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November 29, 2021

Via Electronic Filing

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

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

Dear Secretary Chiavetta:

We are counsel to Aqua Pennsylvania Wastewater, Inc. in the above matter and are submitting, via electronic filing with this letter, the Company's Exceptions to the Recommended Decision of Administrative Law Judge Jeffrey A. Watson. Copies of the Exceptions are being served upon the persons and in the manner set forth on the certificate of service attached to it.

Very truly yours,

THOMAS, NIESEN & THOMAS, LLC

By

Thomas T. Niesen

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

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

The Honorable Jeffrey A. Watson, Presiding

Application of Aqua Pennsylvania Wastewater, Inc., ("Aqua"), under Sections 1102 and 1329 of the Pennsylvania Public Utility Code, 66 Pa C.S. §§ 1102(a) and 1329 (relating to enumeration of acts requiring certificate and valuation of acquired water and wastewater systems), for approval of: (1) the transfer, by sale, of substantially all of the wastewater system assets, properties and rights of Lower Makefield Township related to its wastewater collection and conveyance system; (2) the right of APW to begin to offer or furnish wastewater service to the public in Lower Makefield Township, Bucks County, Pennsylvania; and (3) the use for ratemaking purposes of the lesser fair market value or the negotiated purchase price of the Lower Makefield Township assets related to its wastewater collection and conveyance system.	:	**Docket No. A-2021-3024267**

EXCEPTIONS OF AQUA PENNSYLVANIA WASTEWATER, INC. TO THE RECOMMENDED DECISION OF ADMINISTRATIVE LAW JUDGE JEFFREY A. WATSON

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Attorneys for
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DATED: November 29, 2021

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I. INTRODUCTION

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

The Application asks the Commission to approve Aqua's acquisition of the wastewater system assets of Lower Makefield Township ("Lower Makefield" or "Township") and allow Aqua to begin to provide wastewater service in portions of the Township.

The Application also asks that the Commission include in its order approving the acquisition, a determination that the ratemaking rate base of the assets being acquired by Aqua is $53,000,000 pursuant to Section 1329(c)(2) of the Code.

The Application, additionally, seeks, to the extent necessary, approval of contracts, including assignment of contracts between Aqua and the Township pursuant to Section 507 of the Code and such other approvals, certificates, registrations and relief, if any, under the Code that may be required.

By letter dated June 25, 2021, the Commission conditionally accepted the Application for filing. In compliance with the conditional acceptance letter, Aqua provided individualized notice of the proposed acquisition to its water and wastewater customers and Lower Makefield provided individualized notice of the proposed acquisition to its wastewater customers.

Following confirmation of the required notification, the Commission, by letter dated August 5, 2021, acknowledged its final acceptance of the Application and advised that notice of the filing of the Application would be published in the Pennsylvania Bulletin on August 21, 2021, with a protest deadline of September 7, 2021.

The matter was scheduled for hearing. Administrative Law Judge Jeffrey A. Watson was assigned to preside over the proceeding.

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

By Recommended Decision dated November 16, 2021 ("Recommended Decision"), Judge Watson recommends that the Commission approve the Joint Petition without modification. Concerning the two issues reserved for litigation:

(1) Judge Watson recommends that the Commission adopt adjustments proposed by the OCA to the fair market value appraisals of Gannett Fleming Valuation and Rate Consultants, LLC ("Gannett") and AUS Consultants, Inc. ("AUS"). The effect of the adjustments is to reduce the ratemaking rate base for the acquired assets from $53,000,000 to $51,236,259.

(2) As to the treatment of income tax savings on repairs deductions, Judge Watson recommends that the Commission deny the 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.

Aqua submits the following Exceptions to Judge Watson's recommendation that the Commission reduce the ratemaking rate base for the acquired assets from $53,000,000 to $51,236,259.[1]

II. EXCEPTIONS

Aqua and Lower Makefield negotiated a purchase price of $53,000,000 for the wastewater system. The price was the result of voluntary arms' length negotiations. Aqua and Lower Makefield are not affiliated with each other. They agreed to use the process presented in Section 1329 of the Code to determine the fair market value of the wastewater system and the ratemaking

[1] Pursuant to 52 Pa. Code Section 5.533, Aqua incorporates into its Exceptions, by reference and citation, relevant sections and pages of its previously filed Main and Reply Briefs.

rate base.

Section 1329 provides that two Utility Valuation Experts ("UVEs") shall perform separate appraisals for the purpose of establishing the fair market value of the system assets. Section 1329 further provides that each UVE shall determine fair market value in compliance with the Uniform Standards of Professional Appraisal Practice ("USPAP"), employing the Cost, Market and Income Approaches.

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. Both firms are on the list of qualified appraisers maintained by the Commission. Both firms have extensive and relevant experience with the valuation and appraisal of utility assets.

