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I. INTRODUCTION

This Decision recommends that the Joint Petition of Aqua Pennsylvania Wastewater, Inc., the Bureau of Investigation and Enforcement, the Office of Consumer Advocate, the Office of Small Business Advocate, and Lower Makefield Township for Approval of Partial Settlement be approved without modification, because it is supported by substantial evidence and is in the public interest. This Decision finds that the Partial Settlement complies with the relevant Sections of the Public Utility Code regarding applications for the acquisition of wastewater system assets and is consistent with the Pennsylvania Public Utility Commission (Commission) regulations promoting settlements.

Two issues were not resolved through settlement which are, (1) the determination of the rate base, and (2) the income tax savings on repairs deductions. First, as to the rate base, this Decision recommends that, in order to properly reflect financial and ratemaking principles under Pennsylvania law, the adjusted Gannett Fleming Valuation and Rate Consultants, LLC (Gannett or Gannett Fleming) appraisal result would be \$48,309,516 and the adjusted AUS Consultants, Inc. (AUS) appraisal result would be \$54,163,000. The recalculated average of the two appraisal results is \$51,236,259 for establishing rate base under Section 1329, rather than the \$53,000,000 proposed by Aqua. Second, as to the tax savings on repairs deduction, this Decision recommends that the request by OCA to record the income tax effect of repairs deduction in a regulatory liability account, to be addressed in Aqua's next rate case, be adopted as a condition for approval of the Application, will be denied. OCA failed to present sufficient evidence to determine that Repairs Tax Reductions are an eligible deferral item or that Repairs Tax Reductions are or appear to be substantial in this proceeding.

The statutory deadline for the Commission to act in this proceeding is January 31, 2022.

II. HISTORY OF THE PROCEEDING

On May 14, 2021, Aqua Pennsylvania Wastewater Inc. (Aqua, Applicant or Company) filed its Application for Approval of the acquisition of the Lower Makefield Township (Township or LMT) wastewater system assets pursuant to Sections 1102, 1329, and 507 of Pennsylvania Public Utility Code (Code), 66 Pa. C.S. §§ 1102, 1329, and 507.

On June 9, 2021, the Office of Small Business Advocate (OSBA) filed a Notice of Intervention, and Public Statement.

On June 16, 2021, the Commission's Bureau of Investigation and Enforcement (I&E) filed a Notice of Appearance.

On June 25, 2021, a Secretarial Letter was issued that conditionally accepted the Application. The Commission required individual notice to be provided to Aqua's existing water and wastewater customers, that Aqua ensure concurrent notice is provided to all current LMT wastewater customers, and that newspaper notice in the LMT area be provided. Upon completion, Aqua was directed to file a verification that the notice had been provided.

On June 29, 2021, a Petition to Intervene was filed by LMT. No objections were filed to this Petition to Intervene.

On June 30, 2021, Aqua filed a letter with the Commission, with an attached verification, stating that it had complied with the notice requirements contained in the *June 25, 2021 Secretarial Letter*.

On July 2, 2021, the Office of Consumer Advocate (OCA) filed a Protest and Public Statement.

On August 2, 2021, a Protest was filed by John Char.

On August 5, 2021, a Protest was filed by Barry Summers (Protestant Summers).

On August 5, 2021, a Secretarial Letter was issued accepting the Application for filing.

A Prehearing Conference Order was issued on August 11, 2021, directing the parties to submit prehearing conference memoranda by 1:00 p.m., on September 8, 2021, setting a prehearing conference for September 9, 2021, and providing a tentative litigation schedule and expedited discovery deadlines.

On August 12, 2021, the Commission issued a Telephonic Prehearing Conference Notice scheduling a prehearing conference for 10:00 a.m. on September 9, 2021.

Notice of the Application was published in the August 21, 2021 edition of the *Pennsylvania Bulletin* with a protest deadline of September 7, 2021. 51 Pa.B. 5343.

On August 13, 2021, a Protest was filed by Kevin and Beth Cauley.

On August 25, 2021, a Protest was filed by Jaan Pesti.

Peter A. Lachance (Protestant Lachance) filed a Protest to the Application on August 27, 2021.

On September 8, 2021, Applicant filed preliminary objections seeking dismissal of the protest filed by Peter A. Lachance alleging that Protestant did not establish his standing to protest the application.

The prehearing conference was convened on September 9, 2021, as scheduled. Aqua, the Township, I&E, OCA, and OSBA, appeared and were represented by counsel. In addition, Protestants Barry Summers and Peter Lachance attended the conference. At the prehearing conference, the Township advised it would also be filing preliminary objections to the

Protest filed by Peter A. Lachance by September 10, 2021, and Protestant Lachance agreed to file a response to the preliminary objections on or before September 15, 2021.

On September 10, 2021, Protestant Summers served his direct testimony.

On September 17, 2021, Applicant filed a Motion of Aqua Pennsylvania Wastewater, Inc., to Strike Portions of the Testimony of Barry Summers (Motion to Strike). Applicant asserted that the challenged portion of Mr. Summers' testimony was irrelevant and immaterial to the matters before the Commission and beyond the jurisdiction of the Commission to consider. Applicant further argued that a portion of Mr. Summers' testimony constituted inadmissible hearsay.

On September 17, 2021, an interim order was entered providing a deadline for the filing of responsive pleadings to the Motion of Aqua Pennsylvania Wastewater Inc. To Strike Portions Of The Testimony Of Barry Summers, not later than 4:30 p.m. on Wednesday, September 22, 2021.

On September 22, 2021, Protestant Summers served, by email, Surrebuttal Testimony dated September 19, 2021. The Verification on the last page of the document was dated September 22, 2021. In addition, the undersigned presiding officer received an email from Mr. Summers on September 22, 2021, requesting that his testimony not be stricken. No responsive pleading was filed.

On September 23, 2021, an interim order was entered granting the Motion of Aqua Pennsylvania Wastewater, Inc., to Strike Portions of the Testimony of Barry Summers, specifically requesting that subparagraphs 4, 5, 9 and 13 at pages 2 through 5, as inadmissible hearsay. In addition, the motion to strike testimony of Barry Summers, at pages 2 through 5, numbered subparagraphs 1 through 6, 9, 10 and 13, was denied, without prejudice.

On September 10, 2021, written direct testimony of Peter A. Lachance was served upon the Parties. On September 16, 2021, Applicant filed a Motion of Aqua Pennsylvania

Wastewater, Inc., to Strike the Testimony of Peter A. Lachance. Applicant asserted that the testimony of Peter A. Lachance (Lachance testimony) served by Protestant, Barry Summers, was a criticism of the Township sale process, and was irrelevant to the issues presented in this proceeding. On September 17, 2021, an interim order was entered providing a deadline for the filing of responsive pleadings to the Motion of Aqua Pennsylvania Wastewater Inc. To Strike The Testimony Of Peter A. Lachance, no later than 4:30 p.m. on Wednesday, September 22, 2021.

On September 22, 2021, the undersigned presiding officer was provided with an email that included an attachment from Peter A. Lachance entitled Responsive Pleading by Peter A. Lachance to the Motion of Aqua Pennsylvania Wastewater Inc. to Strike the Testimony of Peter A. Lachance (Responsive Pleading). No responsive pleading was filed and no response to the Motion to Strike was provided by Protestant, Barry Summers. On September 23, 2021, an interim order was entered granting the Motion of Aqua Pennsylvania Wastewater, Inc., to Strike the Testimony of Peter A. Lachance.

On September 10, 2021, Lower Makefield Township filed preliminary objections seeking dismissal of the Lachance Protest because the Township contended that Protestant did not establish his standing to protest the application, and averring that the Protest includes impertinent, scandalous matter and was insufficiently specific. Protestant Lachance served a response to the preliminary objections on September 17, 2021. On September 20, 2021, an initial decision was entered granting the Preliminary Objections filed by Applicant and dismissing the Protest filed by Peter A. Lachance. In accordance with the provisions of Section 332(h) of the Public Utility Code, 66 Pa. C.S. § 332(h), the initial decision became final without further Commission action.

On September 23, 2021, an interim order was entered denying the preliminary Objections filed by the Township, without prejudice, as being moot.

A Public Input Hearing was held on September 23, 2021, at 6:00 p.m. Testimony was presented by Peter Lachance. In addition, Protestant Summers elected to withdraw his written testimony and testified at the Public Input Hearing, as discussed more fully below.

On September 29, 2021, counsel for Aqua submitted a Joint Stipulation of the Bureau of Investigation And Enforcement of the Public Utility Commission, the Office of Consumer Advocate, the Office of Small Business Advocate, Lower Makefield Township and Aqua Pennsylvania Wastewater, Inc., For Admission of Testimony and Exhibits (Joint Petition, Settlement or Settlement Petition) (collectively, the Joint Petitioners or Settling Parties). Subsequently, on September 29, 2021, the evidentiary hearing was convened as scheduled. Aqua, Lower Makefield Township, I&E, OCA, and OSBA, appeared and were represented by counsel. In addition, Protestant Summers attended the hearing but did not remain until its conclusion. At the evidentiary hearing, Protestant, Summers joined in the Joint Stipulation, without objection from any party. The Joint Stipulation was approved. At the conclusion of the evidentiary hearing, the Parties indicated they were continuing to engage in settlement discussions and agreed to a revision to the litigation schedule. In addition, the Parties agreed to a deadline for any Party or Protestant to file objections to any settlement reached in this proceeding and responses to be filed to any objections to settlement.

An interim order was entered on September 29, 2021, following the conclusion of the hearing. The interim order approved the Joint Petition dated September 29, 2021, to include Protestant Barry Summers. In addition, the interim order amended the Litigation Schedule set in this proceeding by Order entered on September 10, 2021.

The amended litigation schedule provided that Main Briefs and Joint Petitions to Approve Settlement or Partial Settlement, to include Statements in Support of Settlement by the Settling Parties, would be filed and served on all Parties and Protestants, electronically, no later than 4:30 p.m. on October 8, 2021; that all Statements of Objections to any Settlement or Partial Settlement, would be filed by non-settling Parties and non-settling Protestants, and served on all Parties and Protestants, electronically, no later than 4:30 p.m. on October 13, 2021, and shall set forth the reasons for the objection to any settlement or partial settlement; that all Reply Briefs

and Responses to Statements of Objections to any Settlement or Partial Settlement would be filed and served on all Parties and Protestants, electronically, no later than 4:30 p.m. on October 18, 2021; addressed requirements for settlement documents and briefs; and cancelled the evidentiary hearing scheduled for September 30, 2021.

At the evidentiary hearing, the Parties stipulated to the admission of the following evidence:

Aqua Statements of Testimony

Aqua Statement No. 1 -Direct Testimony of William C. Packer and Mr. Packer's signed Verification

Aqua Statement No. 1-R - Rebuttal Testimony of William C. Packer and Mr. Packer's signed Verification

Aqua Statement No. 2 - Direct Testimony of Mark J. Bubel, Sr. and Mr. Bubel's signed Verification

Aqua Statement No. 2-R - Rebuttal Testimony of Mark J. Bubel, Sr. and Mr. Bubel's signed Verification

Aqua Statement No. 3 -Direct Testimony of Kurt M. Ferguson and Mr. Ferguson's signed Verification

Aqua Statement No. 3-R- Rebuttal Testimony of Kurt M. Ferguson and Mr. Ferguson's signed Verification

Aqua Statement No. 4 - Direct Testimony of Harold Walker, III and Mr. Walker's signed Verification

Aqua Statement No. 4-R - Rebuttal Testimony of Harold Walker, III and Mr. Walker's signed Verification

Aqua Statement No. 5 - Direct Testimony of Jerome C. Weinert and Mr. Weinert's signed Verification

Aqua Statement No. 5-R- Rebuttal Testimony of Jerome C. Weinert and Mr. Weinert's signed Verification

Aqua Exhibits

Aqua Exhibit 1 - Application of Aqua Pennsylvania Wastewater, including Application Exhibits A through AA2

CONFIDENTIAL Aqua Exhibit 2 - Sewage Facilities Map

CONFIDENTIAL Aqua Exhibit 3 -Confidential Work Paper Files of Gannett Fleming

CONFIDENTIAL Aqua Exhibit 4-Confidential Work Paper File of AUS Consultants

CONFIDENTIAL Aqua Exhibit 5 - Confidential Work Paper File of Appendix A to Packer Testimony

Aqua Exhibit 6 - Work Paper Files for Application Exhibit D

Aqua Exhibit 7 - Letter to the Secretary of the Public Utility Commission dated June 9, 2021

Aqua Exhibit 8 - Letter to the Secretary of the Public Utility Commission dated June 10, 2021

Aqua Exhibit 9 - Letter to the Secretary of the Public Utility Commission dated June 21, 2021

Aqua Exhibit 10 - Verifications

I&E Evidence

I&E Statement No. 1 - The Direct Testimony of D.C. Patel

I&E Exhibit No. 1 -The Exhibit to accompany the Direct Testimony of D.C. Patel

I&E Statement No. 1-SR-The Surrebuttal Testimony of D.C. Patel and Verification of D.C. Patel

I&E Statement No. 2 - The Direct Testimony of Ethan H. Cline and Verification of Ethan H. Cline

OCA Evidence

OCA Statement No. 1 and Exhibits RCS 1-5: the Direct Testimony of Ralph Smith, which contains 43 pages of testimony, Exhibits RCS 1-5 and Mr. Smith's signed Verification

OCA Statement No. ISR: the Surrebuttal Testimony of Ralph Smith, which contains 21 pages of testimony, Exhibits RCS 1-SR, RCS 2-SR, and RCS 5-SR, and Mr. Smith's signed Verification

OCA Hearing Exhibit 1: Lower Makefield responses to OCA Set V (V-1, V-4 V-5 V-7 V-8 V-11 and V-12) '

OCA Hearing Exhibit 2: Aqua responses to OCA Set VI (VI-1, VI-2, VI-3, VI-4, VI-5, and VI-6)

OSBA Evidence

OSBA Statement No. 1 and Exhibit BK-1: the Direct Testimony of Brian Kalcic, which contains 6 pages of testimony, Exhibit BK-1 (Referenced Interrogatories), an appendix and Mr. Kalcic's signed Verification.

OSBA Statement No. 1-S: the Surrebuttal Testimony of Brian Kalcic, which contains 3 pages of testimony, and Mr. Kalcic's signed Verification

On October 6, 2021, Cynthia Williams filed a Protest. The Protest provides that Ms. Williams is the sole resident of her household and is living on a fixed income. Ms. Williams avers that, if Aqua's request is granted, her monthly bill would be double the amount she is currently billed. No objection to the proposed Settlement and no Brief was filed by Ms. Williams.

On October 8, 2021, the Joint Petition of Aqua Pennsylvania Wastewater, Inc., the Bureau of Investigation and Enforcement, the Office of Consumer Advocate, the Office of Small Business Advocate and Lower Makefield Township for Approval of Partial Settlement was filed. On October 8, 2021, Main Briefs were filed by Aqua and OCA. Reply Briefs were filed by Aqua and OCA on October 18, 2021.

The record in this proceeding was closed on the Reply Brief Date of October 18, 2021.

III. FINDINGS OF FACT

The following Findings of Fact were submitted in the Joint Petition. I adopt those findings,¹ based upon the stipulation of the Settling Parties and the record in this proceeding.

Aqua and Lower Makefield

1. Aqua is a certificated provider of wastewater service, duly organized and existing under the laws of the Commonwealth of Pennsylvania. Aqua St. No. 1 at 9 and Aqua Exhibit No. 1, Application ¶ 7.

2. Lower Makefield Township is a duly organized and validly existing Pennsylvania township of the Second Class. Aqua Exhibit No. 1, Application ¶ 8 and Aqua St. No. 1 at 7.

3. Lower Makefield Township owns a sanitary wastewater collection system that provides sanitary wastewater service to 11,151 customers in Lower Makefield Township, Bucks County. Aqua Exhibit No. 1, Application ¶ 8 and Aqua St. No. 1 at 9.

Asset Purchase Agreement

4. Aqua and Lower Makefield are parties to an Asset Purchase Agreement dated as of September 17, 2020. Aqua Exhibit 1, Application ¶ 5 and ¶ 21; *see also* Aqua Exhibit No. 1, Application Exhibit B.

5. The negotiated purchase price, which is based on arms' length negotiation, is Fifty-Three Million Dollars (\$53,000,000). Aqua and Lower Makefield are not affiliated with each other. Aqua Exhibit No. 1, Application ¶ 22 and Aqua St. No. 1 at 9.

¹ For ease of reference, the findings are adopted, verbatim, including paragraph numbering, subheadings and footnotes, as they appear in the Joint Stipulation of Proposed Findings of Fact, Attachment F.

Assets Being Transferred

6. The wastewater system assets to be transferred include the assets, properties and rights of the Township used in the system and all pipes, pumping stations, generators, manholes and pipelines and billing and collections related assets necessary to run the system. Aqua Exhibit No. 1, Application ¶ 24.

7. The wastewater system assets being transferred also include certain contracts to which Township is a party and all Authorizations and Permits of or held by the Township (to the extent transferrable to Aqua under applicable Law), including all Authorizations and Permits which are environmental permits, other operating permits. Aqua Exhibit No. 1, Application ¶ 26.

Fitness

8. Aqua is a Pennsylvania public utility certificated by the Commission to provide wastewater service in the Commonwealth of Pennsylvania. Aqua is fit, in all respects, to own and operate the Lower Makefield wastewater system and provide wastewater service in Lower Makefield Township. Aqua St. No. 1 at 10-11.

Rate Impact

9. Rate impact is addressed in the Joint Petition for Partial Settlement and addressed further by the Joint Petitioners in their respective Statements in Support. Initially, Aqua will implement the Lower Makefield rates in effect as of closing. The Joint Petition for Partial Settlement addresses the submission of cost of service studies in the first base rate case that includes Lower Makefield wastewater system assets and the moving of Lower Makefield rates to cost of service in that first base rate case.

Section 507

10. Section 507 of the Code states that, except for contracts between a public utility and a municipal corporation to furnish service at tariff rates, no contract or agreement between a public utility and a municipal corporation shall be valid unless filed with the Commission at least 30 days prior to its effective date.

11. As presented in the Joint Petition for Approval of Partial Settlement, Joint Petitioners ask that the Commission, to the extent necessary, issue certificates for filing, pursuant to Section 507, for eighteen contracts, including assignments of contracts between Aqua and Lower Makefield.

The following findings of fact are made in this proceeding based upon the record evidence.

Rate-making Rate Base

12. Aqua and Lower Makefield have agreed to use the process presented in Section 1329 of the Code to determine the fair market value of the wastewater system assets and the rate-making rate base. Aqua Exhibit No. 1, Application ¶ 53.

13. Aqua and Lower Makefield agreed on a Licensed Engineer to complete the Assessment of Tangible Property and engaged [Utility Valuation Experts] UVEs to perform Fair Market Value analyses of the system in accordance with [Uniform Standards of Professional Appraisal Practice] USPAP, utilizing the cost, market, and income approaches. Aqua St. No. 1 at 20; *see also* Aqua Exhibit No. 1, Application ¶ 11 and Application Exhibit D.

14. Aqua engaged the services of Gannett. Lower Makefield engaged the services of AUS. Both firms were pre-certified as authorized UVEs and are on the list of qualified appraisers maintained by the Commission. Aqua St. No. 1 at 20 and Aqua Exhibit No. 1, Application ¶ 53.

15. As required by Section 1329(d)(1)(i), copies of the Fair Market Value Appraisal Reports of Gannett and AUS were attached as Exhibit Q and Exhibit R, respectively, to the Application. Aqua Exhibit No. 1, Application ¶ 54, Application Exhibit Q and Application Exhibit R.

16. Pursuant to Section 1329(d)(1)(ii), the purchase price agreed to by Aqua and Lower Makefield was identified as \$53,000,000. Aqua Exhibit No. 1, Application ¶ 55.

17. As required by Section 1329(d)(1)(iii), 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 the fair market value appraisals which is \$54,967,796 – determined by \$55,505,000 presented in the Gannett appraisal and \$54,430,591 presented in the AUS appraisal. Aqua Exhibit No. 1, Application ¶ 56; *see also* Aqua St. No. 1 at 20-21.

