


COMMONWEALTH OF PENNSYLVANIA



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October 18, 2021

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

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

Dear Secretary Chiavetta:

Attached for electronic filing please find the Office of Consumer Advocate's Reply Brief in the above-referenced proceeding.

Copies have been served per the attached Certificate of Service.

Respectfully submitted,

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Certificate of Service

\*318721

CERTIFICATE OF SERVICE

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

I hereby certify that I have this day served a true copy of the following document, the Office of Consumer Advocate's Reply Brief, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 18<sup>th</sup> day of October 2021.

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Dated: October 18, 2021  
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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

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REPLY BRIEF  
OF THE  
OFFICE OF CONSUMER ADVOCATE

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I. STATEMENT OF THE CASE

A. Procedural History

The Office of Consumer Advocate (OCA) submits this Reply Brief in response to the Brief of Aqua Pennsylvania Wastewater Inc. (Aqua or Company). On October 8, 2021, the OCA and Aqua filed Main Briefs. The OCA’s Main Brief contained a comprehensive discussion of the evidence and its position on all issues. Thus, in this Reply Brief, the OCA will respond to only those matters raised by Aqua that were not previously addressed or that require clarification.

B. Overview of the Proposed Transaction

The OCA’s overview of the proposed transaction is contained in the OCA’s Main Brief. OCA M.B. at 3.

II. BURDEN OF PROOF

The burden of proof applicable in this matter is addressed in detail in the OCA’s Main Brief. OCA M.B. at 4. The OCA further notes, however, that as the party with the burden of proof, Aqua must conclusively demonstrate how its claims are justified under the facts and law.

The Pennsylvania Supreme Court has stated:

[T]he appellants did not have the burden of proving that the plant additions were improper, unnecessary or too costly; on the contrary, that burden is, by statute, on the utility to demonstrate the reasonable necessity and cost of the installations and that is the burden which the utility patently failed to carry.

Berner v. Pa. P.U.C., 382 Pa. 622, 631, 116 A.2d 738, 744 (1955). The Commission has also addressed this standard in its rate determinations:

The Respondent, Equitable, has the burden of persuasion in the issue of the reasonableness of an expense level. Respondent must affirmatively establish, on the record, that the test year claim is a reasonable and appropriate amount.

Pa. P.U.C. v. Equitable Gas Co., 57 PaPUC 423, 471 (1983) (emphasis added); accord, University of Pennsylvania v. Pa. P.U.C., 86 Pa. Commw. 410, 485 A.2d 1217 (1984). As discussed below

and in the OCA's Main Brief, Aqua has not met its burden of showing that the valuations provided pursuant to Section 1329 are reasonable under Chapter 13 of the Public Utility Code and accepted financial and ratemaking principles. Further, Aqua has not met its burden to show that its proposed treatment of tax repairs deductions is reasonable.

### III. STATEMENT OF QUESTIONS PRESENTED

The OCA's statement of questions presented is contained in the OCA's Main Brief. OCA M.B. at 5.

### IV. SUMMARY OF ARGUMENT

Aqua argues that, to the extent the OCA's testimony is considered, the Commission should not adopt the OCA's adjustments. Aqua's arguments are inconsistent with Commission precedent. The OCA presented credible and persuasive testimony identifying several adjustments to the appraisals that are required to correct errors and remove unsupported adjustments. The OCA's witness is well-qualified in the area of public utility ratemaking and presented reasonable adjustments to the Utility Valuation Expert (UVE) appraisals that are necessary to comply with the Pennsylvania Public Utility Code, Commission precedent, and principles of public utility ratemaking. Aqua's arguments to the contrary are without merit. The OCA's testimony should be given full weight and its recommended adjustments to the UVE appraisals should be adopted.

Review of the appraisals provided by Aqua and Lower Makefield show that there are judgments made in each type of analysis and also in how much weight is given to each approach. The OCA identified a number of flaws in the exercise of that judgment. When corrected, the average of the two appraisals is less than the purchase price of \$53,000,000. The appropriate amount for ratemaking purposes should be \$51.236 million. OCA Exh. RCS-1SR, Col. G, Ln. 15.

