtain financing through: (i) equity financing, (ii) a \$400 million line of credit through American Water Capital Corp. (“AWCC”); and (iii) long term debt financing at favorable rates from AWCC, the Pennsylvania Infrastructure Investment Authority and the Pennsylvania Economic Development Financing Authority. PAWC St. No. 3 p. 4.

43. PAWC will initially fund the Transaction with short-term debt and will later replace it with a combination of long-term debt and equity capital. PAWC St. No. 3 p. 5.

F. PAWC’s Technical Fitness

44. PAWC’s technical fitness to own and operate the System was not challenged in these proceedings.

45. PAWC currently employs approximately 1,000 professionals with expertise in water and wastewater utility operations, including engineering, regulatory compliance, water and wastewater treatment plant operation and maintenance, distribution and collection system operation and maintenance, material management, risk management, human resources, legal, accounting and customer service. PAWC St. No. 1 p. 11.

46. PAWC is currently the water provider within Sadsbury and is the operator of the System’s pump station. PAWC St. No. 1 p. 12.

47. The System is a sanitary-only collection system and consists of a sewer collection system with one pump station, approximately 90,000 ft. of 8-inch plastic sewer pipe, approximately 450 manholes and a small portion of force main. PAWC St. No. 2 p. 3.

48. Sadsbury has been a bulk wastewater customer of PAWC since PAWC's acquisition of the City of Coatesville Authority's water and wastewater system assets in March 2001. PAWC St. No. 1 p. 12.

49. The Sadsbury System is already interconnected with PAWC's Coatesville wastewater system and will be operated and managed by PAWC's Coatesville operations utilizing existing PAWC employees. PAWC St. No. 2 p. 8.

G. PAWC's Legal Fitness

50. PAWC's legal fitness to own and operate the System was not contested.

51. PAWC is a Commission-regulated public utility with a good compliance history. PAWC St. No. 1 p. 15.

52. There are no pending legal proceedings that would suggest that PAWC is not legally fit to provide service to Sadsbury customers. PAWC St. No. 1 p. 15.

53. PAWC has the expertise, the record of environmental compliance, the commitment to invest in necessary capital improvements and resources, and experienced managerial and operating personnel necessary to provide safe and reliable sewer services to the residents of Sadsbury and surrounding areas. PAWC St. No. 1 pp. 11-12.

H. Benefits of the Transaction

54. PAWC is subject to the jurisdiction of the Commission and must comply with the Code, the Commission's Regulations and Orders. PAWC St. No. 1 p. 14.

55. Sadsbury is not regulated by the Commission and currently does not need to comply with the Code, the Commission's Regulations or Orders. PAWC St. No. 1 p. 14.

56. Sadsbury's current customers will benefit from PAWC's customer services, including additional bill payment options, extended customer service and call center hours, customer information and education programs, and access to PAWC's customer assistance program. PAWC St. No. 1. p. 14; PAWC St. No. 2 pp. 8-10.

57. Customers can reach PAWC via e-mail and can manage their account on-line, in addition to emergency support 24 hours a day, seven days a week. PAWC St. No. 2 p. 8.

58. PAWC's customers can pay bills by mail, on-line, by e-check or electronic funds transfer, in person at multiple authorized payment locations across the state, and over the phone with a debit or credit card. PAWC St. No. 2 p. 8.

59. As customers of PAWC, Sadsbury's existing customers will have access to PAWC's customer assistance program, "H2O Help to Others Program." PAWC St. No. 2 p. 8.

60. The H2O program offers grants of up to \$500 per year and a 15% discount on total wastewater charges, in addition to a water saving kit. PAWC St. No. 2 p. 8.

61. The Transaction will have no immediate impact on PAWC's existing customers. PAWC St. No. 1 p. 14.

62. PAWC plans to implement pump station SCADA and security improvements and collection system improvements consisting of a sewer system survey and Infiltration and Inflow assessment along with routine collection system replacement. PAWC St. No. 2 p. 6.

I. Ratemaking Rate Base

63. The OCA and I&E challenged and proposed adjustments to the appraisals of AUS and HRG in this proceeding. OCA St. No. 1, OCA St. No. 2, I&E St. No. 1, OCA St. No. 1SR, OCA St. No. 2SR, I&E St. No. 1-SR.

64. The rate base agreed-to by the parties in the Settlement is \$8,300,000. Joint Petition for Approval of Settlement of All Issues ¶ 13.

J. Rate Stabilization Plan

65. The APA between PAWC and Sadsbury does not contain a “rate stabilization plan” as defined by 66 Pa. C.S. § 1329(g). PAWC St. No. 3 p. 8.

K. DSIC, AFUDC, Deferred Depreciation and Transaction and Closing Costs

66. PAWC is requesting authority to collect a distribution system improvement charge (“DSIC”) related to the Sadsbury System in the future, prior to the first base rate case in which the System plant-in-service is incorporated into rate base. PAWC St. No. 3 p. 8.

67. PAWC would not begin charging a DSIC until the eligible System plant is approved by the Commission in PAWC’s Long-Term Infrastructure Improvement Plan for wastewater. Settlement ¶ 18.

68. PAWC will make post-acquisition improvements in the Sadsbury System. As such, PAWC will likely accrue an allowance for funds used during construction. PAWC St. No. 3 p. 11.

69. PAWC intends to defer depreciation on non-DSIC-eligible post-acquisition improvements for book and ratemaking purposes. PAWC St. No. 3. Pp. 11-12.

70. Transaction and closing costs that PAWC may seek to recover include the UVE’s appraisal fee, the buyer’s share of the costs related to the engineer’s assessment, and the buyer’s closing costs, including reasonable attorney fees. PAWC is unable to determine the exact extent of transaction and closing costs at this time. In its Application, PAWC estimated the

anticipated range of transaction and closing costs as \$275,000 to \$450,000. PAWC St. No. 3 p.7; Application, Attachment A-12.

L. Rates

71. As required by Section 1329, PAWC included a *pro forma* tariff supplement in its Application. Application, Appendix A-13.

72. Upon closing of the Transaction, PAWC will adopt Sadsbury's current customer charge and consumption charge then in effect. The current consumption charge utilized by Sadsbury is a rate per thousand gallons. Under PAWC ownership, the usage rate will be converted to a usage rate per hundred gallons, in accordance with the bills of all other PAWC customers. PAWC St. No. 3 p. 7.

73. After PAWC closes on the Transaction, System customers will be subject to PAWC's prevailing wastewater tariff on file with the Commission with respect to all rates other than the customer charge and consumption charge, including capacity reservation fees, reconnection fees and the like, as well as non-rate related terms and conditions of service. PAWC St. No. 3 p. 7.

74. Sadsbury's customers are currently billed either monthly or quarterly. As PAWC customers, all Sadsbury customers will be billed monthly. PAWC St. No. 3 p. 8.

75. PAWC is unaware of any industrial customers within Sadsbury's service area that require pretreatment of certain types of industrial wastes pursuant to an Industrial Pretreatment Program ("IPP"); However, PAWC is proposing to modify its tariff to include the Sadsbury Service Area within its IPP. PAWC St. No. 2 pp. 4-5.

M. Municipal Agreements

76. As part of the Transaction, certain agreements will be assigned to PAWC. Application, Appendix A-24-f.

IV. DESCRIPTION OF THE SETTLEMENT

The Joint Petition includes the terms and conditions of the Settlement relating to the agreed upon fair market value for ratemaking purposes, the rate treatment of the acquired system, cost of service study, DSIC, long term infrastructure improvement plan (LTIIP), allowance for funds used during construction, deferral of depreciation and transaction costs and other rate-related issues and the agreements necessary to effectuate the transaction. PAWC, OCA, Sadsbury and I&E submitted statements in support of the Joint Petition.