18. Statements of Gannett and of AUS verifying that they have no affiliation with Aqua or Lower Makefield as specified in Section 1329 and that their Appraisals determined fair market value in compliance with the most recent edition of USPAP, employing the cost, market and income approaches and that they complied with applicable jurisdictional exceptions were attached to the Application as Exhibit T1 and Exhibit T2, respectively. Aqua Exhibit No. 1, Application ¶ 61, Application Exhibit T1 and Application Exhibit T2.

19. Aqua's contract with Gannett to undertake its Fair Market Value Appraisal was included as Exhibit S1 to the Application. Aqua St. No. 1 at 21. Lower Makefield's contract with AUS to undertake its Fair Market Value Appraisal was included as Exhibit S2 to Application. Aqua St. No. 1 at 21.

Regulatory Liability Account For Accumulating Income Tax Effect Of Repairs Deductions

20. The Lower Makefield system has a deficiency in revenue requirement at its existing rates. Aqua St. No. 1-R at 10.

21. 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. Aqua St. No. 1-R at 10.

22. Any tax repair benefit would serve as an offset to this deficiency. Aqua St. No. 1-R at 10.

IV. DISCUSSION

The Settlement presented here is not a full settlement given that Protestants did not join in the Settlement and the Settling Parties did not reach an agreement regarding two of the issues raised in this proceeding.

A. Legal Standard

Section 1102(a) of the Public Utility Code, 66 Pa.C.S. § 1102(a), permits a public utility to undertake certain actions only upon Commission approval evidenced by a certificate of public convenience. Among the activities that require Commission approval is the following:

For any public utility or an affiliated interest of a public utility . . . to acquire from, or to transfer to, any person or corporation . . . by any method or device whatsoever, including the sale or transfer of stock and including a consolidation, merger, sale or lease, the title to, or the possession or use of, any tangible or intangible property used or useful in the public service....

66 Pa.C.S. § 1102(a)(3). The acquisition proposed by the Joint Petition falls under Section 1102(a)(3).

When a certificate of public convenience is required under Section 1102, pursuant to Section 1103(a) of the Public Utility Code, 66 Pa.C.S. § 1103(a), the Commission may issue the certificate only upon a finding or determination that the granting of such certificate is “necessary or proper for the service, accommodation, convenience, or safety of the public.”

Since Aqua is the party that filed the Application at issue in this proceeding, Aqua has the burden of proof to satisfy this particular legal standard.

According to the Pennsylvania Supreme Court, satisfying this standard requires the Commission to find that a proposed transaction would “affirmatively promote the ‘service, accommodation, convenience, or safety of the public’ in some substantial way.” *City of York v. Pa. Pub. Util. Comm’n*, 295 A.2d 825, 828 (Pa. 1972) (*City of York*); *see also, Popowsky v. Pa. Pub. Util. Comm’n*, 937 A.2d 1040, 1057 (Pa. 2007) (when addressing the issue of affirmative public benefits “the appropriate legal framework requires a reviewing court to determine whether substantial evidence supports the Commission's finding that a merger will affirmatively promote the service, accommodation, convenience, or safety of the public in some substantial way”). In addition, Section 1103(a) allows the Commission to impose upon its issuance of a certificate of public convenience “such conditions as it may deem to be just and reasonable.” 66 Pa.C.S. § 1103(a).

Additionally, pursuant to Section 1103 of the Code, Aqua must show that it is technically, legally, and financially fit to own and operate the assets it will acquire from the Township. *Seaboard Tank Lines v. Pa. Pub. Util. Comm’n*, 502 A. 2d 762 (Pa. Cmwlth. 1985); *Warminster Twp. Mun. Auth. v. Pa. Pub. Util. Comm’n*, 138 A.2d 240 (Pa.Super. 1958). As a certificated public utility, there is a rebuttable presumption that Aqua possesses the requisite fitness. *South Hills Movers, Inc. v. Pa. Pub. Util. Comm’n*, 601 A.2d 1308 (Pa. Cmwlth. 1992); *See also*, 66 Pa.C.S. § 1329.

With regard to the recently enacted Section 1329 of the Public Utility Code, this section sets forth a procedure which permits a public utility to utilize fair market valuation for ratemaking purposes instead of the original cost of construction of the acquired facilities minus the accumulated depreciation. 66 Pa.C.S. § 1329. 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. In sum, 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, an “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 and include the following as an attachment to the Section 1102 application: 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). For applications involving an acquiring public entity under Section 1329(d)(1), the Commission has a six-month deadline for issuing a determination. *Id.*

Aqua also seeks approval of 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. *Id.* 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. *Id.* Should the Commission initiate proceedings, the contract or agreement is not effective until the Commission grants its approval. *Id.* Section 507 is a filing requirement and does not require service of the filing on any potentially interested parties. *Id.*

In this case, the Settling Parties submitted a non-unanimous settlement of some of the issues. The Protestants did not reach an agreement with the Settling Parties on the issues in this proceeding. Protestants did not file objections to the Joint Petition.

Commission policy promotes settlements. 52 Pa. Code § 5.231. Settlements lessen the time and expense the parties must expend litigating a case and at the same time conserve administrative resources. The Commission has indicated that settlement results are often preferable to those achieved at the conclusion of a fully litigated proceeding. 52 Pa. Code § 69.401. The focus of inquiry for determining whether a proposed settlement should be recommended for approval is not a “burden of proof” standard, as is utilized for contested matters. *Pa. Pub. Util. Comm’n v. City of Lancaster – Bureau of Water*, Docket No. R-2010-2179103 (Opinion and Order entered July 14, 2011) (*Lancaster*). Instead, the benchmark for determining the acceptability of a settlement or partial settlement is whether the proposed terms and conditions are in the public interest. *Id.*, citing, *Warner v. GTE N., Inc.*, Docket No. C-00902815 (Opinion and Order entered April 1, 1996) (*Warner*); *Pa. Pub. Util. Comm’n v. CS Water & Sewer Assocs.*, 74 Pa. PUC 767 (1991). In addition, the Commission has held that parties to settled cases are afforded flexibility in reaching amicable resolutions, so long as the settlement is in the public interest. *Pa. Pub. Util. Comm’n v. MXenergy Elec. Inc.*, Docket No. M-2012-2201861 (Opinion and Order entered Dec. 5, 2013).

B. Settlement Terms

The terms of the Settlement are set forth below, verbatim, as submitted by the Settling Parties in the Joint Petition for Settlement filed on October 8, 2021. For ease of reference, the original paragraph numbering and headings are also retained.² The Joint Petitioners agree as follows:

22. Joint Petitioners agree to the following terms and conditions in Partial Settlement of this Application proceeding. With the exception of (1) the determination of ratemaking

² These settlement terms can be found on pp. 5-9 of the Joint Petition.

rate base and (2) income tax savings on repairs deductions, the Partial Settlement resolves all issues among the Joint Petitioners:

A. Approval of Application and Acquisition

- (1) The Commission should approve Aqua’s acquisition of Lower Makefield Township wastewater collection system assets and Aqua’s right to begin to offer, render, furnish, or supply wastewater service in the areas served by Lower Makefield.
- (2) The Commission shall issue any necessary approvals or certificates for the transaction pursuant to 66 Pa. C.S. Section 507.³

B. Tariff

The pro forma tariff submitted with the Application, as updated in Aqua’s supplemental information filed by letter dated June 21, 2021, including all rates, rules and regulations regarding conditions of Aqua’s wastewater service, shall be permitted to become effective immediately upon closing of the transaction.

C. Engineering Assessment

On a going forward basis, Aqua will require engineering firms conducting Section 1329 assessments to present, as part of the engineering assessment, a detailed Engineer’s Assessment Study containing the seller’s utility assets description of the condition of inventory and assets. The designation of condition shall be limited to those assets that can be observed and whether the categories of system assets appraised are in poor, fair, good or very good condition

D. Easements and Other Property Rights

Aqua and Lower Makefield will work to ensure the transfer of all real property rights including easements and missing easements as defined in the Asset Purchase Agreement (APA) by Closing. However, Aqua shall be permitted in its discretion to close without the transfer of all of the Real Property Rights, provided that an escrow is established from the Purchase Price to be used to obtain any post-Closing transfers of the Real Property Rights. Aqua will provide an update to I&E, OCA, and OSBA approximately 30 days in advance of the anticipated Closing Date and a final update before Closing regarding the status of the transfer of real property rights including easements related to the system.

³ The OCA does not join in this Subparagraph A(2) but does not oppose Aqua’s request.

E. Cost of Service Study

- (1) In the first base rate case that includes Lower Makefield wastewater system assets, Aqua will submit a wastewater cost of service study that removes all costs and revenues associated with the operation of the Lower Makefield system.
- (2) In the first base rate case that includes Lower Makefield wastewater system assets, Aqua will also provide a separate cost of service study for the Lower Makefield system. Aqua will file a Cost of Service Study separately for the Lower Makefield system consistent with typically filed rate making exhibits including, but not limited to the following: Rate Base (Measures of Value), Statement of Operating Income, and Rate of Return, which correspond to the applicable test year, future test year, and fully projected future test year measurement periods.

F. Allowance for Funds Used During Construction (AFUDC), Deferral of Depreciation and Transaction Costs

- (1) Any claims for AFUDC and deferred depreciation related to post-acquisition improvements not recovered through the Distribution System Improvement Charge (DSIC) for book and ratemaking purposes, will be addressed in Aqua's first base rate case which includes Lower Makefield wastewater system assets.
- (2) Regarding future claims for AFUDC, deferral of depreciation, and transaction costs related to this acquisition, Joint Petitioners reserve the right to litigate their positions fully in future rate cases when these issues are ripe for review. The parties' assent to this agreement should not be construed to operate as its preapproval of Aqua's requests.

G. Long Term Infrastructure Improvement Plan (LTIIIP) and Distribution System Improvement Charge

- (1) If Aqua proposes to modify its LTIIIP to include the Lower Makefield wastewater system, the projects added for Lower Makefield will be in addition to those that Aqua plans for its existing systems.
- (2) In future LTIIIPs or Annual Asset Optimization Plans (AAOP) that include the Lower Makefield wastewater system, Aqua will not reprioritize other existing capital improvements that the Company already committed to undertake. This section does not limit Aqua's

current practice and ability to allocate projects as needed for its capital program.

- (3) Upon approval of the Commission of a modification to its LTIP which includes the Lower Makefield wastewater system, Aqua shall be permitted to collect a DSIC related to the Lower Makefield wastewater system prior to the first base rate case in which the Lower Makefield assets are incorporated into rate base.

H. Lower Makefield Rates

- (1) The current average Lower Makefield residential rate is \$74.32 per month based on four thousand seven hundred gallons of usage. As set forth in the notice sent to Lower Makefield customers in this proceeding (Application Exhibit I2), Aqua provided a non-binding, estimated incremental rate effect of the proposed rate base addition on Lower Makefield wastewater customers of 28.17%.
- (2) Joint Petitioners acknowledge that the Commission retains ultimate authority to set rates including, but not limited to, the authority to allocate revenues to the Lower Makefield customers that are in excess of the restrictions contained in Section 7.03 of the APA.
- (3) Aqua and Lower Makefield agree that, at the time of Aqua's first base rate case that includes the Lower Makefield system, Aqua will propose the timing of the rate effect consistent with the terms of Section 7.03 of the APA. All parties reserve their rights to address Aqua's proposal.
- (4) In the first base rate proceeding filed by Aqua that includes Lower Makefield's wastewater system assets, Aqua shall propose to move the Lower Makefield system to its cost of service, based on a separate cost of service study for Lower Makefield's system; provided, however, that Aqua will not be obligated to propose Lower Makefield wastewater rates in excess of Aqua's proposed Rate Zone 1 system-average rates. The Joint Petitioners acknowledge, however, that Aqua may agree to rates other than those proposed for Lower Makefield customers in the context of a settlement of the base rate case. OCA, I&E, OSBA and Lower Makefield reserve their rights to fully address this proposal, and to make other rate proposals in the base rate case. In the next rate case, Aqua agrees to provide written notice to Lower Makefield Township customers of the rate filing and the level of increase, if any, resulting from this provision.

I. Welcome Letter

Aqua will send a welcome letter to Lower Makefield Wastewater customers within 30 days following Closing which will include information regarding the conversion to monthly billing for their sewer service.

J. Legal Fees

In its next base rate case, Aqua shall separately identify any legal fees included in its transaction and closing costs pursuant to the APA between Aqua and Lower Makefield and specify amounts expended by Aqua on behalf of Lower Makefield. I&E, OCA and OSBA reserve the right to challenge the reasonableness, prudence, and basis for such fees.

C. Public Input Hearing

The Parties cooperated in good faith with Commission staff to promptly schedule one telephonic public input hearing in this matter. The Parties agreed to the method and manner of notice to be provided for the public input hearing at the time of the prehearing conference.

V. CONDITIONS OF PARTIAL SETTLEMENT

The Settling Parties agreed to the following Conditions of Partial Settlement.⁴

1. This Joint Petition is proposed to resolve all but two issues in the instant matter and, except as set forth above, is made without any admission against or prejudice to any positions which any Joint Petitioner might adopt during subsequent litigation in any case, including further litigation in this case if this Joint Petition is rejected by the Commission or withdrawn by anyone of the Joint Petitioners as provided below. Except as set forth above, Joint Petitioners agree that this Joint Petition shall not constitute or be cited as controlling precedent in this or any other jurisdiction.

2. This Joint Petition is conditioned upon the Commission's approval of all terms and conditions contained in the Joint Petition, without modification. If the Commission

⁴ These conditions of partial settlement can be found on pp. 10-11 of the Joint Petition.

should fail to grant such approval or should modify the terms and conditions of the Joint Petition, the Joint Petition may be withdrawn upon written notice to the Commission and all parties within three (3) business days by any one of the Joint Petitioners and, in such event, shall be of no force and effect. Regardless of whether the Partial Settlement is approved or not, no adverse inference shall be drawn to any party in this or any other proceeding as a consequence of the Partial Settlement. Joint Petitioners waive the right to file Exceptions on the issues in the Partial Settlement if the Presiding Officer recommends approval of the Joint Petition without modification.

Positions of the Settling Parties

A. Approval of Application and Acquisition

Aqua's Position

Aqua asserts the proposed transaction is supported by affirmative public benefits and, in settlement of the proceeding, has agreed to a list of conditions for approval of the transaction. Aqua submits the proposed transaction and expansion of service will further the public interest. Aqua St. in Support, p. 2.

I&E's Position

Through this Partial Settlement, I&E explains it's identified concerns have been addressed and I&E opines that Aqua's Application, as modified by the Joint Petition, now meets the requisite standards for approval. I&E asserts that the Application should be approved and recommends that the Commission should issue Aqua a Certificate of Public Convenience pursuant to 66 Pa. C.S. § 1102(a). I&E St. in Support, pp. 5-6.

OCA'S Position

The OCA submits that the terms and conditions of the proposed Partial Settlement will help protect existing Aqua water and wastewater customers and the acquired LMT customers from the risks associated with the acquisition. OCA St. in Support, p. 7.

OSBA's Position

As a term of the Partial Settlement, the OSBA agrees that the Commission should approve Aqua's acquisition of LMT's wastewater system assets. Following investigation, the OSBA is satisfied that Aqua has demonstrated compliance with 66 Pa. C.S. §§ 1102 and 1329 in this proceeding. OSBA is satisfied that Aqua has demonstrated compliance with 66 Pa. C.S. §§ 1102 and 1329 in this proceeding. OSBA St. in Support, p. 3.

Lower Makefield Township's Position

The Township concludes that the Commission should approve Aqua's application to acquire the System and Aqua's right to begin to offer, render, furnish, or supply wastewater service in areas served by the Township and requests that the Commission issue all necessary approvals and certificates for the proposed transaction pursuant to 66 Pa C.S. § 507. Township St. in Support, p. 5.

Discussion

Aqua explains it is seeking to provide service to Lower Makefield's approximately 11,151 wastewater customers.⁵ The record supports the findings that Aqua is technically, legally, and financially fit to acquire the Lower Makefield's wastewater services,⁶

⁵ Aqua Application at Docket No. A-2021-3024267, ¶ 30.

⁶ Aqua Application, Exhibit U, St. No. 1, pp. 10-11.

and no party has refuted those claims through evidence in the record. *South Hills Movers, Inc. vs. PA. Pub. Util. Comm'n*, 6 .2d. 1308 (Pa. Cmwlt. 1992); 66 Pa. C.S. 1239.

Additionally, Aqua's Application will provide affirmative public benefits. The affirmative public benefits are fully set forth in Aqua's direct testimony, and include furthering the goal of regionalizing water systems, benefits of better management practices, economies of scale, and the resulting greater customer/environmental/economic benefits.⁷ In addition, through the Partial Settlement, the value of the public benefits will be better realized because the Partial Settlement contains numerous terms to protect Aqua's ratepayers, both existing and those who will become Aqua's ratepayers through this transaction. The Partial Settlement will also ensure that Aqua's ratepayers receive the benefit of the bargain that Aqua negotiated without being subject to protracted and expensive litigation.

Pursuant to Section 1103 of the Code, 66 Pa.C.S. § 1103, Aqua must demonstrate that it is technically, financially, and legally fit to own and operate the System. *Seaboard Tank Lines, Inc. v. Pa. Pub. Util. Comm'n*, 502 A.2d 762 (Pa. Cmwlt. 1985); *Warminster Twp. Mun. Auth. v. Pa. Pub. Util. Comm'n*, 138 A.2d 240 (Pa. Super. 1958). As a certificated public utility, Aqua enjoys a rebuttable presumption that it possesses the requisite fitness. *South Hills Movers, Inc. v. Pa. Pub. Util. Comm'n*, 601 A.2d 1308 (Pa. Cmwlt. 1992). Although no party challenged Aqua's fitness through record evidence, Aqua introduced evidence demonstrating its technical, legal and financial fitness. Joint Petition, ¶ 23.

In addition to demonstrating fitness, Aqua must demonstrate that the Transaction and Aqua's proposed ownership/operation of the System 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*, 295 A.2d 825, 828 (Pa. 1972). An acquisition provides an affirmative benefit if the benefits of the transaction outweigh the adverse impacts of the transaction. *Application of CMV Sewage Co., Inc.*, 2008 Pa. PUC LEXIS 950. When looking at the benefits and detriments of a transaction, the focus of the analysis must be on all affected parties, not

⁷ Aqua Application, Exhibit U, St. No. 1, pp. 13-19.

merely a particular group or a particular geographic area. *Middletown Twp. v. Pa. Pub. Util. Comm'n*, 482 A.2d 674 (Pa. Cmwlth. 1984).

As the Settling Parties explained, the Transaction, with the conditions described in the Settlement, benefits all of the stakeholder groups impacted by the Transaction: the public-at-large; the Township (as seller of the System); the existing customers of the Township's System; and the existing customers of Aqua. The Transaction benefits members of the public-at-large in that the Transaction promotes the Commission's policy favoring regionalization and consolidation of water and wastewater systems. 52 Pa. Code § 69.721(a); Aqua St. No. 1 at 17.

The Transaction further benefits the Township's and Aqua's existing customers in the same way that it benefits all other members of the public-at-large.

B. Tariff

Aqua's Position

Aqua explains that the *pro forma* tariff submitted by Aqua with its Application as updated in the supplemental information submitted by letter dated June 21, 2021, will be permitted to become effective upon Closing. The *pro forma* tariff will implement the Lower Makefield current rates inclusive of any then-existing miscellaneous fees and charges. Aqua St. in Support, p. 11.

I&E's Position

I&E explains the *pro forma* tariff will accurately include all rates, rules, and regulations regarding the conditions of Aqua's wastewater service, and submits that this full and accurate disclosure of rates is in the public interest. I&E St. in Support, p. 8.

OCA's Position

OCA notes that the *pro forma* tariffs, which includes all rates, rules, and regulations regarding conditions of Aqua's water and wastewater service would become immediately effective upon closing of the transaction. OCA St. in Support, p. 7.

OSBA's Position

OSBA supports the approval of Aqua's acquisition of LMT's wastewater systems and agrees to the approval of the *pro forma* tariff submitted with its Application, as updated in Aqua's supplemental information filed by letter dated June 21, 2021. OSBA St. in Support, pp. 3-4.