In addition to the necessary adjustments to ratemaking rate base under Section 1329, the



OCA recommends that Aqua be required to account for the impact of the tax savings resulting from claimed repairs deductions in a regulatory liability account that would be addressed in Aqua's next base rate case that includes the acquired Lower Makefield Township (LMT) system. OCA St. ISR at 7. If not, under the accounting treatment proposed by Aqua, all income tax savings from the date of acquisition until the LMT system is included in a base rate case, would be retained by shareholders. Preserving the tax savings for the benefit of customers (versus shareholders), is particularly important because Aqua witness Packer estimated a \$10,038,836 annual revenue requirement to support the Lower Makefield system if the \$53,000,000 rate base is approved. Aqua St. 1 at App. A. The deferred amounts could provide some relief to help offset the customer rate increases that would be caused by the change in ownership of the LMT wastewater utility. For all of these reasons and as discussed further herein, the OCA recommends that, if the Commission approves the Application, certain adjustments are necessary to protect the public interest.

V. REPLY ARGUMENT

A. Section 1329

1. Legal Standard for Section 1329 Approvals

The legal standard for Section 1329 approvals is addressed in detail in the OCA's Main Brief. OCA M.B. at 7-8.

2. Challenges to the UVE Appraisals

a. Section 1329 Does Not Eliminate the Commission's Authority to Determine Rate Base or Prohibit the Consideration of the OCA's Testimony on Fair Market Value

Aqua argues that the Commission should not adopt OCA witness Smith's proposed adjustments by arguing that Mr. Smith did not perform an appraisal of the Lower Makefield system, presented "no evidence showing that he has the experience or legal competency to critique

the appraisals of certified UVEs, and that Mr. Smith’s adjustments do not meet a standard of value of fair market value.” See Aqua M.B. at 10-11. Following Aqua’s logic regarding the need for a complete appraisal by the OCA’s witness, even when there are errors and bias in the UVE appraisal calculations, as the OCA has demonstrated here, the Commission could not adjust the appraisals. See Aqua M.B. at 10-11.

Aqua’s position that parties cannot challenge UVE appraisals has repeatedly been rejected by the Commission and it should be rejected in this proceeding as well. Section 1329 creates a valuation process, which begins with two UVEs providing individual appraisals of “fair market value.” 66 Pa. C.S. § 1329(a)(3). The statute anticipates that these appraisals will differ and provides for the appraisals to be averaged. 66 Pa. C.S. § 1329(g). The fact that two UVEs, who both must comply with the Uniform Standards of Professional Appraisal Practice (USPAP) and employ the Cost, Market, and Income approaches, may recommend different fair market values establishes that the appraisal process is not simply a “formulaic” mathematical exercise. The UVEs are required to make judgments in each type of analysis and in how much weight is given to each approach. OCA M.B. at 6. Thus, the consumer interest can only be protected if the Commission may consider evidence regarding errors and unsupported adjustments in the UVE appraisals.

The Commission has stated that “Section 1329 contains no prohibitions on the ability of the Parties to review the UVE appraisals and make arguments as to their reasonableness and to recommend adjustments.” See Application of Aqua Pennsylvania Wastewater, Inc., A-2016-2580061, Order at 53 (June 29, 2017) (New Garden). The Commission may use its expertise, as it did in other Aqua Section 1329 acquisitions such as New Garden and Limerick, to interpret Section 1329 as permitting the review of UVE appraisals.<sup>1</sup>

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<sup>1</sup> See Application of Aqua Pennsylvania Wastewater, Inc., A-2017-2605434, Order at 36 (Nov. 29, 2017) (Limerick)

The Commission further reiterated that Section 1329 contains no prohibitions on the ability of parties to review the UVE appraisals as to their reasonableness and stated as follows:

[T]he Commission has already considered and rejected Aqua’s position and determined that Section 1329 contains no prohibitions on the ability of parties, or the Commission, to review the UVE appraisals as to their reasonableness and, accordingly, propose, or adopt, adjustments to the UVE appraisals. Specifically, in the *Limerick Order*, citing to the *New Garden Order*, we rejected Aqua’s position in those cases, the position Aqua reiterated in this proceeding. *Limerick Order* at 35-36.