The terms of the proposed settlement are set forth below. The Terms and Conditions of the Settlement can be found in Section III, Paragraph Nos. 11-23 of the Joint Petition. *See* Joint Petition, p. 3-9. The Joint Petitioners agree as follows:

A. Approval of Application

The Application shall, subject to the other terms and conditions contained in the Settlement, be approved as being in the public interest and the Commission shall issue such Certificates of Public Convenience as may be necessary to evidence its approval pursuant to 66 Pa. C.S. § 1102(a) of (i) the transfer, by sale, of Sadsbury's assets, properties and rights related to its wastewater collection to PAWC as provided in the Application, and (ii) PAWC's right to begin to offer, render, furnish and supply wastewater service in the areas served by Sadsbury as indicated in the Application.

B. Tariff

The *pro forma* tariff supplement attached to the Application as **Appendix A-13**, including all rates, rules and regulations regarding conditions of PAWC's wastewater service as revised therein, shall be permitted to become effective immediately upon closing of the Transaction.

C. Fair Market Value for Ratemaking Rate Base Purposes

13. Pursuant to 66 Pa. C.S. § 1329, PAWC shall be permitted to use \$8,300,000 for ratemaking rate base purposes for the acquired assets.³

14. The Joint Petitioners agree that the adjustments to the appraisals reflect a compromise of the various positions of the Joint Petitioners. All Joint Petitioners reserve the right to present adjustments and oppose adjustments to appraisals in future cases. The Joint Petitioners further agree, however, for the purposes of this proceeding, that the following adjustments are explicitly accepted by the Joint Petitioners:

(a) Market Approach:

(i) If “comparable acquisitions” are used as a factor in determining market value, the purchase price for each “comparable acquisition” for non-Section 1329 acquisitions shall be based on the actual amount paid for the assets at the time of purchase and future capital improvements shall not be included.

(ii) Comparable sales used to establish the valuation may not be limited to those that the UVE previously appraised.

(iii) The “net book financials” multiplier shall not be used in the market approach.

(b) Income Approach: The rate base/rate of return methodology is not an appropriate analysis for the appraisal.

(c) The “Going Value” and “Provision for Erosion on Return” add-ons will not be adopted or included in the appraisals.

(d) Cost Approach:

(i) The overhead cost add-on will not be adopted or included in the appraisals.

(ii) If the reproduction cost methodology is used, valuation of the collection mains will not be treated differently or as a special circumstance unless reasonably justified.

D. Rates

15. Except as explicitly stated herein, nothing contained in the Settlement or in the Commission’s approval of the Application shall preclude any Joint Petitioner from asserting any position or raising any issue in a future PAWC base rate proceeding.

³ PAWC and Sadsbury have agreed to a purchase price of \$8,600,000. No amendment to the Asset Purchase Agreement is required for this agreed-upon purchase price.

16. At the time of filing its next base rate case, PAWC shall submit a cost of service study that removes all costs and revenues associated with the operations of the Sadsbury system. PAWC also agrees to provide a separate cost of service study for the Sadsbury system at the time of the filing of PAWC's next base rate case.

E. Low Income Program Outreach

17. Within the first 90 days of PAWC's ownership of the Sadsbury system, PAWC shall include a bill insert to Sadsbury-area customers regarding its low income programs or alternatively shall include such information in a welcome letter to Sadsbury-area customers. The bill insert, or welcome letter shall include, at a minimum, a description of the available low income programs, the eligibility requirements for participation in the programs, and PAWC's contact information.

F. Distribution System Improvement Charge

18. Pursuant to 66 Pa. C.S. § 1329, PAWC shall be permitted to collect a distribution system improvement charge ("DSIC") prior to the first base rate case in which the Sadsbury service area plant-in-service is incorporated into rate base; provided, however, that such permission shall be conditioned upon (i) PAWC's filing of an amended wastewater Long-Term Infrastructure Improvement Plan ("Amended LTIP") which does not re-prioritize other existing commitments in other service areas, (ii) the Commission's approval of the Amended LTIP, as may be modified in the discretion of the Commission, and (iii) PAWC's filing of a compliance tariff supplement which incorporates Sadsbury into its existing DSIC tariff, including all customer safeguards applicable thereto, after Commission approval of the Amended LTIP.

G. Accrual of Allowance for Funds Used During Construction

19. The Application includes a request that PAWC be permitted to accrue Allowance for Funds Used During Construction ("AFUDC") for post-acquisition improvements not recovered through the DSIC for book and ratemaking purposes. The Joint Petitioners agree that they will not contest this request in this proceeding, but the Joint Petitioners reserve their rights to litigate their positions fully in future rate cases.

H. Deferral of Depreciation for Post-Acquisition Improvements

20. The Application includes a request that PAWC be permitted to defer depreciation related to post-acquisition improvements not recovered through the DSIC for book and ratemaking purposes. The Joint Petitioners agree that they will not contest this request in this proceeding, but the Joint Petitioners reserve their rights to litigate their positions fully in future rate cases.

I. Approval of Section 507 Agreements

21. Pursuant to 66 Pa. C.S. § 507, the Commission shall issue Certificates of Filing or approvals for the following agreements between PAWC and a municipal corporation:⁴

(a) Asset Purchase Agreement By and Among the Township of Sadsbury, as Seller, and Pennsylvania-American Water Company, as Buyer, Dated as of May 1, 2018;

(b) Settlement Agreement, dated as of May 15, 2000, by and between Sadsbury Township and Pennsylvania-American Water Company;

(c) Wastewater Conveyance Agreement, dated as of September 16, 2003, by and between Sadsbury Township, Pennsylvania-American Water Company, All County Partnership and Calnshire Estates, LLC;

(d) Memorandum dated as of September 16, 2003, Wastewater Conveyance Agreement, recorded September 17, 2003, in the Office of Recorder of Deeds for Chester County;

(e) Second Agreement for the Conveyance of Wastewater from West Caln Township through Sadsbury Township, dated as of August 9, 2013, between Sadsbury Township, Pennsylvania American Water Company, West Caln Township and Lawrence Developers, LP; and,

(f) Intergovernmental Agreement, dated as of November 15, 2011, between Sadsbury Township and Valley Township regarding sanitary sewer service for 2800 West Lincoln Highway.

J. Other Necessary Approvals

22. The Commission shall issue any other approvals or certificates appropriate, customary, or necessary under the Code to carry out the Transaction contemplated in the Application in a lawful manner.

⁴ OCA does not join in this paragraph but does not oppose PAWC's request.

K. Standard Settlement Conditions

23. The Settlement is conditioned upon the Commission's approval of the terms and conditions contained in the Settlement without modification. If the Commission modifies the Settlement, any Joint Petitioner may elect to withdraw from the Settlement and may proceed with litigation and, in such event, the Settlement shall be void and of no effect. Such election to withdraw must be made in writing, filed with the Secretary of the Commission and served upon all Joint Petitioners within five (5) business days after the entry of an Order modifying the Settlement. The Joint Petitioners acknowledge and agree that the Settlement, if approved, shall have the same force and effect as if the Joint Petitioners had fully litigated this proceeding.