Lower Makefield Township's Position

The Township noted that the Joint Petitioners agree that the *pro forma* tariff that Aqua submitted with its application, and as updated in the supplemental information Aqua filed by letter dated June 21, 2021, will be effective upon closing. Township St. in Support, p. 6.

Discussion

Joint Petitioners have agreed that the *pro forma* tariff submitted by Aqua with its Application as updated in the supplemental information submitted by letter dated June 21, 2021, will be permitted to become effective upon Closing. The *pro forma* tariff will implement the Lower Makefield current rates inclusive of any then-existing miscellaneous fees and charges. The Township presently bills on a quarterly basis. Aqua will convert certain customers who receive water service from Pennsylvania-American Water Company to monthly billing, and those customers that receive water service from the Municipal Authority of the Borough of Morrisville will continue with quarterly billing after closing. Aqua St. in Support, p. 11.

Accordingly, the *pro forma* tariff will accurately include all rates, rules, and regulations regarding the conditions of Aqua's wastewater service. This full and accurate disclosure of rates is in the public interest.

C. Engineering Assessment

Aqua's Position

Aqua has agreed, in settlement and in response to concerns expressed by I&E,⁸ to require engineering firms conducting Section 1329 assessments to present, on a going forward basis as part of the engineering assessment, a detailed Engineer's Assessment Study containing the seller's utility assets description of the condition of inventory and assets. Aqua explains the designation of condition shall be limited to those assets that can be observed and whether the categories of system assets appraised are in poor, fair, good or very good condition.⁹ Aqua St. in Support, p. p. 11-12.

I&E's Position

While there is no statutory requirement for the engineering report to provide a condition designation, I&E explains the designation has been available in other Section 1329 cases and it has been relied upon by UVEs, and by I&E in its investigation. I&E avers that absent such designation, questions are raised about what assumptions each UVE made about asset conditions in his/her corresponding fair market value appraisal. Additionally, I&E envisions the possibility that absent the engineering report designating assets' condition, each UVE may make independent and conflicting determinations about the condition that would result in incongruent valuation assumptions and results. I&E explains that ensuring that incongruent valuations are not produced in the future as a result of the engineering report's lack of condition designation is necessary to protect the integrity of the fair market valuations and the Section 1329 process. I&E St. in Support, pp. 8-9.

⁸ See I&E St. No. 1 at 4 – 9.

⁹ Aqua St. No. 2-R at 2 – 4.

OCA's Position

OCA explains that this settlement provision helps to ensure that the engineering assessment required under the Public Utility Code contains sufficiently detailed information regarding the acquired plant and is in the public interest. OCA St. in Support, p. 7.

OSBA's Position

OSBA determined that Aqua's commitment to ensure that, in its future Section 1329 applications, the engineering assessment required will designate the condition of the appraised inventory and assets will benefit ratepayers by providing more information, and thereby simplifying issues, in future cases. OSBA St. in Support, p. 4.

Lower Makefield Township's Position

The Township notes that the requirement to include a detailed description of the condition of inventory and assets is limited to those assets that can be observed and whether the system assets are in poor, fair, good, or very good condition. Township St. in Support, p. 6.

Discussion

As a term of the Partial Settlement, in Paragraph 22(C) Aqua agreed that in any future Section 1329 applications it submits, the engineering assessment required under 66 Pa. C.S. § 1329(a)(4) will designate the condition of the inventory and assets appraised. Aqua further agreed that such designation of condition shall be limited to whether the categories of system assets appraised are in poor, fair, good, or very good condition. This term was agreed upon by the Joint Petitioners, and, as I&E explained, ensuring that incongruent valuations are not produced in the future as a result of the engineering report's lack of condition designation is necessary to protect the integrity of the fair market valuations and the Section 1329 process. Joint Petition, pp. 11-12.

D. Easements and Other Property Rights

Aqua's Position

Aqua explains that it and the Township have agreed to a contractual provision in the APA that Aqua believes reasonably and adequately addresses the transfer of system real property rights, easements and rights of way for Lower Makefield assets that have been in the ground for decades.¹⁰ Supplementing the contractual provision, Aqua has agreed, in settlement and in response to concerns expressed by I&E,¹¹ to work with Lower Makefield to ensure the transfer of all real property rights including easements and missing easements as defined in the APA by Closing and to provide an update to I&E, OCA, and OSBA approximately 30 days in advance of closing and a final update before Closing regarding the status of the transfer of real property rights including easements. Aqua notes that this term does not preclude Aqua and Lower Makefield Township from closing the transaction if any easements remain missing at Closing, provided that an escrow is established from the purchase price to ensure transfer of the real property rights. Aqua St. in Support, p. 12.

I&E's Position

I&E supports this settlement term as necessary to protect the public interest as the public interest would be harmed if Aqua paid a purchase price that assumed that all rights necessary to operate Lower Makefield would be transferred, and at Lower Makefield's cost, and such action did not occur. To protect against this possibility, I&E fully supports the protection measure of the escrow account that would be imposed upon Lower Makefield to ensure that any right not transferred at closing must be financially accounted for via payment to the escrow account. Additionally, I&E explains the public interest is protected because this term provides an additional layer of accountability that would not exist if Aqua and Lower Makefield would ever mutually decide to waive the applicable sections of the APA that bind it to deliver good and

¹⁰ Aqua St. No. 1-R at 4.

¹¹ See I&E St. No. 1 at 10 – 12.

marketable title to all real property necessary for the operation of the acquired system.¹² I&E St. in Support, p. 9.

Additionally, because Aqua has committed to providing I&E, OCA, and OSBA with an update on the status of the transfer of real property rights related to the system within 30 days of advance of the anticipated Closing Date, I&E explains it will have a mechanism in place to gauge Lower Makefield's progress in meeting its property transfer obligations. Through this reporting mechanism, the public interest is further protected because, by being informed of the status of any missing property rights, I&E will be empowered to take any action that may be warranted and available to ensure that Aqua's ratepayers are not paying for property rights that are not obtained or paying any costs associated with obtaining those rights. At the same time, Aqua will be able to monitor any missing easements to either ensure that it does not encounter access issues, or, if such issues are identified, that it can develop a plan to address access. I&E St. in Support, pp. 9-10.

OCA's Position

OCA explains that Aqua and Lower Makefield agreed to continue working to achieve transfer of all real estate, easement rights, access to public rights-of-way, and liens that must be transferred to Aqua by Closing. According to OCA, this provision helps to ensure that Aqua will obtain all transfers necessary to provide service consistent with its Applications. OCA St. in Support, pp. 7-8.

OSBA's Position

OSBA notes that this provision requires Aqua to achieve transfer of all real property rights as required under the APA while simultaneously providing flexibility to Aqua to close without the transfer of all real property rights so long as an escrow is created to obtain post-closing real property transfers. Aqua must also provide updates at certain times to I&E, OCA and the OSBA (collectively, the Statutory Advocates) regarding the status of the transfer

¹² Aqua's Application, Exhibit B, Section 2.01, p. 11.

of real property rights. With the requirement to update the Statutory Advocates, the OSBA asserts it has the means to monitor these transfers, and take corrective action if necessary. OSBA St. in Support, p. 4.

Lower Makefield Township's Position

The Township notes that Aqua, at its own discretion, is permitted to close without the transfer of all real property rights as long as an escrow is established from the Purchase Price to be used for obtaining any post-closing transfers of real property rights. Township, St. in Support, p. 6.

Discussion

Aqua and the Township agreed to provisions in the Asset Purchase Agreement regarding the transfer of system real property rights, easements and rights of way for Lower Makefield assets. Through the Settlement, Aqua has agreed to work with the Township to ensure the transfer of all real property rights including easements and missing easements as defined in the APA by Closing and to provide an update to I&E, OCA, and OSBA in advance of closing and a final update before Closing regarding the status of the transfer of real property rights including easements. The Settlement further includes a provision for the establishment of an escrow from the purchase price to ensure transfer of the real property rights.

I&E explained the public interest would be harmed if Aqua paid a purchase price that assumed that all rights necessary to operate Lower Makefield would be transferred, and at Lower Makefield's cost, and such action did not occur. To protect against this possibility, the Settlement includes establishment of an escrow account that would be imposed upon Lower Makefield to ensure that any right not transferred at closing must be financially accounted for via payment to the escrow account. This Settlement term is in the public interest and, as I&E asserts, provides an additional layer of accountability that would not exist if Aqua and Lower Makefield would ever mutually decide to waive the applicable sections of the Asset Purchase

Agreement that bind it to deliver good and marketable title to all real property necessary for the operation of the acquired system.¹³ I&E St. in Support, p. 9.

In addition, Aqua's agreement to provide the Statutory Parties with an update on the status of the transfer of real property rights related to the system in advance of the anticipated Closing Date, provides a mechanism in place to gauge Lower Makefield's progress in meeting its property transfer obligations, and enables the Statutory Parties with the ability to take any action that may be warranted and available to ensure that Aqua's ratepayers are not paying for property rights that are not obtained or paying any costs associated with obtaining those rights. I&E St. in Support, pp. 9-10.

E. Cost of Service Study

Aqua's Position

Aqua has agreed to submit, in its first base rate case that includes the Lower Makefield wastewater system assets, a wastewater cost of service study that removes all costs and revenues associated with the operation of the Lower Makefield system and to also submit a separate cost of service study for the Lower Makefield system. In doing so, Aqua explains the cost to serve the Lower Makefield system will be separately identified, and the Commission will be informed as to costs when new rates are being considered for implementation. The submission of a separate cost of service study has been a condition for Commission approval in other Section 1329 application proceedings, most recently in *Cheltenham*¹⁴ where a similar condition to meet the affirmative public benefit standard was directed by the Commission.¹⁵ Aqua St. in Support, pp. 12-13.

¹³ Aqua's Application, Exhibit B, Section 2.01, p. 11.

¹⁴ *Application of Aqua Pa. Wastewater, Inc. Pursuant to Sections 1102, 1329 & 507 of the Pub. Util. Code for Approval of its Acquisition of the Wastewater Sys. Assets of Cheltenham Twp. & Contracts between Aqua Pa. Wastewater, Inc. & Cheltenham Twp.*, Docket No. A-2019-3008491 (Opinion and Order entered November 5, 2019) (*Cheltenham*).

¹⁵ *Cheltenham*, mimeo at 86.

I&E's Position

I&E submits that the cost of service study will provide information necessary to determine an appropriate level of rates in the future. The cost of service study will benefit Aqua's ratepayers as well, because if Aqua's Application is approved, Aqua's existing customers will bear the rate impact. However, without a cost of service study, the Commission's ability to evaluate the rate impact of the acquisition upon existing Aqua customers and its options of addressing that impact to provide any appropriate relief to existing customers, could be compromised. Finally, Aqua's cost of service study commitment will serve the public interest because 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. I&E St. in Support, pp. 10-11.

OCA's Position

OCA explains that a separate cost of service study will provide information to establish rates that reflect the costs for that system. OCA St. 1 at 11, 19-20.

OCA further notes that these settlement terms will provide a means for the parties to use the cost of service data to set rates for the Lower Makefield customers that differ, as appropriate, from rates established for other wastewater customers. OCA St. in Support, p.8.

OSBA's Position

The OSBA notes that providing the information identified in this settlement provision will better assist the OSBA in evaluating how best to advocate for small commercial and industrial (C&I) customers in Aqua's next base rate proceeding. OSBA St. in Support, p.5.

Lower Makefield Township's Position

The Township agrees with the settlement provisions regarding separate cost of service studies. Township St. in Support, pp.6-7.

Discussion

Paragraphs 22(E)(1) and 22(E)(2) provide that, in its first base rate case following closing, in which Aqua includes the Township assets in rate base, Aqua will submit a wastewater cost of service study that removes all costs and revenues associated with the Lower Makefield system. The Company will also provide a separate cost of service study for the Lower Makefield Township system. These settlement terms will provide a means for the parties to use the cost of service data to set rates for the Lower Makefield customers that differ, as appropriate, from rates established for other wastewater customers. Joint Petition, p. 7.

As explained by I&E, without a cost of service study, the Commission's ability to evaluate the rate impact of the acquisition upon existing Aqua customers and its options of addressing that impact to provide any appropriate relief to existing customers, could be compromised. In addition, Aqua's cost of service study commitment will serve the public interest because 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. I&E St. in Support, pp. 10-11.

F. Allowance for Funds Used During Construction, Deferral of Depreciation and Transaction Costs

Aqua's Position

Aqua notes that any claims for AFUDC and deferred depreciation related to post-acquisition improvements not recovered through the Distribution System Improvement Charge (DSIC) will be addressed in Aqua's first base rate case which includes Lower Makefield

wastewater system assets and that Joint Petitioners reserve the right to litigate claims for AFUDC, deferral of depreciation and transaction costs in future rate cases. Aqua St. in Support, p. 13.

I&E's Position

I&E notes that the Joint Petitioners agree that they reserve their rights to litigate their positions fully in future rate cases. I&E endorses this term because while it recognizes the potential for Aqua to invoke portions of Section 1329 related to post-acquisition projects,¹⁶ it also empowers parties to review Aqua's proposed treatment of those projects in a future base rate case. Preserving the ability to litigate any of Aqua's proposed AFUDC and deferred depreciation treatment protects the public interest by ensuring that interested parties are not hindered in developing a full and complete record for the Commission on this issue when additional information is available and ratemaking issues are ripe for determination. I&E St. in Support, p. 11.

OCA's Position

OCA notes that, to facilitate the parties' review in Aqua's next base rate case, Paragraph J of the Settlement reflects Aqua's agreement to separately identify any legal fees included in its transaction and closing costs pursuant to the Asset Purchase Agreement between Aqua and Lower Makefield Township and specify amounts expended by Aqua on behalf of Lower Makefield. OCA St. in Support, pp. 8-9.

OSBA's Position

OSBA submits that the settlement provisions related to Allowance for Funds Used During Construction and Deferral of Depreciation and Transaction Costs are reasonable as it creates a process to address claims for AFUDC and deferred depreciation related to post-acquisition improvements not recovered through the DSIC in Aqua's first base rate case that

¹⁶ 66 Pa.C.S. §1329(f).

includes Lower Makefield's wastewater system assets. Partial Settlement, ¶ 22.F.1, at p. 7; OSBA St. in Support, p. 5.

Lower Makefield Township's Position

The Township agrees with the terms agreed upon by the Joint Petitioners. Township St. in Support, p. 7.

Discussion

Aqua has agreed, in settlement, that any claims for AFUDC and deferred depreciation related to post-acquisition improvements not recovered through the DSIC will be addressed in Aqua's first base rate case which includes Lower Makefield wastewater system assets and that Joint Petitioners reserve the right to litigate claims for AFUDC, deferral of depreciation and transaction costs in future rate cases. As Aqua explained, a similar condition to meet the affirmative public benefit standard was directed by the Commission in *Cheltenham*.¹⁷

Through the Settlement, the Joint Petitioners acknowledge that they reserve their rights to litigate their positions fully in future rate cases. As I&E explained that, while it recognizes the potential for Aqua to invoke portions of Section 1329 related to post-acquisition projects,¹⁸ the Settlement also empowers parties to review Aqua's proposed treatment of those projects in a future base rate case. Preserving the ability to litigate any of Aqua's proposed AFUDC and deferred depreciation treatment protects the public interest by ensuring that interested parties are not hindered in developing a full and complete record for the Commission on this issue when additional information is available, and ratemaking issues are ripe for determination. I&E St. in Support, p. 11.

¹⁷ *Cheltenham*, mimeo at 86 – 87.

¹⁸ 66 Pa.C.S. §1329(f).

G. Long Term Infrastructure Improvement Plan and Distribution System Improvement Charge

Aqua's Position.

Aqua notes that, upon approval of a modification to its LTIIIP to include the Lower Makefield system, it shall be permitted to collect a DSIC related to the Lower Makefield wastewater system prior to the first base rate case in which includes the Lower Makefield assets. Aqua also has agreed that, in future LTIIIPs or Annual Asset Optimization Plans that include the Lower Makefield wastewater system, it will not reprioritize other existing capital improvements that it already committed to undertake. Aqua explains this settlement provision does not limit Aqua's current practice and ability to allocate projects as needed by Aqua necessary for its capital program but recognizes that any Lower Makefield system infrastructure will be in addition to capital improvements already planned. The condition allows for improvements to be made to the Lower Makefield system through Aqua's DSIC program in addition to the already existing projects under the Company's LTIIIP. Aqua St. in Support, p. 14.

I&E's Position

I&E notes it's investigation yielded no concerns regarding Aqua's request for approval to collect a DSIC as permitted under Section 1329, as this request appeared to simply memorialize Aqua's intention to employ certain provisions of Section 1329. Nonetheless, I&E reserves the right to address these issues in future proceedings, including base rate, LTIIIP, and DSIC proceedings, when additional information and facts are available and when these issues are ripe for review. I&E St. in Support, pp. 11-12.

OCA's Position

OCA notes that the parties to the proposed Settlement agreed that Aqua may apply the DSIC to customers in the Lower Makefield Township service area prior to the first base rate case in which the system's plant in service is incorporated into rate base pursuant to Section 1329(d)(4) if certain conditions are met. OCA explains that the settlement allows for Lower

Makefield customers to begin contributing, up to 5% of their total wastewater bill, toward DSIC-eligible capital projects.

OCA further explains that paragraph 22(G)(2) also provides that, if Aqua seeks to modify its LTIIP to include the Lower Makefield system, Aqua will not reprioritize other existing capital improvements that the Company already committed to undertake in other service areas. OCA St. in Support, p. 9.

OSBA's Position

OSBA explains that these settlement provisions protect existing customers and ensure that Aqua will not unnecessarily reprioritize projects. (Partial Settlement, ¶¶ 22.G.1-2, at pp. 7-8). OSBA also notes it does not oppose the provisions in the Partial Settlement related to Aqua's ability to collect a DSIC prior to the first base rate case in which the Lower Makefield's wastewater service area plant-in-service is incorporated into rate base. Partial Settlement, ¶ 22.G.3, at p. 8; OSBA St. in Support p. 6.

Lower Makefield Township's Position

The Township notes that it is in agreement with these settlement provisions. Township St. in Support, p. 7.

Discussion

The parties to the proposed Settlement agreed that Aqua may apply the DSIC to customers in the Lower Makefield Township service area prior to the first base rate case in which the system's plant in service is incorporated into rate base pursuant to Section 1329(d)(4) under the circumstances. Paragraph 22(G)(1) states that if Aqua proposes to revise its LTIIP to include Lower Makefield Township and related projects, the projects added for the acquired system will be in addition to those that Aqua plans for its existing systems. Pursuant to Paragraph 22(G)(3), Aqua has agreed that the projects for Lower Makefield Township customers are in addition to the

projects already included in its approved LTIP. This settlement term allows for Lower Makefield customers to begin contributing, up to 5% of their total wastewater bill, toward DSIC-eligible capital projects. Joint Petition, p. 13.

Paragraph 22(G)(2) also provides that, if Aqua seeks to modify its LTIP to include the Lower Makefield system, Aqua will not reprioritize other existing capital improvements that the Company already committed to undertake in other service areas. As noted by the Parties, these terms help to ensure that projects and expenditures already planned for existing Aqua wastewater customers will not be given less priority as a result of the Lower Makefield acquisition. Aqua St. in Support p. 14.

In addition, Aqua points out that this provision does not limit Aqua's current practice and ability to allocate projects as needed by Aqua necessary for its capital program but recognizes that any Lower Makefield system infrastructure will be in addition to capital improvements already planned. Aqua St. in Support p. 14.

H. Lower Makefield Rates

Aqua's Position

Aqua explains that the settlement term reflects the negotiated resolution of the rate interests of I&E, OCA, OSBA, Aqua and Lower Makefield and Aqua accepts it in settlement of this proceeding. Aqua also notes that the settlement term also acknowledges that the Commission retains ultimate authority to set rates including, but not limited to, the authority to allocate revenues to the Lower Makefield customers that are in excess of the restrictions contained in Section 7.03 of the APA. Aqua St. in Support pp. 14-15.

I&E's Position

I&E took no position regarding the rates of Lower Makefield's customers. However, I&E reserves the right to address Lower Makefield's rates in future rate proceedings.