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

The results of the Gannett analyses and calculations are as follows:[2]

Valuation Approach	Indicated Value	Weight	Weighted Value
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**

[2] Aqua St. No. 4 at 13.

The results of the AUS analyses and calculations are as follows:[3]

Valuation Approach	Indicated Value	Weight	Weighted Value
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**

Copies of the Fair Market Value Appraisal Reports of Gannett and AUS were attached as Exhibit Q and Exhibit R, respectively, to the Application. Verified Statements of Gannett and of AUS, verifying that their Appraisals determined fair market value in compliance with USPAP, employing the Cost, Market and Income approaches, were attached to the Application as Exhibit T1 and Exhibit T2, respectively.

The OCA, through its witness Smith, proposed adjustments to the Gannett Income Approach and to the AUS Income and Cost Approaches. The Recommended Decision adopts each of the OCA's proposed adjustments as presented by witness Smith[4] resulting in a recommended ratemaking rate base of $51,236,259.[5]

The adjustments adopted by the Recommended Decision and the resulting recommended ratemaking rate base are not based on USPAP but rather are reflective of a "financial and ratemaking standard," not found in Section 1329. They are also not supported by the evidence of record.

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[3] Aqua St. No. 5 at 3.

[4] The Recommended Decision also recommends that the Commission adopt an OCA adjustment to the AUS Market Approach. This adjustment has no impact on the determination of ratemaking rate base. It is addressed in Exception No. 4, *infra*.

[5] The Recommended Decision states that the recommended ratemaking rate base of $51,236,259 is based on an adjusted Gannett appraisal result of $48,309,516 and an adjusted AUS appraisal result of $54,163,000. The recommended results are transposed. As proposed with the adjustments recommended in the Recommended Decision, the Gannett adjusted result would be $54,163,000 and the AUS adjusted result would be $48,309,516.

The Recommended Decisions' recommended adjustments to the Income Approaches of Gannett and AUS are especially problematic as they are not only not supported by the record – *the methodology used within the Gannett Income Approach to determine terminal value is the same method used by Gannett and not adjusted by the Commission in sixteen prior Section 1329 proceedings*[6] – but are contrary to the Commission's decision in the Cheltenham Section 1329 proceeding where the Commission previously addressed the terminal value within the Income Approach.

In its Final Supplemental Implementation Order entered February 28, 2019, at M-2016-2543193, ("FSIO"), the Commission expressed a clear desire to, ultimately, reduce litigation in Section 1329 proceedings. Aqua submits that that goal is not furthered by questioning valuation methods previously accepted by the Commission or sanctioning repeat litigation of an issue previously resolved by the Commission and a presiding administrative law judge.

Aqua presents the following Exceptions.

<u>EXCEPTION NO. 1</u> - <u>ADJUSTMENT TO GANNETT INCOME APPROACH – TERMINAL VALUE</u>

> ***Aqua excepts to the downward adjustment of the Gannett Income Approach by $5,278,828 based on the use of Net Plant less Accumulated Deferred Income Taxes as the Terminal Value. Recommended Decision, Section VII.G.b and d, Pages 81-82 and 84-87, and Section VII.H, Page 92.[7] Aqua Main Brief, Sections V.A.4.b. i and ii and Reply Brief, Sections V.A.4.b. i., ii and iv.***

The Gannett Appraisal explains that the Income Approach to value is based on the future

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

[7] Although the Recommended Decision, pages 78 and 87, presents the OCA's adjustment to the Gannett Income Approach as $5,278,828 and the adjusted Gannett Income Approach value as $48,462,957, the OCA's proposed adjustment to the Gannett Income Approach as presented in the surrebuttal testimony of OCA witness Smith is $4,024,687 and the OCA's adjusted Gannett Income Approach value is $49,717,098. OCA Statement No. 1SR, OCA Exhibit RCS-1SR, Page 1. Mr. Smith originally presented a proposed adjustment of $3,311,627 to the Gannett Income Approach but, in surrebuttal testimony, revised the adjustment to $4,024,687 to correct an oversight on his part. *See* Aqua Main Brief at 15-16.

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 under the Income Approach.[8] Gannett's Income Approach produced a value of $53,741,785 for the Lower Makefield system.

Within the DCF model, the "terminal value" is 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. The "terminal value" is the present value of future Debt Free Net Cash Flows from time period 24 (year 2045) forward.[9] Under the Income Approach, a terminal value can also be thought of as the future market value, or future sale price, of existing assets.[10]

OCA witness Smith criticized the manner of determining the "terminal value" in the Gannett Income Approach (DCF model).[11] In lieu of a present value determination of the terminal value, Mr. Smith recommended use of Net Plant less Accumulated Deferred Income Taxes ("ADIT") as the terminal value.[12]

The Recommended Decision accepts OCA witness Smith's adjustment to the Gannett Income Approach concluding that the use of net plant less ADIT is appropriate in order to properly reflect financial and ratemaking principles under Pennsylvania Law.[13] Mr. Smith's adjustment to the terminal value reduces the Gannett Income Approach result by $4,024,687.[14]

The Recommended Decision is contrary to the Commission's decision in the Cheltenham[15]

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[8] Aqua Exhibit No. 1, Application Exhibit Q at 27.