24. The Settlement is proposed by the Joint Petitioners to settle all issues in the instant proceeding. If the Commission does not approve the Settlement and the proceedings continue, the Joint Petitioners reserve their respective procedural rights, including the right to present additional testimony and to conduct full cross-examination, briefing and argument. The Settlement is made without any admission against, or prejudice to, any position which any Joint Petitioner may adopt in the event of any subsequent litigation of these proceedings, or in any other proceeding.

25. The Joint Petitioners acknowledge that the Settlement reflects a compromise of competing positions and does not necessarily reflect any Joint Petitioner's position with respect to any issues raised in this proceeding. The Settlement may not be cited as precedent in any future proceeding, except to the extent required to implement the Settlement.

26. The Joint Petitioners shall jointly prepare and submit Proposed Findings of Fact, Proposed Conclusions of Law, and Proposed Ordering Paragraphs, respectively.

27. Each Joint Petitioner shall prepare a Statement in Support of Settlement setting forth the bases upon which the Joint Petitioner believes the Settlement to be fair, just and reasonable and, therefore, in the public interest.

28. If the ALJ recommends approval of the Settlement without modification, the Joint Petitioners will waive their rights to file Exceptions.

V. LEGAL STANDARDS

In the Application, PAWC requested that the Commission approve its acquisition of the wastewater system assets of Sadsbury Township and related wastewater service rights and

contracts, pursuant to Sections 1102(a) and 1329(c)(2), 66 Pa. C.S. §§ 1102(a), 1329(c). Such an acquisition may occur in accordance with the requirements of Section 1329 pertaining to valuation procedures and the ratemaking rate base, among others, discussed more fully within. 66 Pa. C.S. § 1329(c).

As the Applicant, the burden of proving that it meets these requirements was upon the PAWC, the party seeking relief. 66 Pa.C.S. § 332(a). However, PAWC and the other parties - Sadsbury, OCA and I&E - have reached a settlement.

Commission policy promotes settlement. See 52 Pa.Code § 5.231. A settlement lessens the time and expense that the parties must expend litigating a case and, at the same time, conserves precious administrative resources. The Commission has indicated that settlement results are often preferable to those achieved at the conclusion of a fully-litigated proceeding. See 52 Pa.Code § 69.401. In order to accept a settlement, the Commission must determine that the proposed terms and conditions are in the public interest. *Pa. Pub. Util. Comm'n v. York Water Co.*, Docket No. R-00049165 (Order entered Oct. 4, 2004); *Pa. Pub. Util. Comm'n v. C.S. Water and Sewer Assocs.*, 74 Pa. PUC 767 (1991).

Although there is a proposed settlement of this acquisition application, approval of the settlement requires demonstrated compliance with Section 1329 and the requirements to obtain a certificate of public convenience under Sections 1102 and 1103.

Section 1329 of the Code addresses the valuation of the assets of municipally or authority-owned water and wastewater systems that are acquired by investor-owned water and wastewater utilities or entities. The acquiring utility is authorized to collect a distribution system improvement charge. Section 1329 also enables a public utility or other acquiring entity's post-acquisition improvement costs not recovered through a distribution system improvement charge to be deferred for book and ratemaking purposes. Section 1329 helps mitigate the risk that a utility will not be able to fully recover its investment when water or wastewater assets are acquired from a municipality or authority.

If the parties agree to the Section 1329 process, the acquiring public utility and the seller of the municipal system each select a UVE from a list of such experts established and maintained by the Commission. The selected UVEs perform independent appraisals of the system to establish its fair market value. Also, the acquiring public utility and the seller select one licensed engineer to conduct an assessment of the tangible assets of the seller which is incorporated into the valuations of the UVEs.

After receiving the valuations, the acquiring public utility must apply for a certificate of public convenience under Section 1102 of the Code. A certificate of public convenience is required for “any public utility . . . to acquire from . . . any person or corporation, including a municipal corporation, by any method or device whatsoever . . . the title to, or possession or use of, any tangible or intangible property used or useful in the public service.” 66 Pa.C.S. § 1102(a)(3). Further, a certificate of public convenience is required for “any public utility to begin to offer, render, furnish or supply within this Commonwealth service of a different nature or to a different territory than that authorized” 66 Pa.C.S. § 1102(a)(1).

Included in the certificate application are the following attachments: copies of the UVE appraisals; the agreed purchase price; the ratemaking rate base; the transaction and closing costs incurred by the acquiring public utility that will be included in its rate base; and a tariff containing a rate equal to the existing rates of the selling utility at the time of the acquisition and a rate stabilization plan, if applicable. 66 Pa.C.S. § 1329(d)(1).

The Commission issues a certificate of public convenience upon a finding 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). An applicant for a certificate of public convenience must demonstrate that it is technically, financially, and legally fit to own and operate the acquired public utility assets. *Seaboard Tank Lines v. Pa. Pub. Util. Comm’n*, 502 A.2d 762, 764 (Pa.Cmwlth. 1985); *Warminster Township Mun. Auth. v. Pa. Pub. Util. Comm’n*, 138 A.2d 240, 243 (Pa.Super. 1958). The fitness of a currently certificated public utility, such as PAWC, is presumed. *See e.g., South Hills Movers, Inc. v. Pa. Pub. Util. Comm’n*, 601 A.2d 1308, 1310 (Pa.Cmwlth. 1992).

An applicant for a certificate of public convenience must additionally demonstrate that the transaction will “affirmatively promote the service, accommodation, convenience or safety of the public in some substantial way.” *City of York v. Pa. Pub. Util. Comm’n*, 449 Pa. 136, 151, 295 A.2d 825, 828 (1972). Where, as here, the certificate is sought as part of an acquisition, the Commission considers the benefits and detriments as well as the impact on all affected parties and not merely on one particular group or geographic subdivision. *Middletown Twp. v. Pa. Pub. Util. Comm’n*, 482 A.2d 674 (Pa.Cmwlt. 1984).

Also, to determine that the acquisition or merger is in the public interest:

[T]he 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.

Popowsky v. Pa. Pub. Util. Comm’n, 937 A.2d 1040, 1057 (Pa. 2007) (footnote omitted) (*Popowsky*). The Commission also may impose such conditions as it may deem to be just and reasonable. 66 Pa.C.S. § 1103(a).

PAWC also seeks approval of an APA and other connected agreements pursuant to Section 507 of the Public Utility Code. 66 Pa. C.S. § 507. Section 507 requires that contracts between a public utility and a municipal corporation (except for contracts to furnish service at regular tariff rates) be filed with the Commission at least 30 days before the effective date of the contract. The Commission approves the contract by issuing a certificate of filing, unless it decides to institute proceedings to determine whether there are any issues with the reasonableness, legality, or any other matter affecting the validity of the contract. Should the Commission initiate proceedings, the contract or agreement is not effective until the Commission grants its approval. Section 507 is a filing requirement and does not require service of the filing on any potentially interested parties.

VI. DISCUSSION OF THE SETTLEMENT

In their supporting statements, the Joint Petitioners conclude, after extensive discovery and discussion, that this Settlement resolves the contested issues in this case, fairly balances the interests of PAWC, Sadsbury Township and their ratepayers, is in the public interest, and is consistent with the requirements of the Public Utility Code.

After a full consideration of the terms of the Settlement and the statements in support, it is recommended that the Commission adopt the proposed Settlement without modification. The pertinent issues are discussed below.