From I&E's perspective, it is important not to make any assumptions about what rates may be appropriate for acquired Lower Makefield customers in the future because doing so may rely upon assumptions that may prove to be inaccurate and may not account for information and circumstances that emerge in the interim. This term is within the public interest because it complies with Section 1329, but it also preserves I&E's ability to address rates in the future while correctly recognizing the Commission's ultimate authority to set rates. I&E St. in Support p. 17.

OCA's Position

OCA explains that, in the first base rate proceeding filed by Aqua that includes Lower Makefield's wastewater system assets, Aqua agrees to propose to move the Lower Makefield system to its cost of service, based on a separate cost of service study for Lower Makefield's system; provided, however, that Aqua will not be obligated to propose Lower Makefield wastewater rates in excess of Aqua's proposed Rate Zone 1 system-average rates. The Joint Petitioners acknowledge, however, that Aqua may agree to rates other than those proposed for Lower Makefield customers in the context of a settlement of the base rate case. OCA, I&E, OSBA and Lower Makefield reserve their rights to fully address this proposal, and to make other rate proposals in the base rate case. Additionally, in the next rate case, Aqua agrees to provide written notice to Lower Makefield Township customers of the rate filing and the level of increase, if any, resulting from this provision. Partial Settlement ¶ 22(H)(4). Moreover, the Joint Petitioners expressly recognize the Commission's ultimate ratemaking authority to set rates and that notwithstanding these provisions, the Joint Petitioners may enter into a settlement of the base rate case. Partial Settlement ¶ 22(H)(2); OCA St. in Support p.p. 9-10.

OCA further explains that these provisions will provide information to establish rates that reflect the costs for the Lower Makefield system. Parties in the next Aqua base rate case would have the opportunity to propose that the resulting rates for the Lower Makefield customers should differ, as appropriate, from rates established for other wastewater customers. The provisions also establish a reasonable cap on the proposed rate increase for Lower Makefield

customers and will permit the parties to address a reasonable increase for Lower Makefield customers in the next Aqua base rate case. OCA St. in Support p. 10.

OSBA's Position

OSBA notes that the Settlement preserves OSBA's right to address Aqua's rate proposals fully, and to make other rate proposals in the next base rate case, particularly with respect to the rate provisions contained in Section 7.03 of the APA. Partial Settlement, ¶¶ 22.H.3-4, at p. 8. This section additionally requires Aqua to propose to move the Lower Makefield wastewater system customers to its cost of service in its next base rate case, but does not obligate Aqua to propose Lower Makefield wastewater rates in excess of Aqua's proposed Rate Zone 1 system-average rates. Partial Settlement, ¶¶ 22.H.4, at p. 8. The OSBA is satisfied that these provisions protect Aqua's current customers from subsidizing the newly acquired customers on the Lower Makefield wastewater systems. OSBA St. in Support pp. 6-7.

Lower Makefield Township's Position

The Township notes that the Commission retains the authority to set rates for the Township's customers at the first, and all future, base rate cases. The Joint Petitioners reserve their rights to fully address Aqua's rate proposal, and to make other proposals, that includes the System. However, Aqua will not be obligated to propose wastewater rates in excess of Aqua's proposed Rate Zone 1 system-average rates. Aqua will provide Lower Makefield customers with written notice of the first base rate case that includes Lower Makefield customers, including the level of increase. Township St. in Support, pp. 7-8.

Discussion

The Township notes that the current average Lower Makefield residential rate is \$74.32 per month and that notice sent to Lower Makefield customers provided a non-binding estimated incremental rate effect of 28.17% as a result of the proposed rate base addition. Township St. in Support p. 7. Through settlement, the Joint Petitioners have agreed to a

framework for addressing Lower Makefield rates in the first base rate proceeding that includes Lower Makefield's wastewater system assets. It provides that (1) Aqua shall propose to move the Lower Makefield system to its cost of service, based on a separate cost of service study for Lower Makefield's system; provided, however, that Aqua will not be obligated to propose Lower Makefield wastewater rates in excess of Aqua's proposed Rate Zone 1 system-average rates; (2) Aqua may agree to rates other than those proposed for Lower Makefield customers in the context of a settlement of the first base rate case; (3) at the time of Aqua's first base rate case that includes the Lower Makefield system, Aqua will propose the timing of the rate effect consistent with the terms of Section 7.03 of the APA; (4) Aqua will provide written notice to Lower Makefield customers of a base rate case filing and the level of increase in the first base rate case that includes the Lower Makefield assets; and (5) OCA, I&E, OSBA and Lower Makefield reserve their rights to fully address Aqua's proposal, and to make other rate proposals in the base rate case. Joint Petition, pp. 13-14.

I. Welcome Letter

Aqua's Position

Aqua has agreed to send a Welcome Letter to Lower Makefield wastewater customers within 30 days following Closing which will include information regarding the conversion to monthly billing for their sewer service, and notes that this settlement provision will ensure that Aqua's newly acquired customers are made aware of the conversion to monthly billing in a timely manner. Aqua St. in Support p.15.

I&E's Position

I&E notes that, as part of its Welcome Letter to newly acquired Lower Makefield customers, Aqua will include information about the conversion to monthly billing for their sewer service. I&E explains that this will ensure that acquired customers fully understand the billing cycle of their new provider and that acquired customers will have a clear understanding of their new billing period for wastewater service. I&E St. in Support pp. 12-13.

OCA's Position

OCA submits that this settlement provision is reasonable and will provide timely information that may be helpful to some of the Lower Makefield customers. OCA St. in Support p.10.

OSBA's Position

OSBA submits these provisions commit Aqua to providing its newly acquired customers with important information in a timely manner. OSBA St. in Support p. 7.

Lower Makefield Township's Position

The Township points out that the welcome letter will provide important information regarding the transition to monthly billing for wastewater service. Township St. in Support p. 8.

Discussion

Aqua has agreed to send a Welcome Letter to Lower Makefield wastewater customers within 30 days following Closing which will include information regarding the conversion to monthly billing for their sewer service. This settlement provision is in the public interest and will ensure that the newly acquired customers are made aware of the conversion to monthly billing in a timely manner. Joint Petition p. 14.

J. Legal Fees

Aqua's Position

Aqua has agreed to separately identify, in its next base rate case, any legal fees included in the transaction and closing costs and specify amounts expended by Aqua on behalf of

Lower Makefield with I&E, OCA, and OSBA reserving the right to challenge the reasonableness, prudence, and basis for such fees. Aqua St. in Support pp. 15-16.

I&E's Position

I&E submits that Aqua's commitment to separately identify any legal fees included in its transaction and closing costs pursuant to the APA between Aqua and Lower Makefield is consistent with ensuring that Aqua will only be permitted to recover prudently incurred costs from ratepayers. I&E explains that these terms protect ratepayers from paying unwarranted costs and promote rate affordability and ensures that I&E will be able to challenge the basis of any claimed Lower Makefield legal fees in Aqua's next base rate case. I&E St. in Support p. 13.

I&E further notes that Aqua agreed that if it ever does make a claim for any Lower Makefield legal fees in a future base rate case, it will separately identify those fees, ensuring that I&E, and other interested parties will easily be able to identify any portion of claimed fees. I&E St. in Support pp. 13-14.

OCA's Position

Paragraph J reflects Aqua's agreement to separately identify any legal fees included in its transaction and closing costs pursuant to the APA between Aqua and Lower Makefield Township and specify amounts expended by Aqua on behalf of the Township. Joint Petition p. 14. OCA submits that Aqua's agreement to separately identify any legal fees included in its transaction and closing costs pursuant to the APA and to specify amounts expended by Aqua on behalf of the Township provides for a full review of any outside legal fees included in transaction and closing costs pursuant to the APA in future rate cases. OCA St. in Support p. 11.

OSBA's Position

OSBA asserts that this settlement provision protects small C&I customers as it requires Aqua to provide a meaningful opportunity for the Statutory Advocates to review these fees, and, if necessary, to challenge these fees. OSBA St. in Support p. 7.

Lower Makefield Township's Position

The Township supports these settlement provisions. Township St. in Support p. 8.

Discussion

As a part of the Settlement, Aqua has agreed to separately identify legal fees included in its transaction and closing costs pursuant to the APA between Aqua and Lower Makefield, and specify amounts expended by Aqua on behalf of the Township. Partial Settlement ¶ 22(J). In addition, the Statutory Advocates reserve the right to challenge the reasonableness and basis for these legal fees. Joint Petition p. 14.

As noted by I&E, Aqua's commitment to separately identify these legal fees is consistent with ensuring that Aqua will only be permitted to recover prudently incurred costs from ratepayers, protect ratepayers from paying unwarranted costs and promote rate affordability. Additionally, the Settlement term also ensures that statutory parties will be able to challenge the basis of any claimed Lower Makefield legal fees. I&E St. in Support p. 13.

As I&E further explains, Aqua's agreement to separately identify such fees ensures that interested parties will easily be able to identify any portion of claimed fees, easing the administrative burden of uncovering this information when Aqua files its next rate case, which may be several years from now and be complicated by the complexity of the resulting rate investigation. Accordingly, as I&E concluded, these combined commitments will protect Aqua's

ratepayers from bearing the burden of Lower Makefield's legal fees. I&E St. in Support p.p. 13-14.

K. Section 507 Approval and Other Approvals, Certificates, Registrations and Relief, if any, under the Code

Aqua's Position

1. Section 507 Approval

Aqua submits there is no opposition to the issuance of the Certificates of Filing for the contracts listed in the Joint Petition, which are necessary for the ownership and operation of the Lower Makefield system and Aqua asks that the Commission issue the Certificates. Aqua St. in Support p. 18.

2. Other Approvals, Certificates, Registrations and Relief

Aqua further submits that it's Application asked the Commission to issue such other approvals, certificates, registrations and relief, if any, that may be required with respect to Aqua's acquisition of the Lower Makefield wastewater system assets. Aqua asks that the Commission incorporate the contracts listed in the Joint Petition in its Opinion and Order approving the Application. Aqua St. in Support pp. 16-18.

I&E's Position

I&E submits that Aqua's Application meets the requisite standards necessary for approval and supports the Partial Settlement's provision that issuance of any necessary approvals or certificates necessary to carry out the transaction is appropriate and warranted. I&E St. in Support p. 13.

OCA's Position

OCA does not join in this provision but, in furtherance of settlement, does not oppose Aqua's request. OCA St. in Support p. 11.

OSBA's Position

As the OSBA has determined that the relief requested in the Application, as modified by the Partial Settlement, is in the public interest, the OSBA supports this provision that the Commission shall issue Certificates of Filing or approvals for the enumerated agreements in the Partial Settlement pursuant to 66 Pa. C.S. § 507 any other necessary approvals to complete the acquisition of the Lower Makefield wastewater systems by Aqua. OSBA St. in Support pp. 7-8.

Lower Makefield Township's Position

The Township agrees with this settlement provision and requests that the Commission issue such other approvals, certificates, registrations and relief, if any, that may be required with respect to Aqua's acquisition of Lower Makefield's wastewater system assets. Township St. in Support pp. 8-9.

Discussion

Under Paragraph 22.A(2) of the Joint Petition for Partial Settlement, Aqua's request for approval of Section 507 agreements is permitted. Joint Petition pp. 14-17.

Aqua's Application addresses the assignment of contracts¹⁹ which are critical to ensuring that Aqua's ratepayers are protected and that acquired customers will receive safe, adequate, and reliable service and thus within the public interest.

¹⁹ Aqua's Application at Docket No. A-2021-3024267, ¶ 70.

Section 507 of the Code states that, except for contracts between a public utility and a municipal corporation to furnish service at tariff rates, no contract or agreement between a public utility and a municipal corporation shall be valid unless filed with the Commission at least 30 days prior to its effective date. 66 Pa.C.S § 507

The Joint Petition asks that the Commission issue Certificates of Filing, pursuant to Section 507, for the following:

- i. Asset Purchase Agreement, dated September 17, 2020, by and between Lower Makefield Township and Aqua Pennsylvania Wastewater, Inc.
- ii. Sewage Transportation Agreement, dated November 20, 2015, by and among the Municipal Sewer Authority of the Township of Lower Makefield, Lower Makefield Township, and Yardley Borough Sewer Authority
- iii. Agreement, dated September 1, 1977, by and among the Municipal Authority of the Borough of Morrisville, Borough of Yardley, Yardley Borough Sewer Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield
- iv. Agreement, dated February 18, 1982 by and between the Municipal Authority of the Borough of Morrisville, Yardley Borough Sewer Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield
- v. Amendment Agreement, dated October 8, 1991, by and between the Municipal Authority of the Borough of Morrisville, Township of Lower Makefield, the Municipal Sewer Authority of the Township of Lower Makefield, and Yardley Borough Sewer Authority
- vi. Second Amendment Agreement, dated June 24, 1993, by and between the Municipal Authority of the Borough of Morrisville, Township of Lower Makefield, the Municipal Sewer Authority of the Township of Lower Makefield, and Yardley Borough Sewer Authority
- vii. Agreement, dated March 13, 1965, by and between the Township of Falls Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield
- viii. First Supplemental Agreement, dated February 6, 1975, by and between the Township of Falls Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield

- ix. Agreement, dated December 12, 1988, by and between the Township of Lower Makefield, the Municipal Sewer Authority of the Township of Lower Makefield, and the Township of Falls Authority
- x. Agreement, dated April 18, 1996, by and between the Township of Falls, the Township of Lower Makefield, and the Lower Makefield Township Sewer Authority
- xi. Agreement, dated April 11, 1974, by and between Middletown Township Bucks County Municipal Authority, Middletown Township Board of Supervisors, the Municipal Sewer Authority of the Township of Lower Makefield, Lower Makefield Township Board of Supervisors, and Bucks County Water and Sewer Authority
- xii. Addendum Agreement to be attached and made part of the Agreement dated April 11, 1974, by and between Middletown Township Bucks County Municipal Authority, Middletown Township Board of Supervisors, the Municipal Sewer Authority of the Township of Lower Makefield, and Lower Makefield Township Board of Supervisors
- xiii. Agreement, dated October 23, 1975, by and between the Bucks County Water and Sewer Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield
- xiv. Agreement, dated October 28, 1975, by and between the Bucks County Water and Sewer Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield
- xv. Supplemental Agreement Neshaminy Interceptor, dated February 7, 2018, by and between the Bucks County Water and Sewer Authority and the Township of Lower Makefield
- xvi. Agreement, dated January 28, 1980, by and between Middletown Township, Lower Makefield Township, the Municipal Sewer Authority of the Township of Lower Makefield, and the Bucks County Water and Sewer Authority
- xvii. Addendum Agreement, dated April 11, 1989, by and between Middletown Township, Lower Makefield Township, and the Municipal Sewer Authority of the Township of Lower Makefield
- xviii. Agreement, dated September 14, 1987, by and between Newtown Joint Municipal Authority and the Municipal Sewer Authority of the Township of Lower Makefield.²⁰

²⁰

Joint Petition pp. 10-17.

There is no opposition to the issuance of the Certificates of Filing for the contracts listed above and set forth in the Application.

L. Testimony From Public Input Hearing

Three individuals testified at the public input hearing to raise issues to be considered by the Commission, including the potential benefits to Aqua and Township residents, effect on neighboring Yardley Borough, potential costs for system improvements and rate increases, and alternatives to the sale of the system.

Barry Summers, a Protestant and customer of the system expressed concerns whether the acquisition would provide public benefit to the Township. He also testified that the possible impact on rates is outweighed by the recognized benefits of Aqua's ownership. Mr. Summers questioned the valuation of the system and asserted the Township is not honoring its fiduciary responsibility to the Township by completing the sale, which he believes is not in the best interests of the residents. Mr. Summers expressed concerns that Aqua has not identified the repairs it is committed to make to the system and testified the transaction would create significant additional expenses with no demonstrable improvement to the condition of the system.

Jeffrey Hall-Gale, a Township resident, testified that rate increases resulting from the transaction would be burdensome to Township ratepayers and that rates have been significantly increasing. He further expressed concerns that the transfer would have a negative impact on residents and customers of nearby Yardley Borough, that share the sewer system and wastewater treatment system.

Finally, Township resident Peter Lachance testified that proponents of a merger must demonstrate that the merger will affirmatively promote the service, accommodation, convenience or safety of the public in some substantial way and expressed his concern that future rates may substantially increase and should be considered. He also expressed concerns that the

expense of capital improvements to solve the inflow and infiltration problems and other aspects of the system would have on future rates.

The witnesses articulated relevant and legitimate concerns that were addressed by the Company and Settling Parties, in their filings in this Application proceeding.

VI. CONCLUSION

Given all of the foregoing, I conclude that the Settlement should be approved by the Commission without modification, because the Settlement is in the public interest. The Settlement will ensure that the Township residents will receive quality wastewater service from Aqua, a certificated public utility with the necessary financial, technical and legal resources to provide that service into the foreseeable future. Bringing the Township's existing customers into Aqua's customer base will also ensure that Township residents will have access to the Commission's procedures for investigating and enforcing any complaints that the residents may have regarding the Township's wastewater service. Additionally, future rate increases are subject to the Commission's jurisdiction.

In reaching the conclusion that the Settlement should be approved by the Commission without modification, concerns regarding the existing Township System were considered.

Pursuant to Section 1103 of the Code, 66 Pa.C.S. § 1103, Aqua must demonstrate that it is technically, financially, and legally fit to own and operate the System. Furthermore, no record evidence was presented challenging Aqua's technical, financial or legal fitness or expertise with regard to water and wastewater utility operations.

In addition to demonstrating fitness, Aqua must demonstrate that the Transaction and Aqua's ownership/operation of the System will affirmatively promote the service, accommodation, convenience, or safety of the public in some substantial way.²¹

²¹ *Popowsky v. Pa. Pub. Util. Comm'n*, 937 A.2d 1040, 1057 (Pa. 2007)

The Transaction benefits members of the public-at-large in that the Transaction promotes the Commission's policy favoring regionalization and consolidation of water and wastewater systems. 52 Pa. Code § 69.721(a). In addition, the Transaction benefits members of the public-at-large by promoting the Legislature's policy goals when it enacted Section 1329. 66 Pa.C.S. § 1329.

Where the active parties in a proceeding have reached a settlement, the principal issue for Commission consideration is whether the agreement reached is in the public interest.²² Aqua, I&E, OCA, OSBA and Lower Makefield have agreed that Aqua has the requisite technical, financial and legal fitness to own and operate the Lower Makefield system and submit that the resolution of issues as presented in the Partial Settlement will further the public interest. Joint Petition pp. 8-10.

The Joint Petitioners have also agreed that, in future Section 1329 acquisitions, the engineering assessment under 66 Pa.C.S. § 1329(a)(4) will designate the condition of the inventory and assets appraised, and the designation of condition shall be limited to those assets that can be observed and whether the categories of system assets are in poor, fair, good or very good condition. Aqua St. in Support p.11.

Regarding rights of ways, and liens, the Settlement gives Aqua discretion to Close without the transfer of all of the Real Property Rights, provided that an escrow is established from the Purchase Price to be used to obtain any post-Closing transfers of the Real Property Rights. Joint Petition p.p. 6-7.

With regard to approval of Section 507 Agreements, Section 507 of the Code, 66 Pa.C.S. § 507, requires that contracts between a public utility and a municipal corporation (except for contracts to furnish service at regular tariffed rates) be filed with the Commission at least 30 days before the effective date of the contract in order to be valid. The Commission may

²² *Pa. Pub. Util. Comm'n v. City of Lancaster – Bureau of Water*, Docket No. R-2010-2179103 (Opinion and Order entered July 14, 2011), citing *Warner v. GTE N., Inc.*, Docket No. C-00902815 (Opinion and Order entered April 1, 1996) and *Pa. P.U.C. v. C S Water and Sewer Assoc.*, 74 Pa. P.U.C. 767 (1991). See also *Pa. Pub. Util. Comm'n v. Phila. Elec Co.*, 60 Pa. P.U.C. 1 (1985).

allow the contract to become valid and issue a certificate of filing, unless prior to the effective date of the contract, 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.

Aqua seeks certificates of filing of various agreements enumerated in the Joint Petition. Joint Petition p.p. 15-17.

For the reasons discussed above, I recommend that the Commission approve the Settlement without modification. The discussion regarding the contested issues in this proceeding follows below.