Application of Aqua Pennsylvania Wastewater, Inc., A-2019-3008491, Order at 39 (Nov. 5, 2019) (Cheltenham).

Aqua’s arguments with regard to the expertise of the OCA’s witness to review the appraisals and propose adjustments should also be rejected. Mr. Smith is a well-qualified expert in the area of ratemaking and financial issues related to utilities. OCA M.B. at 2. As discussed in the OCA’s Main Brief, Mr. Smith is a Senior Regulatory Consultant at an accounting and regulatory consulting firm. The firm performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups. *Id.* Larkin & Associates has extensive experience in the utility regulatory field as expert witnesses in over 400 regulatory proceedings including numerous telephone, water and sewer, gas, and electric matters. OCA M.B. at 2. Further, Mr. Smith is both a licensed CPA as well as member of the Michigan Bar.<sup>2</sup> *Id.* The OCA’s expert is eminently qualified in utility ratemaking issues and utility regulatory policies, is legally competent, and is a credible expert witnesses in this matter.

The OCA submits that non-UVEs are permitted to recommend adjustments as there is no prohibition on the ability of the parties to recommend adjustments in order to ensure that proposed transactions under Section 1329 comply with Pennsylvania law and result in just and reasonable

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(“We agree that Section 1329 does not prevent a review of the UVE assumptions for reasonableness, and for the reasons discussed below, we find that the ALJ appropriately considered several of the recommendations to the fair market appraisals of the Limerick system.”).

<sup>2</sup> Mr. Smith’s extensive education and experience has been summarized and attached to his Direct Testimony (OCA St. 1) as Attachment A.

rates. Aqua's argument that the OCA's testimony and adjustments should be given no weight is unreasonable as Mr. Smith is a credible expert testifying before the Commission. The Commission has authority and discretion to review and adjust the UVE appraisals to establish the fair market value for the LMT system and, in so doing, the OCA submits that it should adopt the adjustments recommended by OCA witness Smith.

b. The OCA's Adjustments to the UVE Appraisals Are Supported by the Record.

Aqua argues that the appraisal adjustments recommended by Mr. Smith should not be adopted. Aqua M.B. at 10-11. As discussed above, Mr. Smith is highly qualified to review the appraisals and present his critiques. Unlike the UVEs, Mr. Smith employed standard financial and regulatory principles to make recommendations as to how to adjust for assumptions within the UVE appraisals that are unreasonable or inconsistent with utility practice. The analyses of the UVE appraisals conducted by Mr. Smith are derived from standard financial and business concepts properly based on his financial and utility ratemaking expertise. OCA M.B. at 2.

Moreover, while Aqua argues that Mr. Smith lacks the experience to critique appraisals, the Company also critiques Mr. Smith for not presenting an appraisal. See Aqua M.B. at 10. The OCA, however, is not required to submit an appraisal under Section 1329, and only the buyer and seller's appraisals are considered in the average. 66 Pa. C.S. § 1329(g). As such, Aqua's argument that Mr. Smith's testimony lacks support because he did not perform a separate appraisal is unreasonable and should be rejected.

The OCA's recommendations regarding errors and unsupported adjustments in the UVE appraisals are fully supported by the record as discussed in the OCA's Main Brief and herein, warrant consideration by the Commission, and should be adopted.

c. Cost Approach

i. Mr. Smith's Adjustments to the Gannett Fleming Cost Approach Adjustments are Reasonable.

As discussed in greater detail in the OCA's Main Brief, OCA witness Smith recommended adjustments to AUS' Cost Approach due to Mr. Weinert's unreasonable utilization of an 80-year service life for gravity collection mains. See OCA M.B. at 10-13. As it pertains to the OCA's adjustments to Mr. Weinert's Cost Approach, Aqua stated that use of an 80-year service life is appropriate as Mr. Weinert relied upon depreciation studies prepared for Aqua and Pennsylvania-American Water Company by a recognized firm in the depreciation consulting area, Gannett Fleming. Aqua M.B. at 11. It is telling, however, that Gannett Fleming's UVE utilized a shorter service life for gravity collection mains in the Lower Makefield Township system. OCA St. 1 at 35. As OCA witness Smith explained:

A 65-R2.5 survivor curve has been recommended by Gannett Fleming for this LMT account. Gannett Fleming is the firm that performed a number of depreciation rate studies for Pennsylvania utilities, including the depreciation rate studies for Aqua and PAWC that are being relied upon by Mr. Weinert of AUS Consultants. Those studies do not specifically address the composition of Gravity Mains in LMT's system or its useful life. The LMT specific survivor curve / useful life recommendation in this current LMT acquisition case, of 65 years, should therefore carry far more weight than the non-LMT specific studies that were relied upon by Mr. Weinert.