A. Sections 1102 and 1103

1. Fitness

The fitness of PAWC is not disputed. PAWC is a Commission-regulated public utility and there is no evidence that PAWC has a troubled compliance history. PAWC St. No. 1 p. 15. PAWC, as a public utility currently enjoying Commission authorization and providing wastewater service, has a presumption of fitness. *South Hills Movers, Inc. v. Pa. Pub. Util. Comm'n*, 601 A.2d 1308, 1310 (Pa.Cmwlt. 1992).

The fitness of PAWC is also supported by the following facts: PAWC, a subsidiary of American Water Works Company Inc. (“American Water”), is the largest regulated water and wastewater public utility duly organized and existing under the laws of the Commonwealth of Pennsylvania. It furnishes water and wastewater service to the public in a service territory encompassing more than 400 communities in 36 counties. PAWC serves a population of over 2,300,000 throughout the Commonwealth. *PAWC St. No. 1 p. 11*.

As of December 31, 2017, PAWC furnished wastewater services to 64,917 customers in Pennsylvania, including 59,821 residential customers, 4,875 commercial customers, 182 municipal customers, 35 industrial customers and 4 bulk customers. PAWC furnishes water

services to 657,710 customers, including 605,770 residential customers, 45,022 commercial customers, 525 industrial customers, 2,225 municipal, 4,290 fire protection customers and 22 sales for resale customers. *PAWC St. No. 1 p. 13.*

PAWC currently employs approximately 1,000 professionals with expertise in water and wastewater utility operations, including engineering, regulatory compliance, water and wastewater treatment plant operation and maintenance, distribution and collection system operation and maintenance, material management, risk management, human resources, legal, accounting and customer service. *PAWC St. No. 1 p. 11.* PAWC is now the water provider within Sadsbury and is the operator of the System's pump station. *PAWC St. No. 1 p. 12.* Additionally, the System is currently connected to PAWC's wastewater system and sewage from the system is eventually treated and disposed of by PAWC. This includes sewage from customers within West Caln Township. The West Caln Township wastewater agreement is presented to the Commission for approval in this action. See Agreement, Section F.

The record is clear that PAWC is a financially-sound business and can financially support the acquisition of the System. *PAWC St. No. 3 p. 3-5.* There is no indication that the acquisition of the Sadsbury System will have a negative impact on PAWC's cash flows, credit ratings or access to capital or that the Transaction negatively affect PAWC's ability to continue to provide safe, adequate, and reasonable service to its existing customers at just and reasonable rates. *PAWC St. No. 3 p. 3.* Also, PAWC is a subsidiary of American Water, and so has available to it the resource of additional water and wastewater professionals. *PAWC St. No. 2 p. 7; PAWC St. No. 1 p. 13.*

2. Affirmative Public Benefits

The record also supports a finding that there are affirmative public benefits in this Transaction. The acquisition promotes the Commission's policy favoring regionalization and consolidation of water and wastewater systems. *PAWC St. No. 1 p. 13; 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 New Garden Township and*

the New Garden Township Sewer Authority, A-2016-2580061 (Opinion and Order entered June 29, 2017); 52 Pa. Code § 69.72.

Sadsbury notes that the Transaction would add 998 direct or indirect customers to PAWC's existing wastewater customer base of 64,917. *PAWC St. No. 1 p. 12.* The Transaction fosters the Commission goal of regionalizing wastewater systems to provide greater environmental and economic benefits to customers. *PAWC St. No. 1 p. 13.* Approval of the Transaction would enable PAWC to continue to regionalize its operations. Regionalization permits PAWC to seek economies of scale and share costs over a larger customer base for the benefit of all of its ratepayers.

Under PAWC ownership, Sadsbury customers will benefit from PAWC's additional bill payment options, extended customer service and call center hours, enhanced customer information and education programs, and access to customer assistance programs. *PAWC St. No. 1 p. 14. Sadsbury Statement in Support at 6-7.*

OCA points out that as a public benefit PAWC has agreed to provide information about PAWC's low-income programs through a bill insert or as part of its welcome letter to the Sadsbury-area customers, within 90 days of the closing of the transaction. Settlement Section E. The information will describe the available programs, eligibility requirements and contact information for PAWC. The OCA submits that this provision is reasonable and will provide timely information that may be helpful to some of the Sadsbury-area customers. *OCA Statement in Support at 6.*

Although I&E did not take a position on this issue during this proceeding, I&E nonetheless supports the distribution of information about low-income assistance to Sadsbury customers. I&E stated that ensuring that low-income customers are aware of available opportunities for financial assistance is in the public interest because it will better facilitate these customers' access to wastewater service, ensuring that this service remains available to all customers on reasonable terms and conditions. *I&E Statement in Support at 16.*

PAWC asserts that the Transaction will ultimately benefit PAWC's existing wastewater customers because it will add new customers to PAWC's wastewater customer base, who can share the cost of the PAWC wastewater system. *PAWC, St. No. 1 p. 14; PAWC St. No. 1-Rp. 2.*

PAWC notes that it can draw upon a much broader range of engineering and operational experience, as well as deeper financial resources, than can Sadsbury to address any environmental compliance challenges of the System. *PAWC St. No. 2 p. 6.* PAWC has a continuing program of capital investment focused on replacing and adding new pipes, treatment and pumping facilities, and other water and wastewater infrastructure, from which Sadsbury will benefit. *PAWC St. No. 2 p. 8.*

As PAWC noted, Sadsbury voluntarily entered into the APA to remove itself from the utility business and will receive the purchase price for the people of Sadsbury. *PAWC Statement in Support at 6.* PAWC also states that the agreed upon ratemaking rate base of \$8,300,000 is also within the public interest in that it furthers the legislative intent behind Section 1329 by: 1) allowing a municipality that wants to monetize an asset for maximum value to do so and 2) establishing a rate base for the System that is greater than what would have been allowed using traditional ratemaking principles. *PAWC Statement in Support at 9.*

PAWC also emphasizes that it is willing to enter into the Transaction and that Section 1329 would be ineffective if a willing seller would be unable to find a willing buyer. Finally, PAWC states, the Settlement allows the parties to the Transaction to obtain the necessary Commission approval in a timely manner while protecting the existing customers of the acquiring public utility. *Id.*

Permitting that negotiated amount to be utilized in the Settlement, Sadsbury notes, allows the Transaction to close in a timely manner without the threat of a protracted and costly appeal process and is therefore in the public interest because public benefits can be achieved sooner. *Sadsbury Statement in Support at 8-9.* I&E adds that the \$8.3 million figure represents the lower of PAWC and Sadsbury's negotiated purchase price, and the average of two fair

market value appraisals completed by each of these parties' UVEs. *I&E Statement in Support at 8-11*. OCA contends that this number represents a compromise of the parties' positions, more fully discussed herein, and, in the OCA's judgment, represents a result that is within the range of likely outcomes if the case were fully litigated, thereby providing some mitigation of the rate impact of the transaction for existing PAWC customers and the acquired Sadsbury Township customers by reducing overall costs. *OCA Statement in Support at 3*.

3. Cost of Service Studies

The Settlement includes a proposed ordering paragraph that requires PAWC to submit two cost of service studies in its next base rate case, particularly: (a) a cost of service study that removes all costs and revenues associated with the operation of the Sadsbury System; and (b) a cost of service study for the Sadsbury System. For purposes of this Settlement, PAWC's obligation to prepare cost of service studies extends only to its next base rate case. Unnecessary cost of service studies can be avoided in subsequent rate cases but are not precluded in the future. *Joint Petition Paragraph 16; PAWC Statement in Support at 8*.