VII. UNRESOLVED ISSUES

By the Joint Petition, Joint Petitioners proposed a resolution of all but two issues. The two issues not resolved through settlement are (1) the determination of ratemaking rate base and (2) income tax savings on repairs deductions.

A. Determination of Ratemaking Rate Base

The first unresolved issue to be addressed is, pursuant to Section 1329 of the Code, 66 Pa.C.S. § 1329, what is the ratemaking rate base of the wastewater system assets of Lower Makefield Township?

Aqua asserts the ratemaking rate base determined pursuant to Section 1329(c)(2) of the Code is \$53,000,000, being the lesser of the purchase price of \$53,000,000 negotiated by Aqua and Lower Makefield and the average of the fair market value appraisals of \$54,967,796. *Id.*

Section 1329 of the Code addresses the valuation of municipal assets. If the parties agree to the Section 1329 process, the acquiring public utility and the selling municipality each select a UVE from a list of experts maintained by the Commission. *Id.*

Aqua engaged the services of Gannett to provide a fair market value appraisal in accordance with the USPAP, utilizing the cost, market and income approaches. Lower Makefield engaged the services of AUS for the same purpose. Both firms were pre-certified as authorized UVEs. Aqua Main Brief pp. 6-7.

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), as advanced by Aqua is \$53,000,000, being the lesser of the negotiated purchase price of \$53,000,000 and the average of \$54,967,796. Aqua Main Brief p. 7.; 66 Pa.C.S. § 1329.

B. Legal Principles

In regard to the ratemaking rate base, Section 1329(c) directs as follows:

- (c) **Ratemaking rate base.** – The following apply:
- (2) The ratemaking rate base of the selling utility shall be the lesser of the purchase price negotiated by the acquiring public utility or entity and selling utility or the *fair market value* of the selling utility.^[23]

Section 1329(g) defines “fair market value” as “[t]he average of the two utility valuation expert appraisals conducted under subsection (a)(2).” *Id.*

The negotiated purchase price is \$53,000,000. The average of the Gannett and AUS fair market value appraisals, the “fair market value”, is \$54,967,796. The ratemaking rate base of the Lower Makefield wastewater system, Aqua asserts, is \$53,000,000.

C. Aqua's Application

Aqua and Lower Makefield negotiated a purchase price of \$53,000,000 for the wastewater system. They agreed to use the process presented in Section 1329 to determine the fair market value of the wastewater system and the ratemaking rate base. Aqua Main Brief p. 8.

²³ 66 Pa.C.S. § 1329(c)(2) (emphasis added).

Aqua engaged the services of Gannett to provide a fair market value appraisal in accordance with USPAP, utilizing the cost, market and income approaches. Lower Makefield engaged the services of AUS for the same purpose.

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. Aqua Main Brief pp. 8-9; 66 Pa.C.S. § 1329.

The results of the Gannett analyses and calculations are as follows:²⁴

<u>Valuation Approach</u>	<u>Indicated Value</u>	<u>Weight</u>	<u>Weighted Value</u>
Cost Approach	\$54,531,935	33.33%	\$18,175,494
Market Approach	\$58,239,781	33.34%	\$19,417,143
Income Approach	\$53,741,785	33.33%	\$17,912,137
		100%	\$55,504,774
Conclusion			\$55,505,000

The results of the AUS analyses and calculations are as follows:²⁵

<u>Valuation Approach</u>	<u>Indicated Value</u>	<u>Weight</u>	<u>Weighted Value</u>
Cost Approach	\$51,414,555	50%	\$25,707,278
Market Approach	\$55,741,285	10%	\$5,574,129
Income Approach	\$57,872,959	40%	\$23,149,184
		100%	\$54,430,591
Conclusion			\$54,430,591

²⁴ Aqua St. No. 4 at 13.

²⁵ Aqua St. No. 5 at 3.

D. Challenges to the UVE Appraisals

OCA witness Ralph Smith (Mr. Smith) proposed adjustments to several of the UVE appraisal approaches. Aqua asserts that Mr. Smith proposed adjustments do not meet a standard of value of fair market value and are in direct violation of Section 1329 of the Code.²⁶

a. Cost Approach

OCA witness Smith proposed an adjustment to the AUS Cost Approach analysis based on the use of shorter service life for Gravity Collection Mains. The use of a shorter service life reduces the valuation result under the Cost Approach. Mr. Smith did not propose an adjustment to the Gannett Cost Approach analysis. Aqua Main Brief p.11.

b. The AUS Cost Approach – Service Life for Gravity Collection Mains

In the AUS appraisal, the Cost Approach to value is the cost to acquire or build a similar property based on reproduction/replacement cost. Aqua asserts within the AUS Cost Approach, service lives used in depreciation and functional obsolescence calculations were developed based on (1) the specific property and its use; (2) AUS' experience in developing depreciation studies for the water and wastewater industries; and (3) depreciation studies filed with Pennsylvania American Water Company (PAWC) and Aqua rate cases.²⁷

LMT engaged the services of AUS and Aqua engaged the services of Gannett to perform fair market value analyses of the system. In support of the AUS development of service lives for the Cost Approach, Aqua explains that Jerome C. Weinert (Mr. Weinert) of AUS, emphasized, in each of their recent rate case filings, PAWC and Aqua filed depreciation studies in support of their depreciation service lives and associated depreciation expenses contained

²⁶ Aqua St. No. 4-R at 2; Aqua Main Brief p. 11; 66 Pa.C.S. § 1329.

²⁷ Aqua Exhibit No. 1, Application Exhibit R at 5.

within their revenue requirement calculations. The depreciation studies were prepared by Gannett, a recognized firm in the depreciation consulting area.²⁸

OCA witness Smith recommends a shorter service life of 65 years for Gravity Collection Mains, which reduces the AUS Cost Approach by \$4,714,000 from \$51,414,555 to \$46,700,407. In support of his recommendation Mr. Smith explains that Gannett used a service life of 65 years for Gravity Collection Mains in its Appraisal; that the issue was previously addressed in the *Cheltenham* proceeding; and cites a lack of documentation concerning the type and age of pipe in the Township system.²⁹ Aqua asserts that one would expect methods and results to differ from one appraisal to another. Aqua Main Brief pp. 11-12.

Mr. Weinert emphasized that Mr. Smith's attempt to shorten the service life for Gravity Collection Mains is not reflective of, and is at odds with, the new practice of relining existing pipe and associated manholes with cure-in-place plastic (CIPP) linings, which Aqua submits, significantly *extends* the life of existing pipe.³⁰ Aqua Main Brief p. 12.

Aqua submits that the use of CIPP linings has the effect of extending the useful service life of mains and manholes by 50 years thus pushing the useful life of these assets into the low 100-year range. Mr. Weinert explained that this is the reason, if one closely examines the service life statistics, that PAWC service life statistics increase from one study to the next i.e., 2016 – 70-years to 2019 – 80 years. Aqua asserts it can be anticipated that this increasing service life will continue as more mains and manholes are relined. Aqua Main Brief p. 12.

Aqua further asserts that Mr. Smith's criticism of Mr. Weinert's use of an 80-year service life for Gravity Collection Mains is not reasonable.³¹ Mr. Weinert further pointed out that a service life for Gravity Collection Mains in the range of 75 years to 80 years is supported

²⁸ Aqua Exhibit No. 1, Application Exhibit R at 5.

²⁹ OCA St. No. 1 at 35-38.

³⁰ Aqua St. No. 5-R at 6.

³¹ Aqua St. No. 5-R at 6 (emphasis added); Aqua Main Brief p. 13.

by depreciation studies filed by Aqua and PAWC in their recent general rate proceedings.³² Aqua explains the depreciation parameters determined in those depreciation studies were the result of analysis of historical survival and retirement experience over a wide span of years thus representing actual service life experience of wastewater plant.³³ Aqua Main Brief p.p. 12-13.

Aqua concludes that Mr. Weinert's use of an 80-year service life for Gravity Collection Mains is reflective of new maintenance practices and consistent with recent depreciation studies of Aqua and PAWC, and submits the AUS Cost Approach to value is \$51,414,555. Aqua Main Brief p. 13.

c. Income Approach

Introduction

Section 1329 requires the UVEs to conduct a fair market value appraisal of the seller's system using the cost, market and income approaches to valuation. 66 Pa.C.S. § 1329. OCA witness Smith criticized the "terminal value" component of the Income Approaches of both Gannett and AUS. Mr. Smith proposes a terminal value using the amount of Net Plant less Accumulated Deferred Income Taxes (ADIT).³⁴ Aqua Main Brief p. 14.

Aqua submits that Mr. Smith's criticism of the Gannett and AUS terminal value has been presented in several Section 1329 proceedings and roundly rejected by the certified UVEs in each instance. Aqua argues the base failing of Mr. Smith's criticism is that it changes 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

³² The three depreciation studies used in the AUS analysis included data dated back to the early 1900's in two cases and to the mid-1900's in the third case representing a span of time of over 100 years, which is well in excess of one lifecycle. In contrast, the West Virginia case cited by Mr. Smith dates back to only 1996, which is much less than one lifecycle and much less than what is necessary to have reliable statistical analysis of service life. Tr. 60.

³³ Aqua St. No. 5-R at 4-5.

³⁴ OCA St. No. 1 at 33.

Approach. As such, Aqua argues, it is 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. *Id.*

Aqua submits the Commission rejected the proposed use of net plant as the terminal value in the Income Approach in the *Cheltenham* Section 1329 proceeding at Docket No. A-2019-3008491.³⁵

In his direct testimony, Mr. Smith testified that the “income approach involves capitalizing and discounting a future income stream to a present value.”³⁶ That being the case, Aqua asserts it is simply wrong, and, indeed, inconsistent with his own testimony, for Mr. Smith to propose a terminal value based on something other than a present value analysis. Aqua Main Brief p.p. 14-15.

d. The Gannett Income Approach

Aqua points out the Gannett Appraisal explains that the Income Approach theorizes that the value of a business is the future economic benefit that ownership will provide. Capitalizing or discounting a future income stream to a present value provides an indication of the value of a business. The capitalization or discount rate reflects future growth, business risk, economic factors, financial risk and industry risk of the assets.³⁷ Aqua Main Brief p. 15.

The two most common methods of the Income Approach are the capitalization of earning or cash flow method and the discounted cash flow method (DCF). The capitalization of earning method converts a single base economic income number to a value by dividing it by a capitalization rate. The DCF method uses estimates of future free cash flow and discounts them

³⁵ Aqua St. No. 4-R at 7.

³⁶ OCA St. No. 1 at 30.

³⁷ Aqua Exhibit No. 1, Application Exhibit Q at 27.

to arrive at a present value or price of the cash flows.³⁸ Gannett’s Income Approach using the DCF method indicated a value of \$53,741,785 for the Lower Makefield system. Aqua Main Brief p. 15.

Mr. Smith criticizes the manner of determining the “terminal value” used in the Gannett Income Approach (DCF model). Mr. Smith expresses concerns regarding the application of a capitalization rate concept to estimate terminal value. In lieu of a capitalization rate concept, Mr. Smith recommends use of net plant value as the terminal value in the Income Approach. The end-result of Mr. Smith’s adjustment to the “terminal value” in the DCF model is a downward, or negative, adjustment of \$3,311,627 to the Gannett Income Approach to value.³⁹ Aqua Main Brief pp. 15-16.

Aqua argues that Mr. Smith’s criticism of the Gannett terminal value should be denied. Gannett has applied a capitalization rate concept to estimate terminal value in *sixteen* Section 1329 proceedings and the Commission has not adjusted the concept in any one of those prior *sixteen* proceedings.⁴⁰ Administrative Law Judge Jones and the Commission, moreover, *rejected* the use of net plant value as the terminal value in the *Cheltenham* proceeding as set forth above.⁴¹ Aqua Main Brief p. 16.

Within the DCF model, Aqua asserts the “terminal value” is simply a point in time in which the growth in annual Debt Free Net Cash Flows changes from multiple growth rates to a constant growth rate. Within the DCF analysis, the growth rate of annual Debt Free Net Cash Flows during time periods 1 through 24 (year 2022 through 2045) changes multiple

³⁸ Aqua Exhibit No. 1, Application Exhibit Q at 27-28.

³⁹ See Aqua St. No. 4-R at 2 and OCA St. No. 1 at 33. In his surrebuttal testimony, Mr. Smith increased his proposed adjustment to \$4,024,687 to correct an oversight in preparing his Exhibit RCS-2. He suggests that this oversight occurred because Gannett had not identified an amount for Accumulated Deferred Income Taxes (ADIT) in its valuation supporting details. OCA St. No. 1SR at 15. Mr. Smith’s claimed oversight is addressed below.

⁴⁰ Aqua St. No. 4-R at 3.

⁴¹ Aqua St. No. 4-R at 7.

times due to the various assumptions listed in the Gannett Appraisal. After time period 24 (year 2045), the growth in annual Debt Free Net Cash Flows is a constant growth rate. The “terminal value” is simply the present value of future Debt Free Net Cash Flows from time period 24 (year 2045) forward. Under the Income Approach, a terminal value can also be thought of as the future market value, or future sale price, of existing assets.⁴² The Gannett terminal value at year 24 ranges from \$55,984,235 to \$63,887,294 from time period 24 (year 2045).⁴³ Aqua Main Brief pp. 16-17.

Mr. Smith recommends using the \$56.320 million net plant value from time period 24 (year 2045) as the terminal value. Mr. Smith’s recommendation defeats or eliminates the need to appraise plant assets since the indicated value of net cost of the plant assets is simply the net cost of the plant assets under Mr. Smith’s recommendation. If Mr. Smith were correct, then Aqua argues an original cost less depreciation analysis would be the only method needed to value assets. However, Aqua asserts the value of the investment in plant and equipment for the Lower Makefield wastewater system assets is being determined in this proceeding based upon a standard of value of fair market value, not a standard of value of original cost.⁴⁴ Aqua Main Brief p. 17.

Aqua asserts that Mr. Smith’s criticism of, and his proposed adjustment to, the Gannett Income Approach is not in accordance with valuation practice. The use of a “terminal value” in the DCF model, Aqua asserts, is a mathematical shortcut to avoid having to show and/or calculate annual Debt Free Net Cash Flows for hundreds of time periods, or hundreds of years, and is practical and is in accordance with accepted valuation practice. Conversely, Aqua argues Mr. Smith’s proposed alternative of using net plant value from time period 24 (year 2045) as the terminal value is not in accordance with accepted valuation practice and is not reasonable.⁴⁵ Aqua Main Brief p. 17.

⁴² Aqua St. No. 4-R at 4.

⁴³ Aqua Exhibit No. 1, Application Exhibit Q, Exhibit 15, page 6.

⁴⁴ Aqua St. No. 4-R at 4-5.

⁴⁵ Aqua St. No. 4-R at 5; *see also* Tr. 40.

Aqua witness Harold Walker, III. (Mr. Walker) of Gannett Fleming, provided an evidentiary analysis demonstrating that “net plant value” is not a good measure or proxy for future market value. The Gannett Appraisal lists the current market multiples applicable to the corresponding financial and operating statistics of the Lower Makefield system.⁴⁶ These market multiples and the corresponding financial and operating statistics of the Lower Makefield wastewater system that were utilized by Mr. Smith are presented in “Table 1” at page 6 of Aqua Statement No. 4-R.⁴⁷ Aqua Main Brief pp. 17-18.

As shown in Table 1 of Aqua Statement No. 4-R, Aqua asserts the indicated future market value in period 24 (year 2045) applicable to each metric range from \$81.664 million to \$169.716 million, and collectively proves net plant value (i.e., \$56.320 million) is not a good measure or proxy of the future market value, or sales price, of existing assets since the indicated future market value is about 194% higher than Mr. Smith’s recommendation of \$56.320 million (year 2045).⁴⁸ Accordingly, Aqua concludes Mr. Smith’s “terminal value” criticism should be rejected. Aqua Main Brief p. 18.

Mr. Smith made other assertions that Mr. Walker reviewed and countered. First, in the context presented in Mr. Smith’s testimony, Mr. Walker disagreed with Mr. Smith’s assertion that a “regulated utility’s net cash flow is a direct function of its plant in service.” Aqua Main Brief p. 18. The value of the investment in plant and equipment for the Lower Makefield wastewater system assets is being determined in these proceedings. The appraised value estimated by AUS and Gannett is \$54.4 million and \$55.5 million, respectively (OCA Exhibit RCS-1). The purchase price negotiated by Aqua and the Township is \$53 million (OCA Exhibit RCS-1); all of which are considerably higher than the present value of terminal value of net cost of the plant and equipment of \$28.1 million to \$10.0 million used by Mr. Smith (OCA Exhibit RCS-1, pages 2 and 3, respectively).⁴⁹ Aqua Main Brief p. 18.

⁴⁶ Aqua Exhibit 1, Application Exhibit Q, Exhibit 17, page 1 of 3.

⁴⁷ Aqua St. No. 4-R at 6.

⁴⁸ Aqua St. No. 4-R at 6-7.

⁴⁹ Aqua St. No. 4-R at 7.

Second, Aqua asserts Mr. Smith is incorrect when he states that under the UVE assumptions and modeling techniques, the Lower Makefield wastewater utility is depreciating and using up its existing plant faster, and to a higher degree, than it is making investments to replace that plant. To the contrary, over the course of the 24-year DCF model the depreciation expense totals \$48.251 million and the capital expenditures total \$53.979 million (OCA Exhibit RCS-3, pages 2 and 3). 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 (\$2.357M - \$2.321M) difference between depreciation expense and the capital expenditures, it would take 1,564 years to use up existing plant ($\$56.320 \div \$0.036 = 1,564$).⁵⁰ Aqua Main Brief p.p. 18-19.

Third, Mr. Smith, in his direct testimony, did not recalculate the valuation of the terminal value using the amount of net plant less accumulated deferred income taxes remaining at the end of year 24 on Exhibit RCS-2 regarding Gannett Fleming's terminal value. He acknowledged that he did not do so in his surrebuttal testimony and then presented a revised terminal value net of ADIT. He claimed that his failure to reflect his ADIT adjustment in his initial presentation was an oversight and suggested that it occurred because Gannett had not identified an ADIT amount in its valuation support details.⁵¹ Aqua Main Brief p. 19.

Mr. Walker further addressed Mr. Smith's use of net plant as the terminal value in the Income Approach in his oral rejoinder testimony in response to Mr. Smith's surrebuttal testimony. He had four observational criticisms. First, as pointed out above, the use of original cost net plant as the terminal value is incorrect. Second, Mr. Smith used an incorrect present value factor of 7.61% to analyze and attempt to refute the Gannett analysis. Gannett used a present value factor 7.14%. Third, Mr. Smith used a hypothetical value for ADIT in his analysis, which is, simply, wrong. The ratio of ADIT to net plant is never the same for two companies or two Income Approaches. Fourth, Mr. Smith failed to include in his analysis the cash flows from

⁵⁰ Aqua St. No. 4-R at 8.

⁵¹ OCA St. No. 1SR at 15.

the deferred taxes that created the ADIT. Including these positive cash flows in the analysis more than offset the negative effect of ADIT.⁵² Aqua Main Brief pp. 19-20.

In its Reply Brief, Aqua takes exception to OCA's criticism to Mr. Walker's testimony, regarding the Gannett Income Approach, 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. Aqua argues the criticism is a mischaracterization of Mr. Walker's testimony. According to Aqua, 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 difference between depreciation expense and the capital expenditures, it would take 1,564 years to use up dollars of existing plant ($\$56.320 \div \$0.036 = 1,564$) investment. Aqua Reply Brief p. 7.

e. The AUS Income Approach

The AUS Fair Market Value Appraisal explains that the theory behind the income approach is that the value of a business is based on its economic returns. Capitalizing or discounting a future income stream to a present value provides an indication of the value of a business. The capitalization or discount rate reflects future growth, business risk, economic factors, financial risk and industry risk of the assets.⁵³ The AUS Income Approach indicated a value of \$57,872,959 for the Lower Makefield system. Aqua Main Brief p. 20.

Similar to his proposed adjustment to the terminal value in the Gannett Income Approach, Mr. Smith proposed an adjustment to the terminal value in the AUS Income Approach based on the use of net plant as the terminal value. In support of his adjustment, Mr. Smith refers to the discussion of his adjustment to the terminal value in the Gannett Income

⁵² Tr. 42-47.

