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October 18, 2021

Via Electronic Filing

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

In re: Docket No. A-2021-3024267
Application of Aqua Pennsylvania Wastewater, Inc. pursuant to Sections 1102, 1329 and 507 of the Public Utility Code for Approval of its Acquisition of the Wastewater System Assets of Lower Makefield Township

Dear Secretary Chiavetta:

We are counsel to Aqua Pennsylvania Wastewater, Inc. in the above matter and are submitting, via electronic filing with this letter, the Company's Reply Brief. Copies of the Reply Brief are being served upon the persons and in the manner set forth on the certificate of service attached to it.

Very truly yours,

THOMAS, NIESEN & THOMAS, LLC

By

Thomas T. Niesen

cc: Certificate of Service (w/encl.)
The Honorable Jeffrey A. Watson, Administrative Law Judge (via email, w/encl.)
Alexander R. Stahl, Esq. (via email, w/encl.)

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

The Honorable Jeffrey A. Watson, Presiding

Application of Aqua Pennsylvania Wastewater, Inc. Pursuant to Sections 1102, 1329 and 507 of the Public Utility Code for Approval of its Acquisition of the Wastewater System Assets of Lower Makefield Township	: : : : : :	**Docket No. A-2021-3024267**

REPLY BRIEF OF AQUA PENNSYLVANIA WASTEWATER, INC.

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DATED: October 18, 2021

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I. STATEMENT OF THE CASE

This proceeding concerns the Application of Aqua Pennsylvania Wastewater, Inc. ("Aqua" or "Company"), filed with the Public Utility Commission ("Commission") on May 14, 2021, pursuant to Sections 1102, 1329 and 507 of the Public Utility Code ("Code").

On October 8, 2021, Aqua, the Bureau of Investigation and Enforcement ("I&E"), the Office of Consumer Advocate ("OCA"), the Office of Small Business Advocate ("OSBA") and Lower Makefield Township ("Lower Makefield" or "Township") filed a Joint Petition for Approval of a Partial Settlement proposing a resolution of all issues with the exception of (1) the determination of ratemaking rate base; and (2) the treatment of income tax savings on repairs deductions.

Aqua and the OCA filed Main Briefs addressing the two unresolved issues on October 8, 2021. Lower Makefield filed a letter in support of Aqua's Main Brief.

Aqua submits this Reply Brief in accordance with the revised litigation schedule presented in the Interim Order, dated September 29, 2021, Approving Joint Stipulation for the Admission of Testimony and Exhibits, Providing for the Filing of Objections to Any Settlement and Responses to Objections and Revising Litigation Schedule.

Aqua's Reply Brief is supplemental to its Main Brief and is limited to those matters which require additional discussion as a result of the Main Brief filed by the OCA. A Procedural History and Overview of the Proposed Transaction is presented in Section I of Aqua's Main Brief.

II. BURDEN OF PROOF

Aqua addressed Burden of Proof in Section II of its Main Brief. Aqua submits that it has met its burden of proof.

III. STATEMENT OF QUESTIONS INVOLVED

Aqua presented its Statement of Questions Involved in Section III of its Main Brief.

IV. SUMMARY OF ARGUMENT

Valuations Pursuant to Section 1329

Aqua engaged the services of Gannett Fleming Valuation and Rate Consultants, LLC ("Gannett") to provide a fair market value appraisal in accordance with the Uniform Standards of Professional Appraisal Practice ("USPAP"), utilizing the cost, market and income approaches. Lower Makefield engaged the services of AUS Consultants, Inc. ("AUS") for the same purpose. Both firms were pre-certified as authorized UVEs.

Gannett's fair market value appraisal is $55,505,000. AUS' fair market value appraisal is $54,430,591. The average of the two is $54,967,796. The ratemaking rate base determined pursuant to Section 1329(c)(2) is $53,000,000, being the lesser of the negotiated purchase price of $53,000,000 and the average of $54,967,796.

The OCA proposed adjustments to the UVE appraisals which would reduce ratemaking rate base to $51,236,259. The appraisal adjustments proposed by the OCA and its proposed ratemaking rate base of $51,236,259 should be rejected.

Regulatory Liability Account to Accumulate Income Tax Effect of Repairs Deductions

The OCA's attempt to single out one component of the revenue requirement for the Lower Makefield system by imposing deferred accounting for the accumulated income tax effect of repairs deductions should be denied. The revenue requirement for the Lower Makefield system post-closing should be dealt with in the first rate case that includes the system.