[9] Debt Free Net Cash Flows during time periods 1 through 24 (year 2022 through 2045) changes multiple times due to the various assumptions identified in the Gannet Appraisal. After time period 24 (year 2045), the growth in annual Debt Free Net Cash Flows is a constant growth rate. Aqua St. No. 4-R at 4.

[10] Aqua St. No. 4-R at 4. The Gannett terminal value at year 24 ranges from $55,984,235 to $63,887,294 from time period 24 (year 2045). Aqua Exhibit No. 1, Application Exhibit Q, Exhibit 15, page 6.

[11] As discussed in Exception No. 2, Mr. Smith also criticized the terminal value in the AUS Appraisal.

[12] OCA St. No. 1 at 33.

[13] Recommended Decision at 1, 92 and Ordering Paragraph No. 7.

[14] *See* OCA St. No. 1SR, OCA Exhibit RCS-1 SR, Page 1 of 1 and Footnote 7, *supra*.

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

proceeding. In the Cheltenham Section 1329 proceeding at Docket No. A-2019-3008491, Judge Jones and the Commission rejected the use of net plant as the terminal value in the Income Approach.[16] OCA witness Smith, in fact, acknowledged that the Commission rejected the use of net plant as the terminal value in Cheltenham.[17]

In its Cheltenham Opinion and Order, the Commission noted the following in regard to the Gannett terminal value and, in doing so, its rejection of the OCA's criticism of it:

> … [R]egarding the OCA's proposed adjustments relating to the UVEs' use of a terminal value, the ALJ rejected the OCA's arguments challenging Gannett's use of a 13-year terminal value and AUS' use of a 20-year terminal. We adopt the ALJ's recommendation and note the ALJ's recommendation is consistent with our decision in *Limerick. See Limerick Order* at 22.[18]

The Recommended Decision offers no explanation why the use of net plant, previously rejected by the Commission, is appropriate in this proceeding. Rather, the Recommended Decision states, incorrectly, that the Mr. Smith's recommended adjustment is consistent with precedent.[19] OCA witness Smith also made no attempt to distinguish the prior Commission action in his testimony.

While the Recommended Decision and Mr. Smith offered no justification for departing from prior Commission action, Mr. Walker of Gannett emphasized that the capitalization rate concept used by Gannett in this proceeding to determine terminal value is the same concept used by Gannett to estimate terminal value in *sixteen* prior Section 1329 *proceedings* and that the Commission has not adjusted the concept in any one of those prior proceedings.[20] Clearly, the

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[16] Aqua St. No. 4-R at 7.

[17] OCA St. No. 1SR at 13.

[18] Following a lengthy discussion of the issue, the Commission in *Limerick* denied OCA Exceptions "convinced by Aqua's arguments in support of the 13-year model" used in the Gannett appraisal in that proceeding. *Application of Aqua Pennsylvania Wastewater, Inc. – Limerick Township,* Docket No. A-2017-2605434, slip opinion at 50.

[19] Recommended Decision at 92.

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

Recommended Decision is not consistent with precedent.

We point out, in further regard to *Cheltenham*, that Judge Jones' Recommended Decision and the Commission's Opinion and Order there established "unreasonable approach" and "unreasonable results" as bases for determining whether to adjust an UVE's Income Approach. In her Recommended Decision in *Cheltenham*, Judge Jones differentiated adjustments to the Income Approach made in *Limerick*[21] with her analysis in *Cheltenham* stating:

> … the analysis declared unreasonable [in *Limerick*] relied upon an income approach result for an investor-owned utility that far exceeded the RCNLD rate base employed by the UVE and the ultimate Commission-approved ratemaking rate base of $64.4 million. This difference was significant both in dollar value and percentage.
>
> In this proceeding, the disparity between the RB/ROR analysis result for an investor-owned utility, as adjusted, and the aforementioned values is much smaller, both in dollar value and percentage. In fact, as will be discussed infra, AUS' income approach, as adjusted, does not exceed its [CORLD] rate base. Resultingly, I disagree with OCA in that OCA has not shown AUS' reliance on [CORLD] as the basis for its income approach valuation is unreasonable, either by process or outcome. . . Rather, based on the record evidence, AUS' use of [CORLD] in its appraisal [under the income approach] does not appear to be an unreasonable approach nor does it appear to produce an unreasonable outcome.[22]

In its Cheltenham Opinion and Order, the Commission concurred with Judge Jones and adopted her analysis noted the following regarding adjustments to the UVE's Income Approach:

> We concur with and adopt the above discussion contained in the Recommended Decision; however, we acknowledge that the (corrected) adjusted income approach result herein does slightly exceed the (corrected) adjusted beginning plant investment amount. However, we will refrain from simply setting the income approach result equal to the adjusted CORLD result, as the ALJ did. Rather, we are persuaded that, based on the record evidence in this proceeding, the use of the (corrected) adjusted CORLD rate base reflects the adoption of the AUS DCF valuation method and produces a reasonable outcome in this proceeding.[23]

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

[22] *Cheltenham*, Recommended Decision at 36-37.