⁵³ Aqua Exhibit No. 1, Application Exhibit Q at 33.

Approach.⁵⁴ Aqua asserts, the end-result of Mr. Smith’s adjustment is a downward, or negative, adjustment of \$9.41 million to the AUS Income Approach to value.⁵⁵

Aqua concludes that Mr. Smith’s proposed use of net plant as the terminal value in the AUS Income Approach to value should be denied and rejected for the same reasons set forth above in the discussion of Mr. Smith’s proposed use of net plant as the terminal value in the Gannett Income Approach to value. Aqua Main Brief p. 21.

Mr. Weinert explained further why he concludes Mr. Smith’s proposed use of net plant as the terminal value is not reasonable. Mr. Weinert pointed out that Mr. Smith’s analysis replicates AUS’ DCF analysis *with the exception of period 20 and beyond* for which he substituted a net book value adjusted for ADIT. Aqua asserts that Mr. Smith’s analysis is incorrect in several ways:⁵⁶

1. It eliminates the benefits to the owner and customers of operating the property efficiently.
2. It ignores that fact that the Lower Makefield property will continue to remain in service to the benefit of the owner and customers for many years past period 19 of the DCF analysis, which the capitalization of the operation’s cashflows related to periods 20 and beyond is intended to represent.
3. It also ignores the fact that, during the forecast of future periods cashflows, each of those period’s capital expenditures are reflected and during the forecast periods those capital expenditures amount to \$7.6 million. These capital expenditures reflect plant renewal which will allow the Lower Makefield property to continue to provide service for the Lower Makefield customers, and as result will provide economic benefit to the property’s owner which is the fundamental premise of the Income Approach in appraisal determination. As stated in the AUS appraisal, “The income approach to value establishes the

⁵⁴ OCA St. No 1 at 38.

⁵⁵ OCA St. No. 1 at 38.

⁵⁶ Aqua St. No. 5-R at 9.

value of the property based on its economic returns.” Aqua Main Brief p. 21.

In the table presented in his rebuttal testimony, Mr. Weinert demonstrated that, if the AUS DCF forecast period is increased from 20 periods to 60 periods, the impact of ADIT declines from \$4,871,174 to \$948,406 with a corresponding present worth of cash flows being \$57,809,909 (using Mr. Smith’s methodology) in comparison to AUS’ original Income Approach indicated value of \$57,872,959. Aqua argues Mr. Smith’s adjustment of AUS’ Income Approach to value by a negative \$9.41 million to \$48,462,957 does not capture or quantify the entirety of the economic returns of Lower Makefield.⁵⁷ Aqua Main Brief pp. 21-22.

f. Market Approach

Mr. Smith did not recommend any adjustments to the Gannett Market Approach to value.⁵⁸ Mr. Smith, however, did propose an adjustment to the AUS Market Approach to value. Specifically, he testified that the DELCORA acquisition be removed from AUS’ comparison group.⁵⁹ Aqua explains the adjustment has no impact on AUS’ Market Approach to value of \$55,741,000.⁶⁰ Aqua Main Brief p. 22.

Mr. Weinert explained that, although the DELCORA acquisition has not been finalized, it is not necessary to exclude the Aqua-DELCORA wastewater acquisition as a comparable, as the purchase price used in the AUS Consultants Market Approach is a comparison of 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).⁶¹ Since the comparison used is of a purchase price in the

⁵⁷ Aqua St. No. 5-R at 10-11 and Tr. 71-72.

⁵⁸ OCA St. No. 1 at 34.

⁵⁹ OCA St. No. 1 at 38-39.

⁶⁰ OCA St. No. 1 at 38-39.

⁶¹ Aqua St. No. 5-R at 11-12.

original asset purchase agreement, Aqua asserts Mr. Smith's criticism of the AUS Market Approach and proposed removal of the Aqua-DELCORA transaction from the AUS comparables should be rejected. Aqua Main Brief p. 22.

Aqua concludes 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. Aqua Main Brief p. 22.

g. OCA's Position

OCA submits that the appraisals submitted by Aqua for the Seller and Buyer must be revised to reflect the flaws identified by the OCA and discussed below. As a result of these corrections, the average of the two appraisals is less than the purchase price of \$53,000,000. The appropriate amount for ratemaking purposes, according to OCA should be \$51.236 million. OCA Table I, Col. G, Ln. 15; Aqua Main Brief p. 7.

In this proceeding, the two appraisal values were \$55,505,000 (Gannett Fleming) and \$54,430,591 (AUS Consultants). The average of the two appraisals is \$54,967,796. OCA Table I at Col. C, Ln. 13; OCA St. 1-SR at 21. Aqua has proposed a rate base of \$53,000,000 (the purchase price) for the Lower Makefield assets it will acquire because the purchase price is lower than the average of the two appraisals. Using an engineering assessment performed by Ebert Engineering, Inc., Gannett Fleming shows the original cost of Lower Makefield's wastewater system and land to be \$32,003,924, with accumulated depreciation of \$12,195,650 and a net book value of \$19,808,274.⁶² OCA St. 1 at 21-22; OCA Main Brief p. 7.

⁶² Under Section 1329, the net book value does not reflect an adjustment to remove customer contributions or Pennvest grant funds and thus is higher than it would be under original cost ratemaking calculations. See Aqua Exh. Q at 18-19.

OCA submits that Aqua’s proposed rate base is overstated due to errors and flaws in the appraisals, and the correct ratemaking rate base amount is \$51,236,259 under Section 1329. OCA Table I at Col. G, Ln. 15.

E. OCA’s Challenges to Aqua’s Application

The appraisals contained in Aqua’s Application were prepared by Gannett Fleming for Aqua and AUS for LMT Township.

Gannett Fleming’s appraisal determined as follows:

Appraisal Approach	Value Indicator	Weight	Weighted Value
Cost Approach	\$ 54,531,935	33.3300%	\$ 18,175,494
Income Approach	\$ 53,741,785	33.3300%	\$ 17,912,137
Market Approach	\$ 58,239,781	33.3400%	\$ 19,417,143
Total		100.0000%	\$ 55,504,774
Conclusion			\$ 55,505,000

OCA St. 1 at 28.

AUS’ appraisal is summarized as follows:

Appraisal Approach	Value Indicator	Weight	Weighted Value
Cost Approach	\$ 51,414,555	50.0000%	\$ 25,707,278
Income Approach	\$ 57,872,959	40.0000%	\$ 23,149,184
Market Approach	\$ 55,741,285	10.0000%	\$ 5,574,129
Total		100.0000%	\$ 54,430,590
Conclusion			\$ 54,431,000

OCA St. 1 at 35.

AUS gives different weight to each approach while Gannett Fleming gives equal weight to the Cost, Income, and Market approaches. OCA Table I. The indicated value under

each approach vary from approximately \$51,414,455 to \$58,239,781. *Id.* Even before reviewing the specifics of each consultant's analyses, OCA asserts it is clear that judgment is involved in the inputs used, the weighting given to each approach and the determinations. That is why two UVEs have reached different Fair Market Value (FMV) results for the Lower Makefield system. *See* 66 Pa. C.S. §§ 1329(a)(2)-(3). OCA Main Brief pp. 8-9.

As such, OCA submits that the Commission must carefully consider the alleged flaws in the appraisal results identified in the OCA's testimony. OCA witness Smith calculated that the adjusted Gannett Fleming appraisal result would be \$48,309,516, and the adjusted AUS appraisal result would be \$54,163,000, in order to properly reflect financial and ratemaking principles. OCA Table I at Col. G, Ln. 5, 10. The recalculated average of the two appraisal results is \$51,236,259, which is the amount 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 Table I at Col. G, Ln. 13; OCA Main Brief p. 9.

F. OCA Challenges to UVE Appraisals

The issue of whether parties can challenge Utility Valuation Expert (UVE) appraisals was decided in the *New Garden* proceeding. The Commission determined as follows:

Accordingly, we find that Section 1329 permits the Commission and the Parties to develop a record pertaining to the review and analysis of the fair market value appraisals of the UVEs.

Application of Aqua Pa. Wastewater, Inc., Docket No. A-2016-2580061, Order at 69 (June 29, 2017) (*New Garden*) (internal citations omitted). The ratemaking approvals of Section 1329 have to be reconciled with the requirement of Section 1301 of the Public Utility Code, 66 Pa. C.S. § 1301, requiring each rate to be just and reasonable and the requirements of Section 1102 that acquisitions provide substantial affirmative benefits.

In a subsequent Section 1329 proceeding, the Commission 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:

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.

Application of Aqua Pa. Wastewater, Inc., Docket No. A-2017-2605434, Order at 36 (Nov. 29, 2017) (*Limerick*). OCA submits that it would be inconsistent with the requirements of the Public Utility Code and prior Commission orders to permit Aqua to simply present a rate base number, show that the appraisers chose numbers to fill in all the blanks in the formulas, and not permit any review or challenges of those inputs. The Commission has already made the determination that challenges to appraisals are permissible.

a. Cost Approach

Cost Approach is defined as, “A procedure to estimate the current costs to reproduce or create a property with another of comparable use and marketability.” *See* OCA St. 1 at 28⁶³. OCA Witness Smith recommended adjustments to AUS’ Cost Approach valuation.

b. AUS Service Lives

In the AUS appraisal for the Township, Mr. Weinert used an 80-year service life for calculating the valuation of LMT’s Account 361 – Gravity collection Mains. OCA St. 1 at 35. At \$22.142 million, Account 361 is the largest single account in the LMT sewer system. *Id.* at 22. Mr. Weinert’s 80-year service life for Account 361 is 15 years longer than the 65 year service life utilized by Gannett Fleming for the same account. OCA St. 1 at 35. OCA witness Smith explained that under the Cost Approach, having a 15-year discrepancy in the estimated

⁶³ The American Society of Appraisers “Approaches to Value” accessed Jan. 27, 2017, <http://www.appraisers.org/Disciplines/Personal-Property/pp-appraiser-resources/approaches-to-value>.

service life for the largest account in the LMT sewer system could lead to misstated results. *Id.* at 35-36; OCA Main Brief p. 11.

Using an engineering assessment performed by Ebert Engineering Inc., Gannett Fleming shows that documentation was missing for the age, size and material of the gravity collection mains in the LMT system, however, estimates were made as follows:

Sanitary sewer pipes with missing original documents had their age, size, and material estimated with the help of the Township staff's institutional knowledge. Specifically, the sanitary gravity pipe material was assumed to be vitrified clay if the pipe was constructed before 1980. After 1980, the sanitary gravity pipe material was assumed to be SDR-35.

OCA St. 1 at 22, *citing* Aqua Exh. D at 2. As noted by Mr. Smith, Vitrified Clay Pipe (VCP) is pipe that was manufactured using clay and shale as raw materials and historically was widely used in gravity sanitary sewer collection mains. OCA St. 1 at 22. There are some disadvantages to using vitrified clay pipes which can become brittle, allowing cracks to form. OCA St. 1 at 22; OCA Main Brief p. 11.

OCA argues that Aqua has not met its burden of proof to support an 80-year service life for the account at issue. Given that there is missing documentation concerning the type and age of the pipe and the susceptibility of old VCP to cracking, for valuation purposes, OCA witness Smith recommended adjusting the 80-year service life used in AUS' appraisal to match the 65-year service life for this same account utilized by Gannett Fleming. OCA St. 1 at 23, 36; OCA Main Brief p. 12.

OCA cites a previous case involving Aqua and Mr. Weinert as Aqua's UVE, a somewhat similar issue regarding the Cost Approach and service lives for VCP was addressed and the OCA's adjustment was adopted. The Commission determined as follows:

Disposition

Upon review of the record, the ALJ's Recommended Decision and the Parties' Exceptions, we find that the ALJ properly considered and rejected Aqua's arguments regarding the use of a 90-year service life for VCP mains, laterals, and manholes in the AUS' cost approach. Aqua did not meet its burden of proof on this issue. It presented no testimony to support its arguments that "[t]he AUS extended service lives are also supported by the Engineer's Assessment and the AUS detailed cost approach calculations" and that using relining techniques extends the life expectancy of the mains. Aqua Exc. at 7. Mr. Weinert, AUS' UVE, in testimony did not address the relining of mains, so it is not clear whether AUS considered the relining of a very small portion of the collection mains to be relevant to the service life of the collection mains.

We find it compelling that, Mr. Walker, Aqua's UVE, based his appraisal on the same Engineer's Assessment and concluded that a 75-year service life for these same-lined VCP mains was appropriate. OCA R. Exc. at 4 (citing OCA St. 1 at 11). In addition, Aqua's own testimony indicates that the average age of the pipe in the system is approximately 75 years old. Aqua St. No. 2 at 8. Moreover, with Aqua's budgeted \$54.8 million for implementing corrective actions needed under the DEP Corrective Action Plan to address the system's chronic I&I, and the focus of the Corrective Action Plan on lines, manholes and laterals that may be sources of I&I, the service life of 90 years used by AUS is not reasonable. See Aqua St. No. 2 at 7. Accordingly, for all of the foregoing reasons stated above, we deny Aqua Exception No. 2.

We agree with the OCA that the use of a 75-year service life for VCP mains, laterals and manholes is both reasonable and consistent with Gannett Fleming's depreciation analysis under the cost approach in this proceeding. We also agree with the OCA that the correct adjustment amount to the AUS cost approach to reflect the adjustment from a 90-year to a 75-year service life for VCP mains, laterals and manholes is \$12,339,645 to the AUS cost approach (correcting the typographical error shown in the R.D. of \$12,319,645, see R.D. at 41). We shall grant OCA Exception No. 1. This produces an adjusted AUS cost approach result of \$37,544,813.

OCA St. 1 at 36-37, *citing Cheltenham* at 44-45. Moreover, at the evidentiary hearing in this proceeding, Mr. Weinert acknowledged that he relied on Gannett Fleming's depreciation studies in formulating his Cost Approach. Tr. at 77; OCA Main Brief p.p. 12-13.

OCA notes that, in Mr. Weinert's previous appraisals, he has typically used between 65 and 75 years as the service life for gravity collection systems. Moreover, Mr. Weinert's previous appraisals indicate his use of a 75-year service life for VCP. As noted above, in *Cheltenham* Mr. Weinert utilized a 75-year service life for VCP mains, laterals, and manholes, consistent with Gannett Fleming's depreciation analysis in that proceeding. *See Cheltenham* at 44-45; OCA Main Brief p. 13.

In *Limerick*, when an appraisal did not reasonably present a sufficient basis for Aqua's conclusion regarding collection main, the Commission determined as follows:

We agree that Aqua failed to provide any reasonable basis or any convincing evidence as to why the collection mains should be treated differently or as a special circumstance in HRG's valuation under the reproduction cost approach.

Limerick at 56. Similarly, here, OCA argues Mr. Weinert fails 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 collection mains that was used by Gannett Fleming in this proceeding. As such, OCA witness Smith recommended an adjustment of \$4,714,148 to the AUS appraisal to match the 65-year service life utilized by Gannett Fleming. OCA Table I at Col. D, Ln. 2. OCA submits that Mr. Smith's adjustment to the Cost Approach should be accepted. OCA Main Brief pp. 13-14.

c. Income Approach

Mr. Smith recommended several adjustments to the Income Approach analyses as discussed in OCA Statements 1 and 1SR. Mr. Smith's adjustments to Mr. Weinert's Income Approach analysis are \$48,462,957 (\$19,385,183 weighted result). OCA Table I at Ln. 2. Mr.

Smith's adjustments to Mr. Walker's Income Approach analysis are \$49,717,098 (\$16,570,709 weighted result). OCA Table I at Ln. 7; OCA Main Brief p. 14.

OCA explains the theory behind Income Approach valuation is that the value of a business is the future economic benefit that ownership will provide. OCA St. 1 at 29-30; OCA Main Brief, p. 14. OCA witness Smith described the Income Approach models utilized by the UVEs in this proceeding as follows:

The income approach models utilized by both the buyer and seller employ a discounted cash flow model wherein annual cash flows are projected based upon forecasted levels of revenues, cash O&M expenses, income taxes, capital expenditures and changes in working capital. These annual cash flows are modeled for a set number of years into the future and then a terminal value is added to the previous discounted annual cash flows as a measure of the expected cash flows in perpetuity.

OCA St. 1 at 30-31; OCA Main Brief p. 14.

OCA asserts the fundamental flaw in both UVE models is the calculation of terminal values for the LMT Township system. OCA St. 1 at 31. OCA witness Smith notes that, in calculating terminal values, both UVEs utilized a "capitalization rate" to project future cash flows in perpetuity. OCA witness Smith testified as follows:

In calculating the terminal value, both UVEs utilized what is known as a "capitalization rate" to project future cash flows in perpetuity. In simple terms, each UVE calculated a terminal value (in nominal terms) by applying the projected cash flow in the last year of the model to a capitalization rate. Specifically, the last model year's annual cash flow is multiplied by 1, and then divided by the calculated capitalization rate. Mathematically, this approach escalates annual cash flows at a constant annual growth rate (percent) in perpetuity. **It essentially assumes that net cash flows would grow at a constant annual growth rate to infinity.** A capitalization rate is defined as a firm's total cost of capital (k) minus its expected future annual constant rate of growth (g).

OCA St. 1 at 31 (emphasis added).

While the use of capitalization rates may be appropriate for evaluating project feasibilities and for valuing unregulated business enterprises, Mr. Smith explained that there are limitations to capitalization rates in valuing regulated public utilities. OCA St. 1 at 31-32. Regulated public utilities' revenues, income streams, and cash flows are directly based on the capital investments required to operate as a utility and rates are set using this rate base/rate of return method of ratemaking. *Id.* This is commonly referred to as the rate base/rate of return method of ratemaking. OCA St. 1 at 30. 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.

OCA St. 1 at 30; OCA Main Brief p. 15.

OCA argues the theory underlying the use of capitalization rates is that a firm's net cash flow will grow at a constant rate in perpetuity without significant reinvestment greater than historical depreciation. OCA St. 1 at 31. However, this is not the case for regulated utilities. A regulated utility's net cash flow is a direct function of its plant in service. OCA St. 1 at 32. A utility's net cash flow can, and will, only grow with increases to its plant investment and rate base. *Id.* In recent years, the LMT wastewater net plant balance/amount has been declining; however, over a sufficiently long period of time, it is expected that the LMT wastewater utility plant investment will grow as aging plant is replaced. OCA St. 1 at 32; OCA Main Brief p. 16.

OCA submits it is important to understand that, for a regulated utility, the valuation is a direct function of, and is exactly equal to, the selected investment. OCA St. 1 at 31. The utility recoups these additional investments over time through future depreciation rates. *Id.* at 32. Unlike the private sector, for rate regulated utilities, spending on plant additions is a *use* of cash and depreciation expense is a *source* of cash. OCA St. 1 at 32. This is the circularity issue identified by Mr. Smith that is present when using capitalization rates to value public

utilities under rate base/rate of return regulation. *Id.* This limitation to capitalization rates in relation to valuing regulated public utilities has not been recognized by the Gannett Fleming and AUS UVEs but should be considered when reviewing the assumptions used by each UVE in conducting the analyses. OCA Main Brief p. 16.

OCA submits that the failure to consider the source and use of cash in the valuation estimates that have been submitted on behalf of the buyer and the seller results in a significant overstatement of the terminal value. As Mr. Smith stated, a regulated utility's net cash flow "is a direct function of its plant in service in that a utility's net cash flow can, and will, only grow with increases to its plant investment (rate base)." OCA St. 1 at 30. He noted that, for discounted cash flow valuation purposes, "capital expenditures (that give rise to plant additions) are treated as a negative cash outflow during the year in which the expenditure is made and the utility recoups these additional investments over time through future depreciation rates (cash inflow)." OCA St. 1 at 32; OCA Main Brief p.p. 16-17.

OCA asserts the fatal flaw in both the buyer and seller UVEs' estimation of a "terminal" value is that the capital expenditures in the last year of the model are much less than the depreciation expense on existing plant during that year. OCA St. 1 at 32. That would mean that, according to the assumptions and modeling done by both UVEs, LMT would be depreciating and using up its plant faster, and to a higher degree, than it is making investments to replace that plant. OCA St. 1 at 32. OCA submits this practice cannot not be sustained. *Id.* The impact of those unfounded assumptions and modeling is to severely overstate the Income Approach valuation. OCA Main Brief p. 17.