OCA St. 1SR at 18.

Aqua contends that comparison of the AUS fair market value appraisal to the Gannett Fleming fair market value appraisal is inappropriate given that "[o]ne would expect methods and results to differ from one appraisal to another. It is reasonable and appropriate that they do so." Aqua M.B. at 12. In response, the OCA points out that use of a 65-year service life by the Gannett Fleming UVE is not the only reason that using an 80-year service life for the largest account in the LMT sewer system is not reasonable.

There is a lack of historical records for the LMT system and an assumption is being made

that older plant in the Collection Sewers – Gravity Mains plant account for LMT is vitrified clay pipe. OCA St. 1SR at 18-19. For other Section 1329 acquisitions, Mr. Weinert’s previous appraisals indicated a 75-year service life for its gravity collection mains comprised of vitrified clay pipe (VCP). OCA M.B. at 12-13. The OCA further noted that in Cheltenham, which involved a distribution system primarily comprised of VCP, Mr. Weinert utilized a 90-year service life for all of the Cheltenham’s gravity collection mains, the Commission adopted the OCA’s recommended adjustment. OCA M.B. at 11-12.

Additionally, the OCA notes that while Mr. Weinert criticizes Mr. Smith for an alleged lack of consideration regarding CIPP linings, CIPP is not mentioned in either AUS’ appraisal or the engineering report filed with the Application. See Aqua Exhs. D, Q.

The Gravity Mains account is, by far, the single largest utility plant account for LMT, so using an accurate expected useful life for that account is particularly important in arriving at a reasonable valuation for the LMT sewer utility system. 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 for the same collections mains that was used by Gannett Fleming in this proceeding. See OCA M.B. at 12-13. The 80-year estimated useful life for Gravity Mains proposed by Mr. Weinert is unreasonably long and should be rejected.

As such, and for the reasons discussed above and contained in the OCA’s Main Brief, the OCA submits that Mr. Smith’s recommended adjustment to apply Gannett Fleming’s 65-year estimated service life to the LMT Gravity Mains account should be adopted.

d. Income Approach

i. Mr. Smith’s Adjustments to the Gannett Fleming Income Approach Are Reasonable

In its Main Brief, Aqua criticizes Mr. Smith for recommending the use of net plant value from time period 24 (Year 2045) as the terminal value for the LMT plant. Aqua M.B. at 16. Aqua

argues that its UVE witness Mr. Walker presented an evidentiary analysis demonstrating that net plant value is not a good proxy or measure for future market value. Id. at 17.

As explained in the OCA's Main Brief, the assumptions used by Mr. Walker are not consistent with ratemaking principles and are flawed. OCA M.B. at 14-17. Mr. Smith noted that the approach to quantifying the terminal value should recognize that the wastewater assets are for a regulated public utility, not an unregulated business. OCA St. 1 at 31-32. For a regulated utility, Mr. Smith explained:

A utility's allowable revenue requirement is equal to its cash operating expenses plus depreciation plus a return on its net investment (rate base) plus income taxes on the return. Therefore, the resulting annual net cash flow is equal to depreciation plus the after-tax return on the net investment. As such, the higher the assumed level of investment, the higher the periodic cash flows and the higher the ultimate valuation.

Id. at 30.