V. ARGUMENT

A. Section 1329

1. Introduction

Aqua provided an Introduction to its Section 1329 argument in Section V.A.1 of its Main Brief.

2. Legal Principles

Aqua addressed Section 1329 Legal Principles in Section V.A.2 of its Main Brief.

3. Aqua's Application

Aqua addressed its Section 1329 Application details in Section V.A.3 of its Main Brief.

4. Challenges to the UVE Appraisals

a. Cost Approach – AUS Service Lives

The OCA recommends an adjustment of $4,714,000 reducing the AUS Cost Approach from $51,414,555 to $46,700,407 claiming that Mr. Weinert failed to provide any reasonable basis to conclude that the 80-year service life that he uses for collection mains is more appropriate than the 65-year service life used by Gannett in this proceeding and the service lives of 65 years and 75 years used by Mr. Weiner in previous appraisals.[1]

The OCA's attempt to support an adjustment to the AUS appraisal by reference to the Gannett appraisal is inappropriate. One would expect inputs, methods and results to differ from one appraisal and one appraiser to another. It is reasonable and appropriate that they do so and the reason why Section 1329 requires the submission of two independent appraisals. Gannett's use of a 65-year service life for Gravity Collection Mains in its Cost Approach is no support for an OCA

[1] *See* OCA Main Brief at 10-13.

attempt to reduce the service life for Gravity Collection Mains in the AUS Cost Approach from 80-years to 65-years.

Contrary to the OCA's further contention, Mr. Weinert offered very clear – and very convincing – support for his use of an 80-year service life for Gravity Collection Mains in the AUS Cost Approach. Mr. Weinert explained that an 80-year service life is reflective of the new practice of relining existing pipe and associated manholes with cure-in-place plastic ("CIPP") linings, which extends the useful service life of mains and manholes by 50 years thus pushing the useful life of these assets beyond 80-years into the low 100-year range.

The Commission's decision in the Cheltenham proceeding[2] cited by the OCA does not support the OCA's use of a 65-year service life for Gravity Collection Mains in this proceeding. As is clear from the *Cheltenham* Opinion and Order cited on pages 11-12 of the OCA Main Brief, the question in *Cheltenham* was whether the Commission should reduce the AUS service life for manholes and laterals from 90-years to 75-years. The Commission, in *Cheltenham*, agreed with the OCA but, clearly, the decision in *Cheltenham* adjusting the service life for VCP mains, laterals and manholes from 90-years to 75-years in the AUS Cost Approach does not support the further effort in this proceeding to reduce the service life in the AUS Cost Approach still further to 65-years.

Citing the Commission's decision in the Limerick proceeding,[3] the OCA contends that Mr. Weinert failed to provide any reasonable basis to conclude that an 80-year service life for Gravity collection mains is appropriate. Contrary to this contention and as set forth above and in Aqua's

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[2] *Application of Aqua Pennsylvania Wastewater, Inc. – Cheltenham Township*, Docket No. A-2019-3008491, Opinion and Order entered October 24, 2019.

[3] *Application of Aqua Pennsylvania Wastewater, Inc. – Limerick Township*, Docket No. A-2017-2605434, Opinion and Order entered November 29, 2017.

Main Brief,[4] Mr. Weinert presented an entirely reasonable basis and very clear – and very convincing – evidence in support of his use of an 80-year service life for Gravity Collection Mains in the AUS Cost Approach explaining that an 80-year service life is reflective of the new practice of relining existing pipe and associated manholes with CIPP linings.

The OCA's proposed adjustment to the AUS Cost Approach should be rejected. The OCA's is effectively asking the Commission to adjust the service life of Gravity Collection Mains "in the *wrong* direction."[5] The AUS Cost Approach result is $51,414,555.

b. Income Approach

i. Introduction

The OCA recommends adjustments of $4,024,687 to the Gannett Income Approach and approximately $9.41 million to the AUS Income Approach reducing the Gannett Income Approach from $53,741,785 to $49,717,098 and reducing the AUS Income Approach from $57,872,959 to $48,462,957.[6]

The end result of the OCA's recommended adjustments is to change the present value analysis, essential to the Income Approach, to a hybrid analysis that incorporates part of a present value Income Approach with part of a future book value Cost Approach contrary to Section 1329. As such, the adjustments are contrary to legislative intent and inconsistent with clear statutory language that requires a fair market value appraisal reflective of an Income Approach to valuation – not a hybrid Income Approach / Cost Approach to valuation.

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[4] See Aqua Main Brief, Section V.A.4.a.

[5] Aqua St. No. 5-R at 6 (emphasis added).