I&E asserts that the costs of service studies are in the public interest. As background, I&E explained that at the outset of this case, although PAWC indicated its intent to adopt Sadsbury's rates until its next base rate case, there was no clear understanding of the underlying basis for the rates. *I&E St. No. 1, p. 14; I&E Ex. No. 1, Sch. 3*. I&E witness Ethan H. Cline, Fixed Utility Valuation Engineer, explained that there was a need for PAWC to perform a cost of survey study to more clearly understand the actual cost of serving Sadsbury customers. *I&E St. No. 1, pp. 13-14*.

Cline further explained that the cost of service study would be beneficial because it would: (1) determine the true cost of operating the Sadsbury system separately; (2) allow for separation of the costs between the utility's different customer classes; (3) determine if present rates in total and by class are sufficient; (4) attribute costs to the utility's different customer classes; (5) serve as a guide for how costs should be recovered from the utility's different classes; and (6) determine the amount of any subsidy from water customers.

According to Cline, a cost of service study for the Sadsbury system would separate costs, capital, and operating expenses of providing wastewater service to the Sadsbury customers as a standalone rate group. *I&E at pp. 14-15*. Cline asserted that the cost of service study will benefit PAWC's ratepayers as well, stating that without a cost of service study, the Commission's ability to evaluate the rate impact of the acquisition upon existing PAWC customers and its options of addressing that impact to provide any appropriate relief to existing customers, could be unclear.

Additionally, the cost of service study for the Sadsbury system would help the Commission determine Sadsbury's revenue requirement to provide service to its different customer classes, and extend rate making options that may not exist without such a study. As Cline further explained, requiring PAWC to conduct a cost of service study would ensure that in a future rate case, the Commission is provided with a tool to determine the cost to operate the Sadsbury system separately and to calculate the costs of the Sadsbury services. *I&E St. No. 1, p. 15*.

Finally, Cline pointed out, the cost of service study becomes essential when rate subsidization is at issue. A cost of service study can establish the existence and extent of subsidization (inter and intra-class) and assist in determining the appropriate amount of revenue requirement that is reasonable to be shifted from the wastewater customers to the water customers, which PAWC has utilized in past base rate cases. *I&E Statement in Support at 14-15*. Such studies will assist the Commission's evaluation of rates in future filings.

B. Section 1329 Approvals

1. Ratemaking Rate Base, Fair Market Value

Section 1329 provides that the ratemaking rate base will be the lesser of the fair market value (*i.e.*, the average of the buyer's and seller's independently conducted appraisals) or the negotiated purchase price. Provisions in the settlement agreement address various Section 1329 requirements.

(a) Ratemaking rate base. –

PAWC and Sadsbury agreed to use the procedure set forth in Section 1329 for the Transaction. The agreed upon ratemaking rate base is \$8,300,000. *Settlement at Section C.* Section 1329 created a voluntary procedure for valuing a water or wastewater system being sold by a municipality or municipal authority to a public utility or other entity. In that procedure, the buyer and the seller each obtain an appraisal of the system by a Commission approved utility valuation expert ("UVE"). The ratemaking rate base of the selling utility is the lesser of: (1) the purchase price agreed-to by the parties, or (2) the fair market value of the selling utility (defined as the average of the two UVEs' appraisals). This ratemaking rate base of the selling utility is incorporated into the rate base of the acquiring public utility during the acquiring public utility's next base rate case.

There were initially issues of disagreement among the parties regarding the ratemaking rate base. PAWC requested that the ratemaking rate base value of Sadsbury's assets be established at \$9.25 million, the negotiated purchase price between PAWC and Sadsbury. *PAWC St. No. 1, p. 10; PAWC Application Ex. A-11.* The \$9.25 million is also the average of the UVEs' appraisals of the Sadsbury system. *Id.* The UVE appraisals were: (1) an appraisal performed on behalf of PAWC by Jerome C. Weinert, P.E., Principal and Director for AUS Consultants, Inc. ("AUS appraisal") valuing the Sadsbury assets at \$8.91 million as of January 1, 2017 and (2) an appraisal performed on behalf of Sadsbury by Adrienne M. Vicari, P.E., Practice Area Leader, Financial Services, for Herbert, Rowland, and Grubic, Inc. ("HRG appraisal") valued the Sadsbury assets at \$9,590,000 as of December 31, 2016. *PAWC St. No. 4, p.19.; PAWC Application, Ex. 5, HRG Appraisal, p. 1.*

The Settlement ratemaking rate base is a compromise on certain adjustments in the UVEs' appraisals. The OCA witnesses challenged the UVE appraisals presented by PAWC and Sadsbury Township. *See OCA St. 1 at 5-35; OCA St. ISR at 3-14; OCA St. 2 at 5-25; OCA St. 2SR at 1-15.* The OCA's witnesses recommended corrective adjustments. The proposed Settlement includes the following adjustments:

- (a) Market Approach:
 - (i) If “comparable acquisitions” are used as a factor in determining market value, the purchase price for each “comparable acquisition” for non-Section 1329 acquisitions shall be based on the actual amount paid for the assets at the time of purchase and future capital improvements shall not be included.
 - (ii) Comparable sales used to establish the valuation may not be limited to those that the UVE previously appraised.
 - (iii) The “net book financials” multiplier shall not be used in the market approach.
- (b) Income Approach: The rate base/rate of return methodology is not an appropriate analysis for the appraisal.
- (c) The “Going Value” and “Provision for Erosion on Return” add-ons will not be adopted or included in the appraisals.
- (d) Cost Approach:
 - (i) The overhead cost add-on will not be adopted or included in the appraisals.
 - (ii) If the reproduction cost methodology is used, valuation of the collection mains will not be treated differently or as a special circumstance unless reasonably justified.

Settlement Section C.

OCA contends that these adjustments reflect accepted financial and ratemaking principles and help to improve the reliability of data used in appraisals and the integrity of the result. *OCA Statement in Support at 4.* PAWC and the OCA reserve the right to present adjustments and oppose other methodologies, inputs and assumptions in appraisals in future cases and proceedings, including methodologies, inputs and assumptions that were present in this case but not challenged by the OCA or that were accepted by the Commission. *Settlement Section C, p. 14. OCA Statement in Support at 3-4.* Additionally, I&E agrees with the terms because they are similar to those in prior Section 1329 proceedings before the Commission and as a result provide a degree of consistency and guidance for UVE appraisals. *I&E Statement in Support at 12-14.*

Under Section 1329, the ratemaking rate base of the acquired property will be the *lesser* of the fair market value or the negotiated purchase price. Therefore, as I&E witness Cline pointed out, any errors and inconsistencies contained in the UVEs’ appraisals would have an important impact in this proceeding. *I&E St. No. 1, p. 10.* Following that analysis, if the correction of any errors by either or both of the UVEs’ appraisals of the Sadsbury system

resulted in a decreased valuation, by any amount, the ratemaking rate base value of the Sadsbury system must also decrease. *Id. at 11.*

This settlement reflects a compromise on various evaluation issues. Particularly, I&E witness Cline questioned the McKeesport purchase price used⁵ in reaching a valuation for the System as well as the inclusion of the value of undedicated wastewater collection systems in the instant Sadsbury acquisition. *I&E Ex. No. 1, Sch. No. 1; I&E Ex. No. 1, Sch. No. 1; I&E St. No. 1, p.12-13.* Also, PAWC and Sadsbury introduced evidence in support of a ratemaking rate base of \$9,250,000, *i.e.*, the lower of the purchase price (\$9,250,000) and the average of the UVE appraisals (\$9,250,000). *PAWC St. No. 3 p. 6.* OCA introduced evidence in support of a ratemaking rate base of \$7,116,395, *i.e.*, the lower of the purchase price of \$9,250,000 and the average of the UVE appraisals as adjusted by the OCA witnesses (\$7,116,395). *OCA St. No. 1 p. 36.*

The Settlement ratemaking rate base value of \$8.3 million for the Sadsbury assets is a \$950,000 decrease from the value identified in PAWC's Application. Also, given the range of valuations, the \$8.3 million is within the range of litigation positions of the Joint Petitioners and evidence presented.