The OCA submits that the valuation results for each proposed transaction should be evaluated based on the specific information contained in each application, as the facts and evidence presented in each acquisition under Section 1329 vary for each utility and the respective UVEs. In response, Aqua emphasizes that the Commission has not adjusted the Gannett Fleming's terminal value in the prior Section 1329 proceedings. Aqua M.B. at 16. The OCA notes, however, that a significant majority of the prior Section 1329 proceedings were resolved by settlement rather than litigation.<sup>3</sup>

As a witness in the present proceeding, Mr. Smith analyzed the appraisals performed by the UVEs and recommended reasonable adjustment in accordance with traditional ratemaking principals. OCA witness Smith testified as follows:

The fact that LMT would be a rate-regulated public utility under the jurisdiction of the PA PUC distinguishes this from a competitive firm operating without rate regulation. The terminal value approach is valid and appropriate for a rate regulated

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<sup>3</sup> It should be noted that Aqua does not provide citations to the "sixteen proceedings" that they are referring to.

public utility, which LMT would be under Aqua's ownership. I am specifically addressing the facts and valuation results that have been presented for Aqua's proposed acquisition of LMT. What is sought in the current proposed acquisition of the LMT wastewater utility by Aqua is that the Commission review the adjusted valuation results in this proceeding, including the adjustment to the Gannett Fleming Income Approach that has been presented on its merits.

OCA St. 1SR at 13.

The OCA submits that Aqua's position that, after time period 24 (year 2045), the growth in annual debt free net cash flows is a constant growth rate, is inappropriate in the context of a regulated public utility. To further illustrate this point, in his rebuttal testimony, Aqua witness Walker presented a table that showed high results from a "Period 24 Market Multiples Valuation", which ranged from \$81.66 million to \$169.7 million. OCA St. 1SR at 14; Aqua St. 4-R at 6. Each of the values presented by Mr. Walker in his period 24 market multiples valuation are grossly excessive even in comparison to his own recommended Income Approach result of \$53,741,785. OCA St. 1SR at 14. Mr. Smith, on the other hand, correctly explained that a public utility cannot be sustained under the rate base/rate of return approach to determining revenue requirement if depreciation exceeds capital expenditures as follows:

Existing utility plant continues to depreciate and the depreciation is accounted for using the Commission-authorized depreciation rates, by accumulating depreciation in the depreciation reserve account, which is an offset to utility plant in service. In situations where the utility's rate base approaches zero or becomes negative, a rate base/rate of return approach to determining the utility's revenue requirement may no longer be meaningful.

OCA St. 1SR at 14-15.

Also, the OCA submits that Aqua's arguments in regard to Annual Deferred Income Taxes (ADIT) raised in Aqua's Main Brief regarding Gannett Fleming's Income Approach were already resolved. See Aqua M.B. at 19-20; OCA St. 1SR at 15-16. In response to rebuttal testimony indicating that Mr. Smith did not subtract ADIT from his calculations, Mr. Smith addressed the oversight in OCA Exhibit RCS-2-SR and reflected the deduction of ADIT from the amount of net



plant.<sup>4</sup> OCA St. 1SR at 15. Mr. Smith further noted that AUS also reflected a deduction for ADIT in its income approach and that he agreed with both UVEs that ADIT should be deducted from utility net plant for the investor ownership scenarios in the Income Approach. Id. at 11.

In response to OCA witness Smith's explanation that, under the UVE assumptions and modeling techniques, LMT would be depreciating and using up its existing plant faster than it is making investments to replace that plant, Aqua claims that it would take 1,564 years to use up the existing LMT plant. Aqua M.B. at 19. As addressed in the OCA's Main Brief, however, review of the depreciation rates being used for the existing LMT plant confirms that there is no utility plant at LMT which has an expected useful life of anywhere near to 1,564 years. OCA St. 1SR at 15; OCA M.B. at 17-18. As such, OCA witness Smith properly adjusted Gannett Fleming's Income Approach by recalculating the valuation of the terminal value using the amount of Net Plant less ADIT remaining at the end of Year 24. See OCA Exh. RCS-2-SR, page 2.

For the reasons stated above and in the OCA's Main Brief, the OCA submits that the adjusted Income Approach value of \$48,462,957 should be adopted in place of Mr. Walker's proposed amount of \$53,741,785. See OCA Exh. RCS-3-SR.

ii. Mr. Smith's Adjustments to the AUS Income Approach Are Reasonable.