[23] *Cheltenham*, mimeo at 55.

In this proceeding, Gannett's Income Approach produced a value of $53.741 million and its Cost Approach produced a value of $54.531 million for the Lower Makefield system. Mr. Smith did not recommend adjusting Gannett's Cost Approach. Further, Mr. Smith did not claim that Gannett's Income Approach was an "unreasonable approach," nor could he claim that it produced "unreasonable results" since Gannett's Income Approach produced a value which is about 99% of the indicated value determined by Gannett's Cost Approach, which Mr. Smith adopted. In comparison, Mr. Smith recommended an Income Approach value of $49,717,098, which is only 91% of the indicated value Mr. Smith recommended under the Cost Approach, and merely 85% of the Market Approach. It is Mr. Smith's results and approaches that are not reasonable in accordance with the Commission's further analysis in *Cheltenham.*

The Recommended Decision presents its "Rate Making Rate Base Conclusion" in Section VII.H, pages 90 through 92. Although the adjustment to the AUS Cost Approach is presented and discussed,[24] there is no discussion in the "Conclusion" of the recommended adjustment to the Gannett Income Approach other than a conclusion that OCA witness Smith's recommended adjustments are "reasonable, consistent with the Public Utility Code and precedent." The adjustment to the Gannett Income Approach is, in fact, not consistent with precedent as set forth above and, as it is based, according to the OCA, on "financial and ratemaking standards" (and not USPAP), it is not consistent with the Code. Mr. Smith provided no documentation, authoritative citations, or treatises to support the use of net plant as the terminal value. The use of original cost book value is not a recognized method and is not consistent with valuation practices or financial theory under the standard of fair market value.[25]

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[24] The recommended adjustment to the AUS Cost Approach is the subject of Aqua's Exception No. 3, *infra.*

[25] Aqua St. No. 4-R at 2; *see also* Tr. 40. The Recommended Decision inappropriately defeats or eliminates the need to appraise plant assets since the indicated value of net cost of the plant assets would be simply the net cost of the plant assets. If the Recommended Decision were adopted then an original cost less depreciation analysis would be the only method needed to value assets. However, 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

The adjustment to the terminal value in the Gannett Income Approach is also not reasonable. In Section VII.G.d., pages 84 through 87, under the heading "Mr. Smith's Adjustments to the Gannett Fleming Income Approach Are Reasonable," the Recommended Decision repeats several "assertions" and "submissions" of the OCA in support of the use of Net Plant Less ADIT as the terminal value in the Income Approach. It is not clear which of these "assertions" or "submissions," or all of them, is significant to the recommended adjustment but they do not result in a "reasonable" adjustment.[26]

In exception to the Recommended Decision, we state, again, as we did in both the Aqua Main and Reply Briefs, that the base failing of the use of net plant to determine terminal value 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 Approach. As such, it is contrary to legislative intent and inconsistent with clear statutory language that requires a fair market value appraisal reflective of an Income Approach – not a hybrid Income Approach / Cost Approach.

In his direct testimony, OCA witness Smith testified that the "income approach involves capitalizing and discounting a future income stream to a present value."[27] That being the case, it is simply wrong, and, indeed, inconsistent with Mr. Smith's testimony, to use a terminal value within the Income Approach based on something other than a present value analysis. Clearly, the present value determinations of terminal value presented by Gannett and AUS in their respective Income Approaches are entirely consistent with the accepted definition of the Income Approach.

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market value, not a standard of value of original cost.

[26] The Recommended Decision does not expressly state with which of the OCA's assertions or submissions it agrees.

[27] OCA St. No. 1 at 30.

The discussion of Mr. Smith's adjustment to the terminal value in Section VII.G.d., pages 84 through 87, of the Recommended Decision seems to focus on the OCA's contentions that the adjustment is in accord with traditional ratemaking principles and that the Gannett Appraisal is not consistent with ratemaking principles and is flawed. Mr. Walker, a qualified UVE, explained that the use of net plant, as suggested by Mr. Smith, from time period 24 as the terminal value in the Gannett Income Approach is not in accordance with valuation practice.