(b) Rates ⁶

In terms of rates, the Settlement is in the public interest because it provides that after closing, PAWC will charge rates for Sadsbury customers that are equal to Sadsbury's existing rates. PAWC Statement in Support at 9-10. System customers will be subject to PAWC's prevailing wastewater tariff on file with the Commission with respect to all rates other than the customer charge and the consumption charge, including capacity reservation fees,

⁵ *Application of Pennsylvania-American Water Company-Wastewater Pursuant to Sections 1102 and 1329 of the Public Utility Code for Approval of its Acquisition of the Wastewater System Assets of the Municipal Authority of the City of McKeesport*, Docket No. A-2017-2606103 ("PAWC/MACM Section 1329 Proceeding").

⁶ Section 1329(d)(1)(iv) of the Code requires an application to contain a tariff containing a rate equal to the existing rates of the selling utility at the time of the acquisition, together with a rate stabilization plan, if applicable to the acquisition. None of the Joint Petitioners have argued that the Asset Purchase Agreement includes a rate stabilization plan. Consequently, the Settlement does not address this requirement.

reconnection fees and the like, as well as non-rate related terms and conditions of service. *PAWC St. 3, p. 7.*

Attached to the Joint Petition at Appendix A is a *pro forma* tariff. The Joint Petitioners support the *pro forma* tariff supplement, under which Sadsbury's current rates would be initially adopted. The *pro forma* tariff will include all rates, rules, and regulations regarding the conditions of PAWC's wastewater service. The Joint Petitioners have agreed that the *pro forma* tariff supplement, attached to the Joint Petition as Appendix A, will become effective immediately upon closing of the transaction. *I&E Statement in Support at 7-8. Sadsbury Statement in Support at 9.*

PAWC avers that this Transaction will not result in an increase in rates for water customers pursuant to 66 Pa. C.S. § 1311(c) unless, in a future rate case, the Commission determines that an allocation of PAWC's wastewater requirement to water customers is "in the public interest." PAWC Statement in Support at 6-7.

2. Distribution System Improvement Charge

Section 1329(d) of the Code permits an acquiring public utility to collect a distribution system improvement charge ("DSIC") from the date of closing on the Transaction until new rates are approved in the utility's next base rate case. In order to qualify for DSIC recovery, a utility must submit a long-term infrastructure improvement plan ("LTIIP") to and receive approval from the Commission.

PAWC has previously received Commission approval of a wastewater LTIIP plan, and received Commission approval of a DSIC tariff, for other portions of its wastewater system.⁷ In its Application, PAWC requested conditional approval to implement a DSIC for the Sadsbury service territory.

⁷ See R-2017-2595853.

PAWC proposes to file an amended LTIIIP for the Sadsbury service territory. Following Commission approval of that amended LTIIIP, PAWC would make a tariff supplement compliance filing, which would include the Sadsbury service territory in PAWC's existing DSIC tariff. This will require PAWC to specify its plans before a DSIC may be implemented in the Township. *Sadsbury Statement in Support at Section F*. As the parties noted, the accelerated infrastructure repair and replacement achieved with the DSIC would benefit the public and the customers of both companies by more quickly addressing any infrastructure concerns in the System.

OCA reiterates that certain conditions must be met before PAWC may apply the DSIC to customers in the Sadsbury Township service area, i.e., Sadsbury will not be charged a DSIC until certain conditions are met. In particular, Paragraph 18 of the Petition states that PAWC will revise its LTIIIP to include Sadsbury Township and related projects before it begins charging the DSIC to those customers. *Settlement at Section F*. As noted by PAWC, the projects for Sadsbury Township customers are in addition to the projects already included in its approved LTIIIP and will not re-prioritize other existing commitments in other service areas. *PAWC Statement in Support at 10*. The settlement term provides that Sadsbury Township customers will begin contributing up to 5% of their total wastewater bill toward DSIC-eligible capital projects. This also safeguards against shifting DSIC investments away from PAWC's existing wastewater service areas during the amended LTIIIP period. *OCA Statement in Support at 5*.

I&E took no position regarding PAWC's request for approval to collect a DSIC as permitted under Section 1329, characterizing this request as a simple memorialization of PAWC's intention to employ certain provisions of Section 1329. However, I&E reserves the right to address these issues in future proceedings, including base rate, LTIIIP, and distribution system improvement charge proceedings, when additional information and facts are available and when these issues are reviewed by the Commission.

I&E nevertheless supports the DSIC provision in the Settlement, finding that it serves the public interest because PAWC has agreed that existing system improvement

commitments will not be re-prioritized as a result of this settlement while the System customers will benefit from improved wastewater infrastructure, promoting safer and more reliable service. At the same time, the improvements already identified and planned for existing PAWC ratepayers will not be jeopardized by PAWC's commitment to Sadsbury. *I&E Statement in Support at 16-17.*

3. Accrual of Allowance for Funds Used During Construction

Section 1329(f)(1) of the Code permits an acquiring public utility to accrue an allowance for funds used during construction ("AFUDC") on post-acquisition improvements that are not included in a DSIC, from the date the cost was incurred until the earlier of the point in time when the asset has been in service for a period of four years or the asset is included in the acquiring utility's next base rate case.

In the Application, PAWC requested permission to accrue AFUDC on post-acquisition improvements that are not included in a DSIC. *Settlement at Section G.* The Joint Petitioners do not oppose this request and they reserve their rights to litigate their positions fully in future rate cases. Not spending funds to litigate this issue at this juncture is in the public interest. *OCA Statement in Support at 5. PAWC Statement in Support at 11. I and E Statement in Support at 15.*

4. Deferred Depreciation

Section 1329(f)(2) of the Code permits an acquiring public utility to defer depreciation on its post-acquisition improvements that are not included in a DSIC. In the Application, PAWC requested permission to defer depreciation on post-acquisition improvements that are not included in a DSIC. *Petition at 7.* The Settlement is in the public interest because it makes clear that the other Joint Petitioners do not oppose this request and they reserve their rights to litigate their positions fully in future rate cases rather than litigating here. *I&E Statement in Support 18-19; OCA Statement in Support at 5.*

5. Transaction and Closing Costs

The Application requested permission to include the transaction and closing costs incurred here in PAWC's next base rate case. *Application, Attachment A-12*. The transaction and closing costs that PAWC may seek to recover include the UVE's appraisal fee, the buyer's share of the costs related to the engineer's assessment, and the buyer's closing costs, including reasonable attorney fees. At this time, PAWC is unable to determine the exact extent of transaction and closing costs but has estimated the anticipated range of transaction and closing costs as \$275,000 to \$450,000. *PAWC St. No. 3 p. 7; Application, Attachment A-12*.