[6] In its discussion of its recommended adjustment to the Gannett Income Approach in Section V.A.4.b.iii of its Main Brief, the OCA states that its proposed adjustment to the Gannett Income Approach is $5,278,828 and that its proposed adjusted value is $48,462,957. These are not the numbers presented in the surrebuttal testimony of OCA witness Smith. The recommended adjustment as presented in the surrebuttal testimony of Mr. Smith is $4,024,687 and the proposed adjusted value is $49,717,098. OCA Exhibit RCS-1 SR, Page 1.

The OCA's proposed adjustments to the Income Approach are also contrary to language in *McCloskey*[7] where the Commonwealth Court clearly stated that "Section 1329 allows a private utility to acquire a government utility's assets at its fair market value ***rather than at the original cost of assets minus the accumulated depreciation*** and then add that amount to the rate base."[8] The OCA's proposed use of net plant as the terminal value in the Income Approach, moreover, was specifically rejected in *Cheltenham* as Aqua emphasized in its Main Brief. The OCA's proposal also is not in accord with the Commission's decision in *Limerick* as Aqua also emphasized in its Main Brief.

Contrary to the OCA's contention, which, we point out, once again, the Commission has previously rejected, the use of capitalization rates to determine terminal values in the Income Approach is entirely appropriate. The Commission has never expressed misgivings or concerns regarding the usefulness of applying a capitalization rate concept to estimate the terminal value of a regulated public utility in a Section 1329 proceeding. Gannett has applied a capitalization rate concept to estimate the terminal value as part of its fair market value appraisal in sixteen Section 1329 proceedings. The Commission has not adjusted the capitalization rate concept in any one of the prior proceedings.[9]

The OCA's claim of a "the fatal flaw" by both Gannett and AUS is simply wrong. The Lower Makefield wastewater utility is not depreciating and using up its existing plant faster and to a higher degree than it is investing to replace that plant. Contrary to the testimony of OCA witness Smith, over the course of the 24-year DCF model, the depreciation expense totals $48.251

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[7] *McCloskey v. Pa. P.U.C.*, 195 A.3d 1055 (Pa. Cmwlth. 2018), *petition for allowance of appeal denied* No. 703 MAL 2018 (April 23, 2019) ("*McCloskey*").

[8] *McCloskey* at 1057 (emphasis added). The Court also explained that "[f]rom a rate perspective, Section 1329 determines the rate base against which the rate of return and rate are calculated. It does so by determining the fair market value of the municipal utility assets; not original costs of the assets less depreciation." *McCloskey* at 1069.

[9] Aqua St. No. 4-R at 3.

million and capital expenditures total \$53.979 million. In the 24th year (2045) the depreciation expense is \$2.357 million, and the capital expenditures are \$2.321 million, a difference of less than 2%. With a net plant balance of \$56.320 million (year 2045) and the small \$0.036 million (\$2.357 - \$2.321) difference between depreciation expense and the capital expenditures, it would take 1,564 years to use up existing plant (\$56.320 ÷ \$0.036 = 1,564).[10]

ii. The Gannett Income Approach

Specific to the Gannett Income Approach, the OCA criticizes Mr. Walker's testimony, referenced above, that it would take 1,564 years to use up existing plant stating that there is no utility plant at Lower Makefield which has an expected life of anywhere near to 1,564 years. The criticism is a mischaracterization of Mr. Walker's testimony. Obviously, there is no utility plant with an expected life of 1,564 years. Mr. Walker's testimony simply pointed out that, with an investment in net plant of \$56.320 million (year 2045) and the small \$0.036 million (\$2.357 - \$2.321) difference between depreciation expense and the capital expenditures, it would take 1,564 years to use up dollars of existing plant (\$56.320 ÷ \$0.036 = 1,564) investment. The OCA's criticism of the Gannett Income Approach to value should be rejected for all the reasons set forth above and in Section V.A.4.b.i and ii of Aqua's Main Brief.

iii. The AUS Income Approach

Similar to its proposed adjustment to the terminal value in the Gannett Income Approach, the OCA proposes an adjustment to the terminal value in the AUS Income Approach based on the use of net plant as the terminal value. The OCA's proposed use of net plant as the terminal value in the AUS Income Approach to value should be denied and rejected for all the reasons set forth above and in Section V.A.4.b of Aqua's Main Brief.