The use of a "terminal value" in the DCF model 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.[28] Mr. Walker testified that:

> The circularity of this 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 this was the appropriate or correct method to value the assets then an original cost less deprecation analysis would be the only method needed to value assets. However, the value of the investment in plant and equipment for the Township's wastewater system assets is being determined in these proceedings based upon a standard of value of fair market value, not a standard of value of original cost.[29]

Mr. Walker provided an evidentiary analysis demonstrating that "net plant value" is not a good measure or proxy for future market value. The Gannet Appraisal lists the current market multiples applicable to the corresponding financial and operating statistics of the Lower Makefield system.[30] 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.[31]

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[28] Aqua St. No. 4-R at 5; *see also* Tr. 40.

[29] Aqua St. No. 4-R at 4-5 citing Pratt, Shannon P. "Defining Standards of Value." Valuation 34, no. 2, June 1989. http://www.appraisers.org/docs/default-source/college-of-fellows-articles/defining-standards-of-value.pdf.

[30] Aqua Exhibit 1, Application Exhibit Q, Exhibit 17, page 1 of 3.

[31] Aqua St. No. 4-R at 6.

As shown in "Table 1" of Aqua Statement No. 4-R, 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 future 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).[32] The statement in the Recommended Decision that these values are "grossly excessive"[33] reflect a misunderstanding of their purpose as the values are *future values* (year 2045) while OCA's comparison of those values to an Income Approach result of $53.741 million is a *present value* (year 2021).[34]

Mr. Smith, moreover, was incorrect when he stated 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.[35] To the contrary, over the course of the 24-year DCF model within the Gannett Income Approach, 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 ($2.357 - $2.321) difference between depreciation expense and the capital expenditures, it was inaccurate for Mr. Smith to suggest that rate base approaches zero or becomes negative under the UVE assumption

[32] Aqua St. No. 4-R at 6-7.

[33] Recommended Decision at 85.

[34] Tr. 41.

[35] At pages 85-87, the Recommended Decision cites OCA contentions that under the UVE assumptions and modeling techniques, Lower Makefield would be depreciating and using up its existing plant faster than it is making investments to replace that plant with plant approaching zero or becoming negative.

and modeling techniques.[36]

Based upon the difference in depreciation expense and capital expenditures noted above, Mr. Walker testified that it would take 1.564 years to use up the existing LMT plant. Mr. Smith and the Recommended Decision criticize this testimony commenting that no utility plant at LMT has an expected useful life of 1,564 years. The criticism reflects a clear misunderstanding of the nature of Mr. Walker's testimony. His testimony was not suggesting that any individual plant has a depreciation life of 1,564 years. The testimony, rather, was pointing out that the investment dollars of $56.320 million in the plant account balance would last 1,564 years due to the small difference of $0.036 million between depreciation expense and the capital expenditures.

Further, Mr. Smith's use of net plant to determine terminal value is not consistent with his recommendation elsewhere in his testimony. Specifically, Mr. Smith recommended using market multiples of net plant and other financial statistics to determine fair market value by adopting Gannett's Market Approach.[37] However, his use of net plant to determine terminal value does not reflect the same market multiples. For example, as shown in "Table 1" of Aqua Statement No. 4-R, the market multiple for net plant is shown to be 1.45x under the Market Approach. Therefore, Mr. Smith recommends net plant is worth at least 1.45x under the Market Approach but simultaneously testifies net plant used to determine terminal value is only worth 1.00x in his Income Approach. Both recommendations cannot be true.

Mr. Walker also disagreed with the assertion that a "regulated utility's net cash flow is a direct function of its plant in service." 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

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[36] Aqua St. No. 4-R at 8. Mr. Walker explained that would take 1,564 years to use up existing plant ($56.320 ÷ $0.036 = 1,564)

[37] OCA Statement 1 at 34.

(OCA Exhibit RCS-1). The purchase price negotiated by Aqua and the Township is $53.0 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).[38]

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 discount rate of 7.61% to analyze and attempt to refute the Gannett analysis. Gannett used a discount rate of 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 the deferred taxes that created the ADIT. Including these positive cash flows from the deferred taxes in the analysis more than offset the negative effect of ADIT.[39]

As a final point, it is significant to note that the effect of the adjustment to the Income Approach proposed by OCA witness Smith and recommended in the Recommended Decision would be to unreasonably double count the impact of ADIT on ratemaking rate base. Typical and accepted ratemaking practice gives effect to ADIT by subtracting it from net plant in the determination of rate base during a base rate case. Giving effect to ADIT here and in a subsequent rate case would double count its effect as shown in the following example. Assuming that net plant in a Section 1329 application proceeding were $100 and then reduced by $10 of ADIT as part of the Income Approach, the resulting ratemaking rate base would be $90. In the next rate

[38] Aqua St. No. 4-R at 7.