Section 1329(d)(1)(iv) permits an acquiring public utility to include, in its next base rate case, a claim for the transaction and closing costs incurred for the acquisition. In *Implementation of Section 1329 of the Public Utility Code*, Docket No. M-2016-2543193 (Order entered October 27, 2016) p. 14, the Commission stated that there will be no Commission preapproval of the reasonableness of recovery of these costs in a Section 1329 proceeding.

Nevertheless, the Joint Petitioners do not oppose PAWC's request in this proceeding and reserve their rights to litigate their positions fully in future rate cases, where the Commission will fully adjudicate the ratemaking treatment and appropriateness of PAWC's claimed transaction and closing costs. The Settlement is in the public interest because it saves the cost of litigating this matter now and then relitigating the issue at a future date.

6. Section 507 Approvals

Section 507 of the Code requires that except for contracts to furnish service at regular tariff rates, contracts between a public utility and a municipal corporation be filed with the Commission at least 30 days before the effective date of the contract. The Commission approves the contract by issuing a certificate of filing, unless it decides to institute proceedings to determine whether there are any issues with the reasonableness, legality, or any other matter affecting the validity of the contract. 66 Pa. C.S. § 507.

PAWC is seeking Commission approval of the APA, as amended, and five agreements between Sadsbury and area municipalities to be assumed by PAWC at closing. Approval of these six agreements is necessary for PAWC to continue to provide service to the current System customers.

None of the Joint Petitioners object to the Commission's approval of these agreements pursuant to Section 507. The parties jointly ask the Commission to issue Certificates of Filing for, or otherwise approve, the identified agreements with municipal corporations. *PAWC Statement in Support at 12. Sadsbury Statement in Support at Section G. I&E Statement in Support at 19.* Such agreement without extended litigation is in the public interest.

C. Recommendation

It is recommended that the Settlement be approved in its entirety. The presumption of fitness PAWC is afforded as a current water and wastewater utility in the Commonwealth is supported by the expertise and financial and legal fitness of the company. The public and the customers of the System will benefit from the expertise of PAWC as well as its ability to finance and implement improvements in the System, including enhanced customer service and assistance to low-income customers. The ratemaking rate base value agreed upon is less than the valuations presented by Sadsbury and PAWC and more than the lowest valuation, presented by OCA, and is a result of compromise of the parties. The customers of Sadsbury will not see an immediate rate increase and any change in the rate must be approved by the Commission after consideration of a rate case in the future. The cost of service studies will protect against cross-subsidization.

Additionally, the settlement reserves the rights of the parties to contest inclusion of costs attributed to the acquisition in future rate cases. Furthermore, settlement of this matter will negate the need for further litigation, including possible appeals. The avoidance of further expense serves the interests of the parties, and the customers of Sadsbury and PAWC.

The settlement is fair, just, reasonable and in the public interest and saves the cost of litigating the matter, which will benefit all ratepayers. It is recommended that the Joint Petition for Approval of Settlement of All Issues be approved without modification by the Commission.

VII. CONCLUSIONS OF LAW

1. The Commission has jurisdiction over the subject matter of, and the parties to, this application proceeding. 66 Pa.C.S. §§ 1102, 1103, 1329.
2. Pennsylvania-American Water Company has the burden of proof in this proceeding. 66 Pa.C.S § 332(a).
3. Commission policy promotes settlement. See 52 Pa.Code § 5.231.
4. A settlement lessens the time and expense that the parties must expend litigating a case and, at the same time, conserves precious administrative resources. The Commission has indicated that settlement results are often preferable to those achieved at the conclusion of a fully-litigated proceeding. See 52 Pa.Code § 69.401.
5. In order to accept a settlement, the Commission must determine that the proposed terms and conditions are in the public interest. *Pa. Pub. Util. Comm'n v. York Water Co.*, Docket No. R-00049165 (Order entered Oct. 4, 2004); *Pa. Pub. Util. Comm'n v. C.S. Water and Sewer Assocs.*, 74 Pa. PUC 767 (1991).
6. The Commission may issue a certificate of public convenience upon a finding 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) (“Procedure to obtain certificates of public convenience”).

7. A certificate of public convenience is required for “any public utility to begin to offer, render, furnish or supply within this Commonwealth service of a different nature or to a different territory than that authorized” 66 Pa.C.S. § 1102(a)(1).

8. A certificate of public convenience is required for “any public utility . . . to acquire from . . . any person or corporation, including a municipal corporation, by any method or device whatsoever . . . the title to, or possession or use of, any tangible or intangible property used or useful in the public service.” 66 Pa.C.S. § 1102(a)(3).

9. An applicant for a certificate of public convenience must demonstrate that it is technically, financially, and legally fit to own and operate the acquired public utility assets. *Seaboard Tank Lines v. Pa. Pub. Util. Comm’n*, 502 A.2d 762, 764 (Pa.Cmwlth. 1985); *Warminster Township Mun. Auth. v. Pa. Pub. Util. Comm’n*, 138 A.2d 240, 243 (Pa.Super. 1958).

10. The fitness of a currently certificated public utility is presumed. *See e.g., South Hills Movers, Inc. v. Pa. Pub. Util. Comm’n*, 601 A.2d 1308, 1310 (Pa.Cmwlth. 1992).

11. An applicant for a certificate of public convenience must demonstrate that the transaction will “affirmatively promote the service, accommodation, convenience or safety of the public in some substantial way.” *City of York v. Pa. Pub. Util. Comm’n*, 449 Pa. 136, 151, 295 A.2d 825, 828 (1972).

12. In granting a certificate of public convenience, the Commission may impose such conditions as it may deem to be just and reasonable. 66 Pa.C.S. § 1103(a).

13. For an acquisition in which a municipal authority and the acquiring public utility agree to use the valuation procedure delineated in 66 Pa.C.S. § 1329, the ratemaking rate base of the selling utility shall be the lesser of the purchase price negotiated by the parties or the fair market value of the selling utility. 66 Pa.C.S. § 1329(c)(2).

14. “Fair market value” is defined as “the average of the two utility valuation expert appraisals conducted under subsection (a)(2).” 66 Pa.C.S. § 1329(g).

15. For an acquisition in which a municipal authority and the acquiring public utility agree to use the valuation procedure delineated in 66 Pa.C.S. § 1329, the application is to contain a tariff equal to the existing rates of the selling utility at the time of the acquisition and a rate stabilization plan, if applicable to the acquisition. 66 Pa.C.S. § 1329(d)(1)(v).

16. During the period that the *pro forma* tariff supplement is in effect, an acquiring public utility may collect a distribution system improvement charge, as approved by the Commission. 66 Pa.C.S. § 1329(d)(4).

17. A wastewater utility must submit a long-term infrastructure improvement plan to, and receive approval from, the Commission prior to collecting a distribution system improvement charge. *Implementation of Act 11 of 2012*, Docket No. M 2012-2293611 (Final Implementation Order entered August 2, 2012).

18. Section 1329 permits an acquiring public utility’s post-acquisition improvements, which are not included in a DSIC, to accrue allowance for funds used during construction after the date the cost was incurred until the asset has been in service for a period of four years or until the asset is included in the acquiring public utility’s next base rate case, whichever is earlier. 66 Pa.C.S. § 1329(f)(1).

19. Section 1329 permits an acquiring public utility to defer depreciation on post-acquisition improvements, which are not included in a DSIC. 66 Pa.C.S. § 1329(f)(2).