Mr. Smith adjusted the income approach of Gannett Fleming's and AUS' UVEs to recalculate the terminal value using the amount of Net Plant less Accumulated Deferred Income Taxes projected to be remaining at the end of 2044 and 2049, respectively. OCA St. 1 at 33, 38. The terminal value approach used by Aqua and LMT unrealistically overstates the valuation and would result in excessive valuation and return and should not be adopted. Mr. Smith's approach ensures that investors will earn a fair rate of return over the life of the plant in service and will recoup their initial investment through depreciation. Mr. Smith's approach does

not increase rates to provide excessive returns over the life of the plant. Further, OCA submits Mr. Smith's approach is consistent with the most fundamental principles of ratemaking. OCA Main Brief p. 17.

d. AUS Income Approach Adjustment

On behalf of LMT, Mr. Weinert, with AUS, developed an Income Approach resulting in an estimated fair market value of \$57,872,959. OCA St. 1 at 35. AUS allocated 40% weight to the Income Approach which gave it a weighted value of \$23,149,184. *Id.*

Mr. Smith recommended an adjustment to the terminal value used in the AUS income approach. 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 Exhibit RCS-4. Mr. Smith's adjustment to terminal value results in an Income Approach valuation of \$48,462,957. OCA Table I. This adjustment reduces the AUS Income Approach amount by approximately \$9.41 million. OCA St. 1 at 38; OCA Main Brief pp. 17-18.

e. Gannett Fleming Income Approach Adjustment

On behalf of Aqua, Mr. Walker of Gannett Fleming, developed a valuation under the Income Approach resulting in an estimated fair market value of \$53,741,785. OCA St. 1 at 28, 33. Mr. Walker allocated 33.33% weight to that approach which gave it a weighted value of \$17,912,137. OCA St. 1 at 28.

In response to Mr. Smith's explanation that, under the UVE's assumptions, LMT would be depreciating and using up its plant faster than it is making investments to replace that plant, OCA asserts that Aqua witness Walker claimed in rebuttal testimony that that "it would take 1,564 years to use up existing plant." OCA St. 1-SR at 15; Aqua St. 4-R at 8. LMT's existing plant would be expected to be "used up" over the expected remaining life of that plant, however. A 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. 1-SR at 15. As such, OCA witness Smith 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* Exhibit RCS-2-SR, page 2; OCA Main Brief p. 18.

The adjusted Income Approach value of \$48,462,957 is \$5,278,828 lower than Mr. Walker's proposed amount of \$53,741,785. *See* OCA Table I.

f. Market Approach

In reaching his Market Approach valuation for the LMT system, Mr. Weinert included the Delaware County Regional Water Quality Authority (DELCORA) in his comparison group and indicated a final purchase price of \$276,500,000. OCA St. 1 at 38-39; Aqua Exh. R at 10. The Aqua-DELCORA acquisition, however, is an ongoing matter as the transaction has not closed. OCA notes the \$276,500,000 purchase price and ratemaking rate base proposed by Aqua in the DELCORA proceeding has not been finalized and, further, in March 2021, the Commission issued an Order to vacate the Recommended Decision, reopen the record, and remand the proceeding, which has since been stayed.⁶⁴ As such, OCA asserts including the DELCORA acquisition and indicating \$276,500,000 as the "final purchase price" for the DELCORA system is inaccurate and potentially misleading. OCA Main Brief p. 19.

OCA also asserts that Aquas argument should be rejected because it is inconsistent with the Final Supplemental Implementation Order (*FSIO*). *See implementation of section 1329 of the Public Utility Code, M-2016-254319, Final Supplemental Implementation Order (February 28, 2019)*. The FSIOs states as follows regarding the jurisdictional exceptions under the Market Approach:

⁶⁴ *Application of Aqua Pa. Wastewater, Inc., A-2017-2606103, ALJ Order Staying Proceeding (Apr. 16, 2021)*.

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).

As the DELCORA system has not been purchased for \$276,500,000, and as there is no final purchase price for the system, Mr. Smith recommended that the LMT acquisition be removed from AUS' comparison group. *See* OCA St. 1 at 39. Including the DELCORA system in the proxy group under the Market Approach and indicating a "final purchase price" for the DELCORA system is misleading and is purely speculative. Additionally, the DELCORA customers are not the currently customers of Aqua. The OCA notes that based on how the AUS Market Approach was derived, eliminating the DELCORA acquisition from the comparison group did not impact the final resulting valuation under the AUS Market Approach. OCA St. 1 at 39. The OCA submits, however, that removing the DELCORA acquisition AUS' proxy group for the LMT acquisition is reasonable, given the circumstances surrounding the pending Aqua-DELCORA acquisition. OCA Main Brief p.p. 19-20.

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, in order to properly reflect financial and ratemaking principles. OCA Table I 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 Table I at Col. G, 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. OCA Main Brief p. 20.

G. Resolution to 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 because 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, the Commission could not adjust the appraisals. *See* Aqua M.B. at 10-11.

OCA submits that 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 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. OCA Reply Brief p.p. 3-4.

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." *New Garden* at 53. 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.⁶⁵ OCA Reply Brief p. 4.

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.

Cheltenham at 39.

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 rates. 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

⁶⁵ See *Limerick* at 36. (“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.”).

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; OCA Reply Brief, p. 6.

OCA notes that it 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, OCA submits that Aqua's argument that Mr. Smith's testimony lacks support because he did not perform a separate appraisal is unreasonable. OCA Reply Brief p. 6.

c. Cost Approach

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

OCA witness Smith recommended adjustments to AUS' Cost Approach due to Mr. Weinert's 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. OCA notes 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; OCA Reply Brief p.7.

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. *Id.*

OCA explains 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. 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; OCA Reply Brief pp. 7-8.

Additionally, 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; OCA Reply Brief p. 8.

The Gravity Mains account is 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. OCA argues the 80-year estimated useful life for Gravity Mains proposed by Mr. Weinert is unreasonably long and should be rejected, and Mr. Smith's recommended adjustment to apply Gannett Fleming's 65-year estimated service life to the LMT Gravity Mains account should be adopted. OCA Reply Brief p. 8.

d. Income Approach

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; OCA Reply Brief p.p. 8-9.

OCA asserts 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; OCA Reply Brief p. 9.

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.⁶⁶ 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. OCA Reply Brief p. 9.

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 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; OCA Reply Brief pp. 9-10.

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

⁶⁶ It should be noted that Aqua does not provide citations to the "sixteen proceedings" that they reference.

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; OCA Reply Brief pp. 9-10.

OCA further submits that Aqua's arguments in regard to Annual Deferred Income Taxes 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.⁶⁷ 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; OCA Reply Brief pp. 10-11.

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 adjusted Gannett Fleming's

⁶⁷ 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.

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, p. 2; OCA Reply Brief p. 11.

OCA asserts 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; OCA Reply Brief p. 11.

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

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 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. 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 Commission-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.⁶⁸ 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; OCA Reply Brief pp. 12-13.

⁶⁸ 0.171 / 0.014 = 12.2 times.

OCA submits that Mr. Smith’s recommended adjustment to the AUS Income Approach result to \$48,462,957 is reasonable, supported, by the record and should be adopted. OCA St. 1SR at 10; OCA Exh. RCS-1 SR at Col. G, Ln. 11; OCA Reply Brief p. 13.

e. Market Approach

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.

OCA submits this argument lacks merit; the DELCORA acquisition is an outlier; all of the other acquisitions in the comparison group are closed transactions; and including the DELCORA acquisition and indicating \$276,500,000 as a “final purchase price” for that system is inaccurate and potentially misleading. OCA Reply Brief pp. 13-14.

OCA submits 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.⁶⁹ Additionally, the DELCORA customers are not currently customers of Aqua.

For these reasons, OCA submits Mr. Smith's recommendation to remove the DELCORA acquisition AUS' proxy group for the LMT acquisition is reasonable and should be adopted. OCA Reply Brief pp. 13-14.

H. Rate Making Rate Base 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-ISR 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-ISR, 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. OCA Reply Brief p. 14.

With regard to the question of the appropriate service life for Account No. 361, Gravity Collection Mains, a service life for gravity collection sewers municipally owned and consisting of a large quantity of Vitrified Clay Pipe, of 65 years, is appropriate and supported by the record evidence in this proceeding. The record evidence, specifically, the engineering assessment provided as Exhibit D to the Application identified the quantity of VCP in the Lower Makefield collection system.

⁶⁹ As discussed in the OCA's Main Brief, the DELCORA acquisition has not been approved by the Commission. The ALJ's 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).

Obviously, the appropriate service life is dependent on various factors including the materials used in the construction of the collection system. Aqua argues the use of CIPP linings has the effect of extending the useful service life of mains and manholes by 50 years thus pushing the useful life of these assets into the low 100-year range. Aqua Main Brief p. 12. The problem with this argument is that there is no evidence that Lower Makefield has used this technology to extend its service life of its VCP. The service life applied to the asset should be reflective of the actual assets being acquired in the condition that they are being acquired, in this case a collection system which includes of a large quantity of VCP installed by developers and the township.

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. Accordingly, OCA witness Smith recommended an adjustment of \$4,714,148 to the AUS appraisal to match the 65-year service life utilized by Gannett Fleming. OCA Table I at Col. D, Ln. 2. I agree with OCA and conclude that Mr. Smith's adjustment to the Cost Approach should be accepted.

Aqua, as the proponent of the Application, bears the burden of proof to establish that it is entitled to receive the relief requested in the Application.⁷⁰ Aqua must establish this burden, by a preponderance of evidence which is substantial and legally credible.⁷¹ In order to meet its burden of proof, Aqua must "present evidence more convincing, by even the smallest amount, than that presented by any opposing party."⁷² To satisfy its burden, Aqua must demonstrate, by a preponderance of the evidence, that its proposed transaction complies with Pennsylvania law and should be approved.⁷³

⁷⁰ 66 Pa.C.S. § 332(a).

⁷¹ *Samuel J. Lansberry, Inc. v. Pa. Pub. Util. Comm'n*, 578 A.2d 600 (Pa. Cmwlth. 1990).

⁷² *Se-Ling Hosiery v. Margulies*, 70 A.2d 854 (Pa. 1950).

⁷³ *Samuel J. Lansberry, Inc. v. Pa. Pub. Util. Comm'n*, 578 A.2d 600 (Pa. Cmwlth. 1990).

With regard to the first unresolved issue in this proceeding, the request by OCA to an adjustment of \$4,714,000 reducing the plus cost approach will be granted, and OCA's proposed 65 year service life, as discussed above, will be adopted. In addition, as 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, in order to properly reflect financial and ratemaking principles. OCA Table I 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 Table I at Col. G, Ln. 13. I conclude 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.

For all of the reasons discussed herein, this decision recommends that the Commission approve the recommendation of OCA to adopt OCA's determination of ratemaking rate base.

I. Second Unresolved Issue: Income Tax Savings on Repairs Deductions

Regulatory Liability Account to Accumulate Income Tax Effect of Repairs Deductions

The second unresolved issue is whether OCA's proposal to record the income tax effect of repairs deductions in a regulatory liability account, to be addressed in Aqua's next rate case, be adopted as a condition for approval of the transaction.

OCA witness Smith recommended 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. OCA St. 1 at 41; OCA Main Brief p.19.

OCA explains, 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. 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.* Mr. Smith noted that Aqua has treated federal income tax deductions for repairs for regulatory purposes by applying flow-through accounting for the impact of those deductions. OCA St. 1 at 40. Mr. Smith anticipated in direct testimony that Aqua would attempt to utilize flow-through accounting for the impact of repair deductions related to the assets of LMT after completing a full assessment of the property relative to the IRS Tangible property regulation. OCA St. 1 at 40; OCA Main Brief pp. 19-20.

OCA submits that, in rebuttal, Aqua witness Packer agreed with Mr. Smith's characterization of Aqua's ability to avail itself of tax deductions for repairs completed on the LMT system after closing and that Aqua has applied flow-through accounting for the impact of those deductions. OCA St. 1-SR; Aqua St. 1-R at 9. Aqua witness Packer, however, claims that the likelihood of repair deductions being realized by the Company is remote in the first five years, which are the years prior to the first rate case that the LMT system would be included. OCA St. 1-SR at 5; Aqua St. 1-R at 9; OCA Main Brief p. 20.

OCA asserts that Aqua witness Packer is essentially asking that Aqua be allowed to retain any benefits from repairs deductions on the acquired LMT system as an offset to the revenue deficiency that he claims exists for LMT's existing rates. OCA St. 1-SR at 21. OCA witness Smith summarized Mr. Packer's reasoning as follows:

In essence, his response is that (1) federal income tax repairs deductions claimed by Aqua for the acquired LMT wastewater utility system are likely to be small, and (2) Aqua should be allowed to keep the benefits of those repairs deductions through the date of establishing new rates for the LMT wastewater utility because Aqua claims that the LMT system has a revenue deficiency that would not be addressed until Aqua's next base rate case in which the LMT system were to be included.

OCA St. 1-SR at 5; OCA Main Brief p. 20.

OCA acknowledges that the size of those repairs deductions is not currently known. OCA St. 1-SR at 6. OCA submits that the fact that Aqua expects the repairs deductions to be relatively small in the early years of Aqua's ownership of the LMT wastewater utility is not a valid reason against the deferred accounting recommendation. OCA submits the federal income tax repairs deductions for the acquired LMT system are related to Aqua's ownership of the LMT wastewater utility and 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. OCA St. 1-SR at 6. Conversely, OCA argues that 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. 1-SR at 6; OCA Main Brief p.p. 20-21.

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. 1-SR at 7. OCA argues 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, OCA argues, 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, OCA submits that Mr. Smith's recommendation 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 is reasonable and should be adopted. Accordingly, OCA has requested 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.

Aqua explains that OCA recommends, as a condition to 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. OCA contends that repairs deductions, if any, will be related to Aqua's ownership of the Lower Makefield system and could help offset the rate increases Aqua projected. Aqua Main Brief p. 23.

Aqua argues the attempt to single out one component of the cost of service for deferred accounting is unreasonable and inappropriate. Aqua further asserts that 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, Aqua argues it would serve as an offset to this deficiency during the time before the rate case that includes the Township system.⁷⁴ 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. Aqua Main Brief p. 23.

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

Aqua concludes that OCA's proposed condition and creation of a regulatory liability account should be denied. Aqua notes that OCA has not cited any instance where the

⁷⁴ Aqua St. No. 1-R at 10.

Commission has required the creation of a regulatory liability account as a condition for approval of a fair market value transaction.

In the case of a utility seeking Commission authorization to defer and record certain expenses as a regulatory asset, the Commission found that the standard that must be met to obtain Commission authorization is whether, based on Commission precedent, the expense item appears to be within the scope of the type of items that the Commission has allowed as an exception to the general rule against retroactive recovery of expenses (Eligible Deferral Item). *See Petition of Pa. Am. Water Co.*, P-2012-2308982 (Opinion and Order entered August 30, 2012). There, the Commission stated that authorizations for deferral accounting are not intended to develop a factual record and are not an assurance of future ratemaking treatment.

It appears reasonable to apply a similar standard in this instance. In other words, OCA, as the proponent for deferral accounting, must demonstrate that, based on Commission precedent, Repairs Tax Reductions appear to be within the scope of the type of items that the Commission has allowed as an exception to the general rule against retroactive ratemaking. Based on the record, I find OCA has not presented sufficient evidence to determine that Repairs Tax Reductions are an Eligible Deferral Item. Accordingly, I do not recommend that the Commission approve the creation of a regulatory liability at this time.

Notwithstanding whether Repairs Tax Reductions are an Eligible Deferral Item, OCA's recommendation involves the Commission directing, rather than allowing, deferral accounting. In the case of the Commission directing utilities to defer and record certain expense reductions as a regulatory liability, the Commission found that such expense reductions were extraordinary, substantial, and non-recurring. *See Tax Cuts and Jobs Act*, Docket No. M-2018-2641242 (Order entered May 17, 2018).

It appears that directing the use of a regulatory liability for Repairs Tax Reductions requires the Commission to determine that such amounts are, or appear to be, extraordinary, substantial, and non-recurring. I find that OCA has failed to demonstrate that Repairs Tax Reductions are, or appear to be, substantial.

For the reasons set forth above, this Decision recommends that the Commission deny the proposed accumulation of the income tax effect of repairs deductions in a regulatory liability account as a condition for approval of the transaction.

VIII. CONCLUSION

Aqua, as the proponent of the Application, bears the burden of proof to establish that it is entitled to receive the approvals being sought and relief requested in the Application.⁷⁵ Aqua must establish this burden, by a preponderance of evidence which is substantial and legally credible.⁷⁶ In order to meet its burden of proof, Aqua must “present evidence more convincing, by even the smallest amount, than that presented by any opposing party.”⁷⁷ To satisfy its burden, Aqua must demonstrate, by a preponderance of the evidence, that its proposed transaction complies with Pennsylvania law and should be approved.⁷⁸

It is well-settled that in order to ensure that a transaction is in the public interest, the Commission may impose conditions on granting a certificate of public convenience as it may deem to be just and reasonable.⁷⁹ In this case, Aqua has agreed to the terms and conditions of the Settlement.

As stated in detail above, Aqua has established that it has the financial, legal and technical fitness to own and operate the system under the circumstances. Aqua and the other Settling Parties have also introduced sufficient record evidence to demonstrate that the transaction proposed in the Settlement will provide affirmative public benefits. The main benefit noted is that Aqua will ensure that Township customers will receive high quality wastewater service meeting all applicable regulatory requirements and customer service standards pursuant

⁷⁵ 66 Pa.C.S. § 332(a).

⁷⁶ *Samuel J. Lansberry, Inc. v. Pa. Pub. Util. Comm’n*, 578 A.2d 600 (Pa. Cmwlth. 1990).

⁷⁷ *Se-Ling Hosiery v. Margulies*, 70 A.2d 854 (Pa. 1950).

⁷⁸ *Samuel J. Lansberry, Inc. v. Pa. Pub. Util. Comm’n*, 578 A.2d 600 (Pa. Cmwlth. 1990).

⁷⁹ 66 Pa.C.S. § 1103(a).

to the Code. Given the foregoing, I conclude that the Settlement should be approved by the Commission without modification, because the Settlement is in the public interest.

The Settlement will ensure that, upon closing, the Township residents will receive high quality wastewater service from Aqua, a certificated public utility with the necessary financial, technical, and legal resources to provide that service into the foreseeable future. Bringing the Township's existing customers into Aqua's customer base will also ensure that Township residents will have access to the Commission's procedures for investigating and enforcing any complaints that the residents may have regarding the Township's wastewater service. Additionally, although the parties in this proceeding acknowledge that Aqua may apply for a rate increase in the future, any such rate increase application will be subject to the Commission's jurisdiction.

In reaching the conclusion that the Settlement should be approved by the Commission without modification, the testimony from the public input hearing was also considered. Further, as noted by the Parties in this proceeding, Section 1329 of the Public Utility Code explicitly provides for the acquisition of municipal water systems by existing public utilities. Also, as noted by Aqua and the Township, the legislative intent behind Section 1329 of the Code is to encourage the sale of municipal water systems so that those systems will be operated by public utilities with the resources and expertise to ensure those systems' viability into the future. Additionally, the Township noted that the proceeds of the sale of its wastewater system may provide immediate and substantial benefits to its residents. For the reasons discussed above, it is my recommendation that the Commission approve the Settlement without modification.

With regard to the first unresolved issue in this proceeding, OCA's challenges to the UVE appraisals, including the request by OCA to an adjustment of \$4,714,000 reducing the plus cost approach will be granted, and OCA's proposed 65 year service life, as discussed above, will be adopted. It is further recommended that the Commission grant the recommendation of OCA to adopt OCA's determination of ratemaking rate base.

With regard to the second unresolved issue, for the reasons set forth above, OCA's proposed condition and creation of a regulatory liability account will be denied.

IX. CONCLUSIONS OF LAW

Background and Burden of Proof

1. The Commission has jurisdiction over the parties and the subject matter of this proceeding. 66 Pa.C.S. §§ 1102 and 1329.

2. The Public Utility Code requires Commission approval in the form of a certificate of public convenience for a public utility to expand its service territory and to acquire property used or useful in the public service. 66 Pa.C.S. §§ 1102(a)(1) and 1102(a)(3).