[39] Tr. 42-47.

case, however, the ratemaking rate base of $90 as determined in the Section 1329 proceeding would be reduced a second time by ADIT of $10 resulting in a ratemaking rate base of $80 and a double counting of ADIT.

In sum, for all the reasons presented above and in Aqua's Main and Reply Briefs, the Commission should reverse the recommended adjustment of the terminal value within the Gannett Income Approach. The Gannett Income Approach result of $53,741,785 should be accepted without adjustment.

Aqua's Exception No. 1 should be granted.

<u>EXCEPTION NO. 2</u> - <u>ADJUSTMENT TO AUS INCOME APPROACH – TERMINAL VALUE</u>

Aqua excepts to the downward adjustment of the AUS Income Approach by $9,410,000 based on the use of Net Plant less Accumulated Deferred Income Taxes as the Terminal Value. Recommended Decision, Section VII.G.b and d, Pages 81-82 and 87-89, and Section VII.H, Page 92. Aqua Main Brief, Section V.A.4.b, and Reply Brief, Section V.A.4.b.

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.[40] The AUS Income Approach indicated a value of $57,872,959 for the Lower Makefield system.

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 referred to the

[40] Aqua Exhibit No. 1, Application Exhibit Q at 33.

discussion of his adjustment to the terminal value in the Gannett Income Approach.[41] 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.[42]

The Recommended Decision concludes that the proposed adjustment to the terminal value in the AUS Income Approach is reasonable, consistent with the Code and precedent. It is neither consistent with precedent nor the Code; nor is it reasonable, as set forth above in Exception No. 1, which we incorporate herein by reference. The Commission should reject the use of net plant as the terminal value in the AUS Income Approach for the same reasons as it should reject the use of net plant as the terminal value in the Gannett Income Approach.

Mr. Weinert of AUS explained further why the use of net plant as the terminal value is not reasonable. Mr. Weinert pointed out that OCA witness 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. Mr. Smith's analysis is incorrect in several ways:[43]

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 value of the property based on its economic returns."

[41] OCA St. No 1 at 38.

[42] OCA St. No. 1 at 38.

[43] Aqua St. No. 5-R at 9.

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. Clearly, 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.[44]

In sum, for all the reasons presented above and in Exception No. 1 and in Aqua's Main and Reply Briefs, the Commission should reverse the recommended adjustment of the terminal value within the AUS Income Approach. The AUS Income Approach result of \$57,872,959 should be accepted without adjustment.

Aqua's Exception No. 2 should be granted.

EXCEPTION NO. 3 - ADJUSTMENT TO AUS COST APPROACH – SERVICE LIFE FOR ACCOUNT NO. 361 – GRAVITY COLLECTION MAINS

Aqua excepts to the downward adjustment of the AUS Cost Approach by \$4,714,148 to reflect a change in the service life for Gravity Collection Mains from 80 years to 65 years. Recommended Decision, Section VII.G.b and c, Pages 81-84, and Section VII.H, Pages 90-92. Aqua Main Brief, Section V.A.4.a, and Reply Brief, Sections V.A.4.a.

In the AUS appraisal, the Cost Approach to value of \$51,414,555 is the cost to acquire or build a similar property based on reproduction/replacement cost. Within the AUS Cost Approach, service lives are developed and used that reflect the survival / retirement characteristics of normal and functional service lives of water and wastewater properties.[45] Mr. Weinert of AUS used a

[44] Aqua St. No. 5-R at 10-11 and Tr. 71-72.

[45] Aqua St. No. 5 at 8.

service life of 80 years for Gravity Collection Mains in the AUS Cost Approach.[46] Mr. Weinert explained that 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.

The Recommended Decision recommends that the service life for Gravity Collection Mains be adjusted from 80 years to 65 years based on the testimony of OCA witness Smith. The Recommended Decision concludes that Mr. Weinert failed to provide any reasonable basis to conclude that the 80-year service life that he uses for collection mains is more appropriate than the 65-year service life used by Gannett.[47] The adjustment reduces the AUS Cost Approach result by $4,714,148.

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

There is no evidence of record that OCA witness Smith considered, or was even aware of, CIPP lining and its significance in the development of service lives within the Cost Approach to value. What is clear, however, is that Mr. Smith's criticism of Mr. Weinert's use of an 80-year service life for Gravity Collection Mains is not reasonable. As summarized by Mr. Weinert, Mr. Smith's proposed shortening of the service life of Gravity Collection Mains from 80 years to 65 years is an adjustment that is exactly "in the *wrong* direction."[48]

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[46] Aqua Exhibit No. 1, Application Exhibit R at 6-7.

[47] Recommended Decision, Section H, Page 91.