As discussed in the OCA's Main Brief, Mr. Smith also recommended an adjustment to the terminal value used in the AUS income approach. OCA M.B. at 17. Specifically, Mr. Smith recalculated the valuation of the terminal value using the amount of Net Plant less ADIT projected to be remaining at the end of 2049. See OCA Exh. RCS-4. Aqua argues that Mr. Smith's analysis is incorrect in several ways because: (1) it eliminates the benefits to the owner and customers of operating the property efficiently; (2) the property would continue to remain in service for many

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<sup>4</sup> The specific amount of ADIT that Mr. Smith used in his adjustment to the Gannett Fleming Income Approach was a ratio to the AUS Consultants' calculated amount of ADIT, because an ADIT amount could not be located in the Gannett Fleming valuation supporting detail. OCA St. 1SR at 16.

additional years; and (3) future forecasted cash flows and capital expenditures were reflected in the Income Approach and those would continue to provide service for LMT customers. Aqua M.B. at 21.

First, the terminal value approach does not eliminate the benefits to the owner at the end of the valuation period. The terminal value calculates the remaining benefit in a reasonable manner, reflecting that LMT under Aqua's ownership is a regulated public utility, not a competitive business. OCA St. 1SR at 8. Indeed, a terminal value provides a benefit to the owner of the system of \$7.038 million as shown at the end of the valuation period for the Income Approach. OCA St. 1SR at 8. To be clear, the terminal value component is \$7.038 million, not zero, which indicates that the benefit to the owner at the end of the valuation period is not eliminated. Id.

Second, while the OCA agrees that the utility property will continue to remain in service for years, the value should be calculated based on the equivalent of a utility net depreciated plant rate base amount, net of the ADIT offset, recognizing Aqua's ownership as a PUC-regulated public utility. Simply put, the LMT wastewater utility is a rate regulated public utility, not a competitive business. The OCA further notes that extending the Income Approach for an additional lengthy period, such as for another 40 years as presented by AUS, should be viewed as inherently unreliable. As explained by Mr. Smith, the further out projections are made into the future, the more unreliable they become. OCA St. 1SR at 9. OCA witness Smith noted the following flaws in AUS' Income Approach:

Projections out for an additional 40 years, i.e., through year 59.5, as presented by Mr. Weinert on page 10 of his rebuttal testimony should be viewed as inherently unreliable. A 60 year (or 59.5 year) projection should not be used. The further out into the future projections are made, the more unreliable they are. Additionally, it appears that some of the projections made by Mr. Weinert on page 10 are unsupported or erroneous. For his "period 60" he shows a "present worth" factor of 0.171; however, for his "period 59" he shows a "present worth" factor of 0.014. For each period, period 20 through period 59, shown on Mr. Weinert's page 10 table, the "present worth" factor is declining. However, for period 60, it is vastly increased over the period 59 present worth factor he used. Since period 60 is further out into

the future than period 59, it seems that the “present worth” factor for period 60 should be lower than the present worth factor for period 59, reflecting an additional year of discounting. Mr. Weinert’s “present worth” factor for period 60, on page 10 of his rebuttal, however, is more than 12 times his period 59 “present worth” factor.<sup>5</sup> This apparent error in the period 60 “present worth” factor thus overstates his results.

He also attempts to apply a “Plant Construction Inflation Rate” of 0.0422 on his rebuttal testimony page 10 calculations, which is questionable. Attempting to forecast future plant construction price changes for as far as 59 or 60 years into the future is purely speculative.

On page 11 of his rebuttal, he indicates that he has also used a 6% assumed rate increase occurring every third year. Ultimately, Mr. Weinert claims on page 11 of his rebuttal, that his DCF (i.e., Income Approach) conclusion of \$57.873 million is reasonable and should not be adjusted.

OCA St. 1SR at 9-10.

For the reasons discussed in the OCA’s Main Brief and above, Mr. Smith’s recommended adjustment to the AUS Income Approach result to \$48,462,957 is reasonable, supported, and should be adopted. OCA St. 1SR at 10; OCA Exh. RCS-1 SR at Col. G, Ln. 11.

e. Market Approach

i. Mr. Smith’s Adjustment to the AUS Market Approach Comparison Group is Reasonable.