20. Section 1329 permits an acquiring public utility to include transaction and closing costs in its rate base, during its next base rate proceeding. 66 Pa.C.S. § 1329(d)(2). The Commission will not approve these costs during the Section 1329 proceeding. *Implementation of Section 1329 of the Public Utility Code*, Docket No. M-2016-2543193 (Final Implementation Order entered October 27, 2016).

21. A contract between a municipality and a public utility (other than a contract to furnish service at regular tariff rates) must be filed with the Commission at least 30 days before the effective date of the contract. The Commission may approve it by issuing a certificate of filing or institute proceedings to determine whether there are any issues with the reasonableness, legality, or any other matter affecting the validity of the contract.

66 Pa.C.S. § 507.

VIII. ORDER

THEREFORE,

IT IS RECOMMENDED:

1. That the Joint Petition for Approval of Settlement of All Issues, filed by Pennsylvania-American Water Company, the Office of Consumer Advocate, the Pennsylvania Public Utility Commission's Bureau of Investigation and Enforcement, and Sadsbury Township ("Joint Petitioners"), on September 14, 2018 at Docket No. A-2018-3002437, including all terms and conditions thereof, is approved, without modification.

2. That the Application filed by Pennsylvania-American Water Company on June 19, 2018 is granted, subject to the following conditions:

a. That Pennsylvania-American Water Company, at the time of filing its next base rate case, shall submit a cost of service study that removes all costs and revenues associated with the operation of the Sadsbury system.

b. That Pennsylvania-American Water Company, at the time of filing its next base rate case, shall also provide a separate cost of service study for the Sadsbury System.

3. That the Commission's Secretary's Bureau shall issue Certificates of Public Convenience under 66 Pa. C.S. §§ 1102(a) and 1103(a) evidencing Commission approval

of: (i) the transfer, by sale, of Sadsbury's assets, properties and rights related to its wastewater collection System to Pennsylvania-American Water Company as provided in the Application, and (ii) Pennsylvania-American Water Company's right to begin to offer, render, furnish and supply wastewater service to the public in the areas served by Sadsbury as indicated in the Application.

4. That Pennsylvania-American Water Company, upon closing of the Transaction, shall issue a compliance tariff supplement, consistent with the *pro forma* tariff supplement attached to the Joint Petition for Approval of Settlement of All Issues, to be effective on the date of issuance.

5. That the Commission approve, under 66 Pa. C.S. § 1329(c), a rate base addition of \$8,300,000 associated with PAWC's acquisition of the Sadsbury System.

6. That, although the Commission acknowledges that the Joint Petitioners reserve the right to present adjustments and oppose adjustments to appraisals in future cases, for purposes of this proceeding, the Commission accepts the following adjustments:

a. Market Approach:

(i) If "comparable acquisitions" are used as a factor in determining market value, the purchase price for each "comparable acquisition" for non-Section 1329 acquisitions shall be based on the actual amount paid for the assets at the time of purchase and future capital improvements shall not be included.

(ii) Comparable sales used to establish the valuation may not be limited to those that the UVE previously appraised.

(iii) The "net book financials" multiplier shall not be used in the market approach.

b. Income Approach: The rate base/rate of return methodology is not an appropriate analysis for the appraisal. Pennsylvania-American Water Company

- c. The “Going Value” and “Provision for Erosion on Return” add-ons will not be adopted or included in the appraisals.
- d. Cost Approach:
 - (i) The overhead cost add-on will not be adopted or included in the appraisals.
 - (ii) If the reproduction cost methodology is used, valuation of the collection mains will not be treated differently or as a special circumstance unless reasonably justified.

7. That, within the first 90 days of Pennsylvania-American Water Company’s ownership of the Sadsbury system, Pennsylvania-American Water Company shall include a bill insert to Sadsbury-area customers regarding its low-income programs or, alternatively, shall include such information in a welcome letter to Sadsbury Township-area customers. The bill insert, or welcome letter shall include, at a minimum, a description of the available low-income programs, the eligibility requirements for participation in the programs, and Pennsylvania-American Water Company’s contact information.

8. That Pennsylvania-American Water Company, pursuant to 66 Pa. C.S. § 1329(d), may collect a distribution system improvement charge related to the Sadsbury System prior to the first base rate case in which the System plant-in-service is incorporated into rate base only if the following conditions are met: They are:

- i. Pennsylvania-American Water Company files for approval an amended wastewater long term infrastructure investment plan incorporating the Sadsbury area, which does not re-prioritize other existing commitments in other service areas;
- ii. The Commission approves the amended wastewater long term infrastructure improvement plan incorporating the Sadsbury area, as may be modified in the discretion of the Commission; and
- iii. Pennsylvania-American Water Company files a compliance tariff supplement which incorporates Sadsbury Township into its existing DSIC tariff, including all customer safeguards applicable thereto, after Commission approval of the amended long-term infrastructure improvement plan.

9. That Pennsylvania-American Water Company, pursuant to 66 Pa. C.S. § 1329(f), may accrue an allowance for funds used during construction for post-acquisition improvements not recovered through the DSIC for book and ratemaking purposes. The Commission recognizes that the Joint Petitioners reserve their rights to litigate their positions fully in future rate cases when this issue is ripe for review and does not construe the Joint Petitioners' assent to this term to operate as their preapproval of Pennsylvania-American Water Company's request.

10. That Pennsylvania-American Water Company, pursuant to 66 Pa. C.S. § 1329(f), may defer depreciation related to post-acquisition improvements not recovered through the DSIC for book and ratemaking purposes. The Commission recognizes that the Joint Petitioners reserve their rights to litigate their positions fully in future rate cases when this issue is ripe for review and does not construe the Joint Petitioners' assent to this term to operate as their preapproval of Pennsylvania-American Water Company's request.

11. That Pennsylvania-American Water Company, pursuant to 66 Pa. C.S. § 1329(d)(iv), may include, in its next base rate case, a claim for transaction and closing costs related to the acquisition of the Sadsbury system. The Commission recognizes that the Joint Petitioners reserve their rights to litigate their positions fully in future rate cases when this issue is ripe for review and does not construe the Joint Petitioners' assent to this term to operate as their preapproval of Pennsylvania-American Water Company's request.

12. That the Commission's Secretary's Bureau shall issue Certificates of Filing or approvals for the following agreements between Pennsylvania-American Water Company and a municipal corporation:

i. Asset Purchase Agreement By and Among the Township of Sadsbury, as Seller, and Pennsylvania-American Water Company, as Buyer, Dated as of May 1, 2018;

ii. Settlement Agreement, dated as of May 15, 2000, by and between Sadsbury Township and Pennsylvania-American Water Company;

iii. Wastewater Conveyance Agreement, dated as of September 16, 2003, by and between Sadsbury Township, Pennsylvania-American Water Company, All County Partnership and Calnshire Estates, LLC;

iv. Memorandum dated as of September 16, 2003, Wastewater Conveyance Agreement, recorded September 17, 2003, in the Office of Recorder of Deeds for Chester County;

v. Second Agreement for the Conveyance of Wastewater from West Caln Township through Sadsbury Township, dated as of August 9, 2013, between Sadsbury Township, Pennsylvania-American Water Company, West Caln Township and Lawrence Developers, LP; and,

vi. Intergovernmental Agreement, dated as of November 15, 2011, between Sadsbury Township and Valley Township regarding sanitary sewer service for 2800 West Lincoln Highway.

13. That the Commission's proceeding at Docket No. A-2018-3002437 is terminated and marked closed.

Date: October 4, 2018

_____/s/
Darlene D. Heep
Administrative Law Judge