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

The Recommended Decision dismisses the significance of CIPP lining stating that there is no evidence that Lower Makefield has used this technology to extend the service life of VCP. Contrary to this conclusion, there is substantial evidence that Lower Makefield has used, and is using, CIPP lining. Chapter 94 Reports submitted with the Application explain that the Township undertook CIPP lining in 2020 and has budgeted significant monies to continue its CIPP lining efforts as follows:

> Lower Makefield Township significantly increased the Township budget to address I/I issues as well as the need to upgrade their existing pump stations. Starting in 2020 and moving forward Lower Makefield Township has budgeted approximately $215,000.00 per year for Cured In Place Pipe (CIPP) liners and $20,000.00 per year to rehabilitate manholes. In 2020 Lower Makefield Township lined approximately 2,125 linear feet of twelve inch sanitary sewer mains and lined six manholes. The same amount of work is currently being bid for 2021.[49]
>
> Lower Makefield Township as part of the CAP and in conjunction with their I/I program budgeted $175,000.00 for cured in place pipe liners and $20,000.00 for manhole rehabilitation in 2020. These projects were completed and 1,977 linear feet of ten inch sanitary sewer mains were lined using CIPP and 5 manholes were rehabilitated utilizing a spray liner in 2020.[50]

We submit, moreover, that it was inappropriate for the Recommended Decision to rely on Gannett's use of a 65-year service life for Gravity Collection Mains to reduce the service life for Gravity Collection Mains in the AUS Cost Approach from 80-years to 65-years. The Gannett and AUS Appraisals were conducted independently by qualified and unbiased appraisers, as required by statute and Section 1329 filing requirements. One, consequently, would expect inputs, methods and results to differ from one appraisal and one appraiser to another. It is reasonable and appropriate that they differ and the reason why Section 1329 requires the submission of two independent appraisals. The inputs and results of one are not the measure of appropriateness for the inputs and results of the other.

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[49] Aqua Exhibit No. 1, Application Exhibit E2, Page 231 – Chapter 94 Report for 2020 – Municipal Authority of the Borough of Morrisville.

[50] Aqua Exhibit No. 1, Application Exhibit E1, Page 68 – Chapter 94 Report for 2020 – Lower Makefield Township.

Mr. Weinert emphasized that a service life for Gravity Collection Mains in the range of 75 years to 80 years is supported by depreciation studies filed by Aqua and PAWC in their recent general rate proceedings.[51] 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.[52]

The Commission's decision in *Cheltenham* cited by the OCA[53] does not support the use of a 65-year service life for Gravity Collection Mains in this proceeding. The question in *Cheltenham* was whether the Commission should reduce the AUS service life for manholes and laterals from 90-years to 75-years. The Commission, in *Cheltenham*, agreed with the OCA but, clearly, the decision in *Cheltenham* adjusting the service life for VCP mains, laterals and manholes from 90-years to 75-years in the AUS Cost Approach does not support the further effort in this proceeding to reduce the service life in the AUS Cost Approach still further to 65-years.

The AUS Cost Approach result of $51,414,555 should be accepted, without adjustment, in the determination of ratemaking rate base. The adjustment to the AUS Cost Approach proposed by the OCA and recommended in the Recommended Decision should be rejected. The adjustment is effectively asking the Commission to adjust the service life of Gravity Collection Mains "in the *wrong* direction."[54]

Aqua's Exception No. 3 should be granted.

[51] 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.

[52] Aqua St. No. 5-R at 4-5.

[53] *See* Recommended Decision, page 83.

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

<u>EXCEPTION NO. 4</u> - <u>ADJUSTMENT TO AUS MARKET APPROACH – REMOVAL OF DELCORA TRANSACTION</u>

Aqua excepts to the removal of the DELCORA transaction from the AUS Market Approach. Recommended Decision, Section VII.G.e, Pages 89-90. Aqua Main Brief, Section V.A.4.c, and Reply Brief, Section V.A.4.c.

Although it has no impact on the AUS Market Approach to value of $55,741,000, the Recommended Decision recommends that the Delaware County Regional Water Quality Control Authority ("DELCORA") acquisition be removed from the AUS comparison group as the acquisition has not closed.

The removal of the DELCORA transaction is neither reasonable nor necessary. Mr. Weinert of AUS 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).[55] Since the comparison used is of a purchase price in the original asset purchase agreement, the OCA's criticism of the AUS Market Approach and proposed removal of the Aqua-DELCORA transaction from the AUS comparables should be rejected.

Aqua's Exception No. 4 should be granted.

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

EXCEPTION NO. 5 - **DETERMINATION OF RATEMAKING RATE BASE AND RECOMMENDED RATEMAKING RATE BASE OF $51,236,259**

Aqua excepts to the redetermination of ratemaking as a result of the adjusting of the Gannett and AUS Appraisals and the recommended ratemaking rate base of $51,236,259. Recommended Decision, Page 1, Section VII.G.a, Pages 80-81, Section VII.H, Pages 90-92, and Ordering Paragraphs 7, 10 and 11.