OCA witness Smith recommends removing the \$276,500,000 “final purchase price” of the DELCORA system from AUS’ comparison group because the DELCORA system has not been purchased for \$276,500,000 – it has not been purchased at all. OCA M.B. at 18-19; OCA St. 1 at 39. Aqua argues that it is not necessary to remove the DELCORA acquisition from AUS’ comparison group since the comparison used is of a purchase price in the asset purchase agreement comparability measures, such as customers. Aqua M.B. at 22.

This argument lacks merit. The DELCORA acquisition is an outlier. All of the other acquisitions in the comparison group are closed transactions. Including the DELCORA acquisition

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<sup>5</sup> 0.171 / 0.014 = 12.2 times.

and indicating \$276,500,000 as a “final purchase price” for that system is inaccurate and potentially misleading.

This argument should also be rejected because it is inconsistent with the Final Supplemental Implementation Order. See Implementation of Section 1329 of the Public Utility Code, M-2016-254319, Final Supplemental Implementation Order (Feb. 28, 2019) (FSIO). The FSIO states as follows regarding the jurisdictional exceptions under the Market Approach:

3. Speculative growth adjustments will not be used.
- ...
6. Comparable sales used to establish the valuation should use the current customers. FSIO at 87-88 (emphasis in original).

Whether the DELCORA acquisition will close and have a final purchase price of \$276,500,000 is speculative.<sup>6</sup> Additionally, the DELCORA customers are not currently customers of Aqua.

For these reasons, Mr. Smith’s recommendation to remove the DELCORA acquisition AUS’ proxy group for the LMT acquisition is reasonable and should be adopted.

f. Conclusion

OCA witness Smith calculated that, in order to properly reflect financial and ratemaking principles under Pennsylvania law, the adjusted Gannett Fleming appraisal result would be \$48,309,516, and the adjusted AUS appraisal result would be \$54,163,000. OCA Exh. RCS-1SR at Col. G, Ln. 5, 10. The recalculated average of the two appraisal results is \$51,236,259, which is what Mr. Smith recommends be used by the Commission for establishing rate base under Section 1329 rather than the \$53,000,000 proposed by Aqua. OCA Exh. RCS-1SR, Ln. 13. The OCA submits that Mr. Smith’s recommended adjustments are reasonable, consistent with Public Utility Code and precedent, and should be adopted by the Commission in this proceeding.

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<sup>6</sup> As discussed in the OCA’s Main Brief, the DELCORA acquisition has not been approved by the Commission. The initial Recommended Decision denied the Application for acquisition. Application of Aqua Pennsylvania Wastewater, Inc., A-2017-2606103, Recommended Decision (Jan. 12, 2021). The matter is currently on remand, which has been stayed since March 2021. Application of Aqua Pennsylvania Wastewater, Inc., A-2017-2606103, ALJ Order Staying Proceeding (Apr. 16, 2021).

B. Income Tax Savings on Repairs Deductions

The OCA's Main Brief includes a detailed discussion as to why OCA witness Smith recommended in testimony that, if the Commission approves the transaction, the impact on income tax expense from repairs deductions claimed by Aqua for LMT wastewater utility system assets should be recorded in a regulatory liability account and addressed in Aqua's first base rate case in which rates for the acquired LMT wastewater utility customers are addressed. See OCA M.B. at 20-22.

Aqua argues that Mr. Smith is attempting to single out one component of the cost of service for deferred accounting and that, given that it will be a few years before LMT is included in a base rate case, the deficiency will be borne by the Company as regulatory lag. Aqua M.B. at 23. Moreover, Aqua claims that the benefits from repairs deductions "while unlikely and small in benefit" would offset the deficiency in revenue requirement as a result of the acquisition for the Company between base rate cases. Aqua M.B. at 23.

As discussed extensively in the OCA's Main Brief, as a result of the proposed transaction, Aqua is expected to have federal income tax deductions for repairs for the acquired LMT wastewater system. OCA St. 1 at 40-42; OCA M.B. at 20-22. As such, Aqua can avail itself of tax deductions for repairs even where the accounting treatment results in the repairs costs being capitalized for book purposes. Repairs deductions can be substantial and result in reducing income tax expense. OCA St. 1 at 40.