3. A certificate of public convenience will be issued "only if the Commission shall find or determine 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).

4. In the context of a utility merger, the issuance of a certificate of public convenience requires the Commission to find affirmatively that public benefit will result from the merger. In *City of York v. Pa. Pub. Util. Comm'n*, 295 A.2d 825 (Pa. 1972).

5. The party receiving the assets and service obligation must be technically, legally, and financially fit. *Joint Application of Peoples Nat. Gas Co. LLC, Peoples TWP LLC, & Equitable Gas Co., LLC*, Docket No. A- 2013-2353647, 309 P.U.R.4th 213 (2013).

Aqua Is Fit to Acquire the Lower Makefield Wastewater System and Initiate Wastewater Service in Lower Makefield Township

6. An existing provider of public utility service is presumed fit. *Re Pa.-Am. Water Co.*, 85 PA PUC 548 (1995).

7. Aqua is fit to acquire the Lower Makefield wastewater system assets and to initiate wastewater service in Lower Makefield Township. *Re Pa.-Am. Water Co.*, 85 PA PUC 548 (1995).

Section 507 (66 Pa.C.S § 507)

8. The following contracts, including the assignment of contracts ii through xviii, are accepted as valid pursuant to Section 507⁸⁰:

- i. Asset Purchase Agreement, dated September 17, 2020, by and between Lower Makefield Township and Aqua Pennsylvania Wastewater, Inc.
- ii. Sewage Transportation Agreement, dated November 20, 2015, by and among the Municipal Sewer Authority of the Township of Lower Makefield, Lower Makefield Township, and Yardley Borough Sewer Authority
- iii. Agreement, dated September 1, 1977, by and among the Municipal Authority of the Borough of Morrisville, Borough of Yardley, Yardley Borough Sewer Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield
- iv. Agreement, dated February 18, 1982 by and between the Municipal Authority of the Borough of Morrisville, Yardley Borough Sewer Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield
- v. Amendment Agreement, dated October 8, 1991, by and between the Municipal Authority of the Borough of Morrisville, Township of Lower Makefield, the Municipal Sewer Authority of the Township of Lower Makefield, and Yardley Borough Sewer Authority
- vi. Second Amendment Agreement, dated June 24, 1993, by and between the Municipal Authority of the Borough of Morrisville, Township of Lower Makefield, the Municipal Sewer Authority of the Township of Lower Makefield, and Yardley Borough Sewer Authority
- vii. Agreement, dated March 13, 1965, by and between the Township of Falls Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield

⁸⁰ The OCA does not join in this Paragraph 8 but does not oppose Aqua's request.

- viii. First Supplemental Agreement, dated February 6, 1975, by and between the Township of Falls Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield
- ix. Agreement, dated December 12, 1988, by and between the Township of Lower Makefield, the Municipal Sewer Authority of the Township of Lower Makefield, and the Township of Falls Authority
- x. Agreement, dated April 18, 1996, by and between the Township of Falls, the Township of Lower Makefield, and the Lower Makefield Township Sewer Authority
- xi. Agreement, dated April 11, 1974, by and between Middletown Township Bucks County Municipal Authority, Middletown Township Board of Supervisors, the Municipal Sewer Authority of the Township of Lower Makefield, Lower Makefield Township Board of Supervisors, and Bucks County Water and Sewer Authority
- xii. Addendum Agreement to be attached and made part of the Agreement dated April 11, 1974, by and between Middletown Township Bucks County Municipal Authority, Middletown Township Board of Supervisors, the Municipal Sewer Authority of the Township of Lower Makefield, and Lower Makefield Township Board of Supervisors
- xiii. Agreement, dated October 23, 1975, by and between the Bucks County Water and Sewer Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield
- xiv. Agreement, dated October 28, 1975, by and between the Bucks County Water and Sewer Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield
- xv. Supplemental Agreement Neshaminy Interceptor, dated February 7, 2018, by and between the Bucks County Water and Sewer Authority and the Township of Lower Makefield
- xvi. Agreement, dated January 28, 1980, by and between Middletown Township, Lower Makefield Township, the Municipal Sewer Authority of the Township of Lower Makefield, and the Bucks County Water and Sewer Authority
- xvii. Addendum Agreement, dated April 11, 1989, by and between Middletown Township, Lower Makefield Township, and the Municipal Sewer Authority of the Township of Lower Makefield

- xviii. Agreement, dated September 14, 1987, by and between Newtown Joint Municipal Authority and the Municipal Sewer Authority of the Township of Lower Makefield

Background and Burden of Proof

9. The Commission has jurisdiction over the parties and the subject matter of this proceeding. 66 Pa. C.S. §§ 1102 and 1329.

10. As the proponent of a proposed rule or order, an applicant has the burden of proof. 66 Pa.C.S. § 332; *Se-Ling Hosiery v. Margulies*, 70 A.3d 854 (Pa. 1950); *Samuel J. Lansberry, Inc. v. Pa. Pub. Util. Comm'n*, 578 A.2d 600 (Pa. Cmwlth. 1990).

11. The term “burden of proof” means a duty to establish a fact by a preponderance of the evidence. *Se-Ling Hosiery v. Margulies*, 70 A.3d 854 (Pa. 1950). The term “preponderance of the evidence” means that one party has presented evidence which is more convincing, by even the slightest degree, than the evidence presented by the opposing party. *Id.*

12. Any finding of fact necessary to support an adjudication of the Commission must be based upon substantial evidence, which is such relevant evidence as a reasonable mind might accept as adequate to support a conclusion. *Mill v. Comm., Pa. Pub. Util. Comm'n*, 447 A.2d 1100 (Pa. Cmwlth. 1982); *Edan Transp. Corp. v. Pub. Util. Comm'n*, 623 A.2d 6 (Pa. Cmwlth. 1993); 2 Pa.C.S. § 704.

13. More is required than a mere trace of evidence or a suspicion of the existence of a fact sought to be established. *Norfolk & W. Ry. v. Pa. Pub. Util. Comm'n*, 413 A.2d 1037 (Pa. 1980); *Erie Resistor Corp. v. Unemployment Com. Bd. Of Review*, 166 A.2d 96 (Pa. Super. 1960); *Murphy v. Pa. Dep't of Pub. Welfare, White Haven Ctr.*, 480 A.2d 382 (Pa. Cmwlth. 1984).

Section 1329 and Ratemaking Rate Base

14. Section 1329 of the Public Utility Code, 66 Pa.C.S. § 1329, 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.

15. In regard to the ratemaking rate base, the General Assembly directed as follows for acquisitions proceeding under Section 1329, 66 Pa.C.S. § 1329:

(c) Ratemaking rate base. – The following apply:

(2) The ratemaking rate base of the selling utility shall be the lesser of the purchase price negotiated by the acquiring public utility or entity and selling utility or the fair market value of the selling utility.

16. Section 1329(g) defines “fair market value” as “[t]he average of the two utility valuation expert appraisals conducted under subsection (a)(2).” 66 Pa.C.S. § 1329(g).

17. Commission policy promotes settlement. 52 Pa. Code § 5.231.

18. 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. 52 Pa. Code § 69.401.

19. 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 & Sewer Assocs.*, 74 Pa. PUC 767 (1991). The instant settlement is in the public interest. *Id.*

20. 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).

21. 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).

22. 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).

23. 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 (Pa. Cmwlth. 1985); *Warminster Twp. Mun. Auth. v. Pa. Pub. Util. Comm’n*, 138 A.2d 240 (Pa. Super. 1958). PAWC has demonstrated that it is technically, financially and legally fit. *Id.*

24. 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 (Pa. Cmwlth. 1992).

25. 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*, 295 A.2d 825, 828 (Pa. 1972).

26. 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).

27. For an acquisition in which a municipal corporation 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).

28. “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).

29. For an acquisition in which a municipal corporation 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).

30. 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.

31. The settlement and its proposed terms and conditions are in the public interest and, therefore, should be approved without modification. *Warner v. GTE North, Inc.*, Docket No. C-00902815, (Opinion and Order entered April 1, 1996); *Pa. Pub. Util. Comm'n v. CS Water and Sewer Associates*, 74 Pa. PUC 767 (1991).

XI. ORDER

THEREFORE,

IT IS RECOMMENDED:

1. That the Joint Petition for Partial Settlement, filed with the Commission on October 8, 2021, by Aqua Pennsylvania Wastewater, Inc., the Bureau of Investigation and Enforcement, the Office of Consumer Advocate, the Office of Small Business Advocate and Lower Makefield Township, at Docket No. A-2021-3024267, including all terms and conditions thereof, is approved without modification.

2. That the Application filed by Aqua Pennsylvania Wastewater, Inc. on May 14, 2021, and accepted by the Commission on August 5, 2021, is granted, subject to resolution of the issues reserved for litigation and the following conditions, consistent with the Joint Petition for Partial Settlement:

A. Approval of Application and Acquisition

- (1) The Commission should approve Aqua's acquisition of Lower Makefield Township wastewater collection system assets and Aqua's right to begin to offer, render, furnish, or supply wastewater service in the areas served by Lower Makefield.
- (2) The Commission shall issue any necessary approvals or certificates for the transaction pursuant to 66 Pa.C.S. § 507.

B. Tariff

The *pro forma* tariff submitted with the Application, including all rates, rules and regulations regarding conditions of Aqua's wastewater service, shall be permitted to become effective immediately upon closing of the transaction.

C. Engineering Assessment

On a going forward basis, Aqua will require engineering firms conducting Section 1329 assessments to present, as part of the engineering assessment, a detailed Engineer's Assessment Study containing the seller's utility assets description of the condition of inventory and assets. The designation of condition shall be limited to those assets that can be observed and whether the categories of system assets appraised are in poor, fair, good or very good condition.

D. Easements and Other Property Rights

Aqua and Lower Makefield will work to ensure the transfer of all real property rights including easements and missing easements as defined in the Asset Purchase Agreement by Closing. However, Aqua shall be permitted in its discretion to close without the transfer of all of the Real Property Rights, provided that an escrow is established from the Purchase Price to be used to obtain any post-Closing transfers of the Real Property Rights. Aqua will provide an update to I&E, OCA, and OSBA approximately 30 days in advance of the anticipated Closing Date and a final update before Closing regarding the status of the transfer of real property rights including easements related to the system.

E. Cost of Service Study

- (1) In the first base rate case that includes Lower Makefield wastewater system assets, Aqua will submit a wastewater cost of service study that removes all costs and revenues associated with the operation of the Lower Makefield system.
- (2) In the first base rate case that includes Lower Makefield wastewater system assets, Aqua will also provide a separate cost of service study for the Lower Makefield system. Aqua will file a Cost of Service Study separately for the Lower Makefield system consistent with typically filed rate making exhibits including, but not limited to the following: Rate Base (Measures of Value), Statement of Operating Income, and Rate of Return, which correspond to the applicable test year, future test year, and fully projected future test year measurement periods.

F. Allowance for Funds Used During Construction, Deferral of Depreciation and Transaction Costs

- (1) Any claims for AFUDC and deferred depreciation related to post-acquisition improvements not recovered through the Distribution System Improvement Charge for book and ratemaking purposes, will be addressed in Aqua's first base rate case which includes Lower Makefield wastewater system assets.
- (2) Regarding future claims for AFUDC, deferral of depreciation, and transaction costs related to this acquisition, Joint Petitioners reserve the right to litigate their positions fully in future rate cases when these issues are ripe for review. The parties' assent to this agreement should not be construed to operate as its preapproval of Aqua's requests.

G. Long Term Infrastructure Improvement Plan and Distribution System Improvement Charge

- (1) If Aqua proposes to modify its LTIIIP to include the Lower Makefield wastewater system, the projects added for Lower Makefield will be in addition to those that Aqua plans for its existing systems.
- (2) In future LTIIIPs or Annual Asset Optimization Plans that include the Lower Makefield wastewater system, Aqua will not reprioritize other existing capital improvements that the Company already committed to undertake. This section does not limit Aqua's current practice and ability to allocate projects as needed for its capital program.
- (3) Upon approval of the Commission of a modification to its LTIIIP which includes the Lower Makefield wastewater system, Aqua shall be permitted to collect a DSIC related to the Lower Makefield wastewater system prior to the first base rate case in which the Lower Makefield assets are incorporated into rate base.

H. Lower Makefield Rates

- (1) The current average Lower Makefield residential rate is \$74.32 per month based on four thousand seven hundred gallons of usage. As set forth in the notice sent to Lower Makefield customers in this proceeding (Application Exhibit I2), Aqua provided a non-binding,

estimated incremental rate effect of the proposed rate base addition on Lower Makefield wastewater customers of 28.17%.

- (2) Joint Petitioners acknowledge that the Commission retains ultimate authority to set rates including, but not limited to, the authority to allocate revenues to the Lower Makefield customers that are in excess of the restrictions contained in Section 7.03 of the APA.
- (3) Aqua and Lower Makefield agree that, at the time of Aqua's first base rate case that includes the Lower Makefield system, Aqua will propose the timing of the rate effect consistent with the terms of Section 7.03 of the APA. All parties reserve their rights to address Aqua's proposal.
- (4) In the first base rate proceeding filed by Aqua that includes Lower Makefield's wastewater system assets, Aqua shall propose to move the Lower Makefield system to its cost of service, based on a separate cost of service study for Lower Makefield's system; provided, however, that Aqua will not be obligated to propose Lower Makefield wastewater rates in excess of Aqua's proposed Rate Zone 1 system-average rates. The Joint Petitioners acknowledge, however, that Aqua may agree to rates other than those proposed for Lower Makefield customers in the context of a settlement of the base rate case. OCA, I&E, OSBA and Lower Makefield reserve their rights to fully address this proposal, and to make other rate proposals in the base rate case. In the next rate case, Aqua agrees to provide written notice to Lower Makefield Township customers of the rate filing and the level of increase, if any, resulting from this provision.

I. Welcome Letter

Aqua will send a welcome letter to Lower Makefield Wastewater customers within 30 days following Closing which will include information regarding the conversion to monthly billing for their sewer service.

J. Legal Fees

In its next base rate case, Aqua shall separately identify any legal fees included in its transaction and closing costs pursuant to the APA between Aqua and Lower Makefield and specify amounts expended by Aqua on

behalf of Lower Makefield. I&E, OCA and OSBA reserve the right to challenge the reasonableness, prudence, and basis for such fees.

3. That the Commission's Secretary issue a certificate of public convenience evidencing Aqua Pennsylvania Wastewater, Inc.'s right under Sections 1102(a)(1), 1102(a)(3) and 1329(c)(1) and (2) of the Public Utility Code, 66 Pa.C.S. §§ 1102(a)(1), 1102(a)(3) and 1329(c)(1) and (2), to: (a) acquire, by sale, the wastewater system assets of Lower Makefield Township situated within Lower Makefield Township, Bucks County, Pennsylvania and (b) the right of Aqua Pennsylvania Wastewater, Inc. to begin to offer, render, furnish and supply wastewater service to the public in portions of Lower Makefield Township, Bucks County, Pennsylvania.

4. That within ten (10) days after closing of the acquisition, Aqua Pennsylvania Wastewater, Inc. shall file a tariff supplement in the form filed with Aqua's Application on May 14, 2021, as updated in Aqua Pennsylvania Wastewater, Inc.'s supplemental information filed by letter dated June 21, 2021, implementing rates for Lower Makefield Township customers post-closing.

5. That the Secretary's Bureau shall issue certificates of filing pursuant to Section 507 of the Public Utility Code for the following agreements between Aqua Pennsylvania Wastewater, Inc., and Lower Makefield Township:

- i. Asset Purchase Agreement, dated September 17, 2020, by and between Lower Makefield Township and Aqua Pennsylvania Wastewater, Inc.
- ii. Sewage Transportation Agreement, dated November 20, 2015, by and among the Municipal Sewer Authority of the Township of Lower Makefield, Lower Makefield Township, and Yardley Borough Sewer Authority
- iii. Agreement, dated September 1, 1977, by and among the Municipal Authority of the Borough of Morrisville, Borough of Yardley, Yardley Borough Sewer Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield
- iv. Agreement, dated February 18, 1982 by and between the Municipal Authority of the Borough of Morrisville, Yardley Borough Sewer

Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield

- v. Amendment Agreement, dated October 8, 1991, by and between the Municipal Authority of the Borough of Morrisville, Township of Lower Makefield, the Municipal Sewer Authority of the Township of Lower Makefield, and Yardley Borough Sewer Authority
- vi. Second Amendment Agreement, dated June 24, 1993, by and between the Municipal Authority of the Borough of Morrisville, Township of Lower Makefield, the Municipal Sewer Authority of the Township of Lower Makefield, and Yardley Borough Sewer Authority
- vii. Agreement, dated March 13, 1965, by and between the Township of Falls Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield
- viii. First Supplemental Agreement, dated February 6, 1975, by and between the Township of Falls Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield
- ix. Agreement, dated December 12, 1988, by and between the Township of Lower Makefield, the Municipal Sewer Authority of the Township of Lower Makefield, and the Township of Falls Authority
- x. Agreement, dated April 18, 1996, by and between the Township of Falls, the Township of Lower Makefield, and the Lower Makefield Township Sewer Authority
- xi. Agreement, dated April 11, 1974, by and between Middletown Township Bucks County Municipal Authority, Middletown Township Board of Supervisors, the Municipal Sewer Authority of the Township of Lower Makefield, Lower Makefield Township Board of Supervisors, and Bucks County Water and Sewer Authority
- xii. Addendum Agreement to be attached and made part of the Agreement dated April 11, 1974, by and between Middletown Township Bucks County Municipal Authority, Middletown Township Board of Supervisors, the Municipal Sewer Authority of the Township of Lower Makefield, and Lower Makefield Township Board of Supervisors
- xiii. Agreement, dated October 23, 1975, by and between the Bucks County Water and Sewer Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield

- xiv. Agreement, dated October 28, 1975, by and between the Bucks County Water and Sewer Authority, Township of Lower Makefield, and the Municipal Sewer Authority of the Township of Lower Makefield
- xv. Supplemental Agreement Neshaminy Interceptor, dated February 7, 2018, by and between the Bucks County Water and Sewer Authority and the Township of Lower Makefield
- xvi. Agreement, dated January 28, 1980, by and between Middletown Township, Lower Makefield Township, the Municipal Sewer Authority of the Township of Lower Makefield, and the Bucks County Water and Sewer Authority
- xvii. Addendum Agreement, dated April 11, 1989, by and between Middletown Township, Lower Makefield Township, and the Municipal Sewer Authority of the Township of Lower Makefield
- xviii. Agreement, dated September 14, 1987, by and between Newtown Joint Municipal Authority and the Municipal Sewer Authority of the Township of Lower Makefield

6. That all other approvals, certificates, registrations and relief are hereby issued with respect to Aqua Pennsylvania Wastewater, Inc.'s acquisition of the wastewater system assets of Lower Makefield Township pursuant to Sections 1102, 1329, and 507 of the Public Utility Code. 66 Pa.C.S. §§ 1102, 1329, 507.

7. 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. The recalculated average of the two appraisal results is \$51,236,259 for establishing rate base under Section 1329, rather than the \$53,000,000 proposed by Aqua. Accordingly, the Commission should approve, under 66 Pa.C.S. § 1329(c), a rate base of \$51,236,259 associated with the acquisition of the System.

8. That all Protests filed in this proceeding, are hereby denied and dismissed.

9. That the Commission's proceeding at Docket No. A-2021-3024267 be terminated and marked closed.

10. That the proposed accumulation of the income tax effect of repairs deductions in a regulatory liability account as a condition for approval of the transaction is denied. The adjusted Gannet Fleming appraisal result shall be \$48,309,516 and the adjusted AUS appraisal result is \$54,163,000.

11. That the recalculated average of the two appraisal results is \$51,236,259 for establishing the rate base under section 1329 and not the \$53,000,000 proposed by Aqua.

12. That the Office of Consumer Advocate proposed income tax expense from repairs deduction and request that Wastewater utility system assets be recorded in a regulatory liability account and addressed in Aqua's first base rate case in the which rates for the acquired Township wastewater utility customers is denied.

Date: November 16, 2021

_____/s/
Jeffrey A. Watson
Administrative Law Judge