Giving effect to the recommended adjustments to the Gannett Income Approach and to the AUS Cost and Income Approaches, the Recommended Decision concludes 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 in $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."

As set forth above in Exceptions Nos. 1, 2 and 3, Aqua excepts to the individual adjustments to the Gannett Income Approach and to the AUS Cost and Income Approaches that reduce ratemaking rate base. In this Exception No. 5, Aqua excepts to the end result of those adjustments that reduce ratemaking rate base from $53,000,000 to $51,236,259. The adjustments are not supported by the record and are inconsistent with the Code and precedent.

In addition to what we have already presented in the previous exceptions, we disagree with the Recommended Decision and the adjustment of the Appraisals on a basis other than USPAP – specifically, the application of "financial and ratemaking" principles to support the adjustments. The statutory standard is "fair market value in compliance with the Uniform Standards of Professional Appraisal Practice ("USPAP") employing the cost, market and income approaches."[56]

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[56] 66 Pa. C.S. § 1329(a)(3).

This was affirmed in *New Garden*[57] where the Commission stated that "when construing Section 1329 in conjunction with both Section 505 and Section 1103(b) of the Code, it is clear that the Commission retains the authority to review and analyze the UVE valuations to determine compliance with the USPAP standards and whether the three methods were accurately applied to the UVEs' analyses."[58]

We are not suggesting that the determination of ratemaking rate base must be "formulaic;" nor are we suggesting that Appraisals cannot be challenged. We submit, however, that UVE Appraisals are prepared and sponsored by certified UVEs who are qualified by statute and Commission sanction. Considerable weight should be given to their unbiased and independent analyses in the Commission's final determination of ratemaking rate base in a Section 1329 proceeding.

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

Aqua's Exception No. 5 should be granted.

III. <u>CONCLUSION</u>

The Public Utility Commission should grant Aqua's Exceptions and modify the Recommended Decision as aforesaid, approve Aqua's Application filed pursuant to Section 1102, 1329 and 507 of the Public Utility Code, and:

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[57] *Application of Aqua Pennsylvania Wastewater, Inc. Pursuant to Sections 1102 and 1329 of the Public Utility Code for Approval of its Acquisition of the Wastewater System Assets of New Garden Township and the New Garden Township Sewer Authority*, Docket No. A-2016-2580061, Opinion and Order entered June 29, 2017 ("*New Garden*").

[58] *New Garden*, slip op. at 14.

a. Issue Certificates of Public Convenience under Section 1102:

(1) Authorizing Aqua to acquire, by purchase, the wastewater system assets of Lower Makefield Township; and

(2) Authorizing Aqua to begin to offer, render, furnish and supply wastewater service to the public in the Requested Territory.

b. Authorize Aqua to file tariff revisions, effective upon one day's notice, to:

(1) Include within its territory all the Requested Territory;

(2) Adopt and apply within the Requested Territory, Lower Makefield's rates as Aqua's Base Rates; and

(3) Apply Aqua's *Rules and Regulations* within the Requested Territory.

c. As part of its Order approving the Application include a determination that the ratemaking rate base of the Lower Makefield system is $53,000,000 pursuant to Section 1329(c)(2);

d. As part of its Order approving the Application approve Contracts, including Assignment of Contracts, between Aqua and Lower Makefield, pursuant to Section 507 of the Public Utility Code; and

e. Issue such other approvals, certificates, registrations and relief, if any, under the Public Utility Code as may be appropriate.

Respectfully submitted,

AQUA PENNSYLVANIA WASTEWATER, INC.

By______________________________

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Counsel for Aqua Pennsylvania Wastewater, Inc.

Date: November 29, 2021

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

The Honorable Jeffrey A. Watson, Presiding

Application of Aqua Pennsylvania Wastewater, Inc., (APW), under Sections 1102 and 1329 of the Pennsylvania Public Utility Code, 66 Pa C.S. §§ 1102(a) and 1329 (relating to enumeration of acts requiring certificate and valuation of acquired water and wastewater systems), for approval of: (1) the transfer, by sale, of substantially all of the wastewater system assets, properties and rights of Lower Makefield Township (LMT) related to its wastewater collection and conveyance system; (2) the right of APW to begin to offer or furnish wastewater service to the public in Lower Makefield Township, Bucks County, Pennsylvania; and (3) the use for ratemaking purposes of the lesser fair market value or the negotiated purchase price of the LMT assets related to its wastewater collection and conveyance system.	:	**Docket No. A-2021-3024267**

CERTIFICATE OF SERVICE

I hereby certify that I have this 29th day of November, 2021, served a true and correct copy of the foregoing Exceptions of Aqua Pennsylvania Wastewater, Inc. upon the persons and in the manner set forth below:

VIA ELECTRONIC MAIL

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