As discussed extensively in the OCA's Main Brief, as a result of the proposed transaction, Aqua is expected to have federal income tax deductions for repairs for the acquired LMT wastewater system. OCA M.B. at 20. As such, Aqua can avail itself of tax deductions for repairs even where the accounting treatment results in the repairs costs being capitalized for book purposes. The repairs deductions can be substantial and result in reducing income tax expense. Id.

Contrary to Aqua's assertion that the repairs deductions are unlikely or small in benefit, the size the repairs deductions is not currently known. OCA St. 1SR at 6. Moreover, the fact that Aqua expects the repairs deductions to be relatively small is not a valid reason against the deferred accounting recommendation. Regardless of size, they should be accounted for correctly.

Further, the OCA has "singled out" these federal income tax repairs deductions for deferred accounting because they represent a potential benefit to Aqua's ratepayers that could be significant and that could help offset the estimated rate increases that Aqua has projected as a result of its acquisition of LMT. See OCA St. 1 at 42; OCA St. 1SR at 6. Conversely, not requiring such deferred accounting would essentially allow Aqua to keep for its investors all of the income tax savings from repairs deductions for the LMT wastewater utility system from the date of acquisition through the timing of Aqua's next base rate case in which the LMT utility would be included. OCA St. 1SR at 6.

Accordingly, OCA witness Smith recommended that Aqua should be required to account for the impact of the tax savings resulting from claimed repairs deductions in a regulatory liability account that would be addressed in Aqua's next base rate case that includes the acquired LMT system. OCA St. 1SR at 7. Mandating the deferred accounting in a regulatory liability account of Aqua's repairs deductions for the acquired LMT system from the date of the acquisition through the test year being used in Aqua's next base rate case will preserve the issue so that it can be addressed in Aqua's next rate case. If Aqua believes that the amounts accumulated in the regulatory liability account for the LMT wastewater utility repairs deductions should not be used to offset rate increases in that case, Aqua would have the opportunity to present its reasoning in that future rate case.

Given the size of the proposed transaction and the potential benefits of utilizing tax repairs, requiring Aqua to defer the tax savings is reasonable. As such, the OCA respectfully requests that

the Commission include OCA witness Smith's recommended condition regarding the treatment of tax repairs deductions as part of its Order in this proceeding.

C. Miscellaneous

On October 8, 2021, a Joint Petition for Approval of a Partial Settlement was filed, wherein the settling parties jointly agreed to findings of fact, conclusions of law, and ordering paragraphs related to the issues proposed to be resolved through the Partial Settlement. In its Main Brief on the litigated issues in this proceeding, the Company presented its own additional and separate findings of fact, conclusions of law, and ordering paragraphs. The OCA's position with regard to Aqua's proposals is consistent with that set forth in the OCA's testimony and briefs. The OCA provides the following specific response, however, to Aqua's proposed finding of fact #17.

1. Aqua Proposed Finding of Fact #17

Aqua presents the following as a proposed finding of fact:

17. It is not appropriate to single out the accumulating tax effect of repair deductions as one component of the cost of service of the Lower Makefield system and impose deferred accounting for it. Aqua St. No. 1-R at 10.

Aqua M.B., Proposed Finding of Fact 17. Aqua's averment is not fact, it is legal argument. Further, deferred accounting is reasonable and appropriate because, among other reasons, it preserves the issue so that it can be addressed in Aqua's next base rate case when the amount of the tax savings will be known. See, supra, Section V.B. Accordingly, the OCA submits that the Commission should not adopt Aqua's proposed finding of fact #17.

VI. CONCLUSION

For the reasons stated above and in the OCA's Main Brief the Office of Consumer Advocate's proposed recommendations should be adopted, including the OCA's proposed adjustments to the appraisals resulting in an overall ratemaking rate base of \$51,236,269. In addition, the impact on income tax expense from repairs deductions claimed by Aqua for LMT wastewater utility system assets should be recorded in a regulatory liability account and addressed in Aqua's first base rate case in which rates for the acquired LMT wastewater utility customers are addressed.

Respectfully submitted,

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