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[10] Aqua St. No. 4-R at 8.

iv. Income Approach - Conclusion

The Commission rejected the OCA's proposed use of net plant as the terminal value in the Income Approach in *Cheltenham* and it should reject it, again, in this proceeding. Gannett's Income Approach to value is $53,741,785. AUS' Income Approach to value is $57,872,959.

c. Market Approach

Although it has no impact on the AUS Market Approach to value of $55,741,000, the OCA recommends that the Delaware County Regional Water Quality Control Authority ("DELCORA") acquisition be removed from AUS comparison group claiming that doing so would be reasonable under the circumstances as the acquisition has not closed.[11] The removal of the DELCORA transaction is neither reasonable nor necessary. Mr. Weinert explained that the AUS Market Approach compares the purchase price as detailed in the initial asset purchase agreement to the various comparability measures, i.e., original cost less depreciation, replacement cost less depreciation, customers, and cash flows (EBITDA).[12] Since the comparison used is of a purchase price in the original asset purchase agreement, the OCA's criticism of the AUS Market Approach and proposed removal of the Aqua-DELCORA transaction from the AUS comparables should be rejected.

5. Conclusion – Section 1329 Fair Market Valuation

The ratemaking rate base of the Lower Makefield wastewater system, determined pursuant to Section 1329(c)(2), is $53,000,000, being the lesser of the negotiated purchase price of $53,000,000 and the average of the UVE appraisals of $54,967,796. The OCA's criticisms of the appraisals should be rejected and given no weight.

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[11] OCA Main Brief, Section V.A.4.c.

[12] Aqua St. No. 5-R at 11-12.

B. Income Tax Savings on Repairs Deductions

The OCA recommends as a condition for approval of the Application that, from closing to the first base rate case that includes the Lower Makefield system, Aqua should record the income tax effect of repairs deductions in a regulatory liability account, which will be addressed in Aqua's first rate case that includes the Lower Makefield system. The OCA contends that repairs deductions, if any, will be related to Aqua's ownership of the Lower Makefield system and could help offset rate increases Aqua projected.

The attempt to single out one component of the cost of service for deferred accounting is unreasonable and inappropriate. The OCA's position disregards other costs of operation that are likely to increase and be borne by the Company as regulatory lag before the next rate case that includes the Lower Makefield system. The Lower Makefield system has a deficiency in revenue requirement at its existing rates. Given that it will be a few years before the system is presented in a base rate case, the deficiency in revenue requirement will be borne by the Company as regulatory lag without deferral. If the Company is able to yield any tax repair benefit, while unlikely and small in benefit, it would serve as an offset to this deficiency during the time before the rate case that includes the Township system.[13] When the Company does present itself before the Commission in a base rate case, any repair benefits will accrue to customers at that time and going forward.

Additionally, Internal Revenue Service regulations dictate that in order to claim repairs deductions on assets the wear and tear on those assets must have occurred during the taxpayer's use of the assets. The wear and tear on the system assets to date has been under the ownership of

[13] Aqua St. No. 1-R at 10.

Lower Makefield, not Aqua. It is unlikely that any meaningful repair benefit would be realized on a recently acquired acquisition.

The OCA's proposed condition and creation of a regulatory liability account should be denied. The OCA has not cited a single instance where the Commission has required the creation of a regulatory liability account as a condition for approval of a fair market value transaction.

VI. CONCLUSION

For the reasons set forth above and in its Main Brief, Aqua Pennsylvania Wastewater, Inc. requests that the Public Utility Commission approve the Joint Petition of Aqua, Lower Makefield, I&E, OCA and OSBA for Approval of Partial Settlement and as part of the Order approving the Joint Petition:

a. Include a determination that the ratemaking rate base of the Lower Makefield Township system is $53,000,000 pursuant to Section 1329(c)(2); and

b. Deny and reject the proposed accumulation of the income tax effect of repairs deductions in a regulatory liability account as a condition for approval of the transaction.

Respectfully submitted,

AQUA PENNSYLVANIA WASTEWATER, INC.

By______________________________

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Date: October 18, 2021

BEFORE THE
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The Honorable Jeffrey A. Watson, Presiding

Application of Aqua Pennsylvania Wastewater, Inc. Pursuant to Sections 1102, 1329 and 507 of the Public Utility Code for Approval of its Acquisition of the Wastewater System Assets of Lower Makefield Township :	**Docket No. A-2021-3024267**

CERTIFICATE OF SERVICE

I hereby certify that I have this 18th day of October, 2021, served a true and correct copy of the foregoing Reply Brief of Aqua Pennsylvania Wastewater, Inc. upon the persons and in the manner set forth below:

VIA ELECTRONIC MAIL

The Honorable Jeffrey A. Watson
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