

COMMONWEALTH OF PENNSYLVANIA



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December 6, 2021

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

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

Dear Secretary Chiavetta:

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

Copies have been served per the attached Certificate of Service.

Respectfully submitted,

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Enclosures:

cc: The Honorable Jeffrey A. Watson (**email only**)
Office of Special Assistants (**email only**: ra-OSA@pa.gov)
Certificate of Service

*320626

CERTIFICATE OF SERVICE

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

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

Dated this 6th day of December 2021.

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Dated: December 6, 2021
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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

**REPLY EXCEPTIONS OF THE
OFFICE OF CONSUMER ADVOCATE**

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Dated: December 6, 2021

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I. INTRODUCTION

The Office of Consumer Advocate (OCA) submits this Reply to the Exceptions of Aqua Pennsylvania Wastewater, Inc. (Aqua). If the Commission approves the Application under Sections 507, 1102 and 1329, the adjustments to the appraisals recommended by Administrative Law Judge (ALJ) Jeffrey A. Watson should be adopted.

II. REPLY EXCEPTIONS

Reply to Aqua Exception No. 1: The Recommended Decision's Adoption of the OCA's Terminal Value Adjustment to Gannett Fleming's Income Approach Testimony Is Reasonable, Appropriate, and Consistent with Ratemaking Principles and Commission Precedent. R.D. at 84-87; OCA M.B. at 10-23; OCA R.B. at 8-11.

Aqua argues that ALJ Watson's adoption of the OCA's terminal value adjustment to the Gannett Fleming Income Approach is contrary to Commission precedent. Aqua Exc. at 6-8. Aqua criticizes the OCA's witness, Mr. Smith, for recommending the use of net plant value from time period 24 (Year 2045 forward) as the terminal value for the Lower Makefield Township (LMT) plant. Aqua Exc. at 6. Aqua also argues that its own witness, Mr. Walker presented an evidentiary analysis demonstrating that net plant value is not a good proxy or measure for future market value. Aqua Exc. at 11. The ALJ, however, determined that in order to properly reflect Pennsylvania law, the OCA's adjustment to the Gannett Fleming Income Approach is reasonable and should be adopted by the Commission in this proceeding. R.D. at 83-87, 92.

As explained at length in the OCA's Main Brief and Reply Brief, the assumptions used by Mr. Walker are not consistent with ratemaking principles and are flawed. OCA M.B. at 14-17; OCA R.B. at 8-11. The traditional concepts of cost-based utility regulation indicate that an approach to terminal value for a rate-regulated public utility should focus on the remaining amount of net plant, not on a perpetual capitalization of prospective earnings. OCA St. 1 SR at 19. If a

firm is expected to earn a return on its investment at its cost of capital and also recover its depreciation expense, the present value of that future cash flow is exactly equal to the present value of its investment. OCA St. 1 SR at 13. Therefore, it is reasonable to base the terminal value for a rate-regulated monopoly utility on the remaining amount of net plant for LMT's system.

Aqua further claims that OCA witness Smith "made no attempt" to distinguish the Commission's determinations in prior cases in his testimony. Aqua Exc. at 7. Aqua's assertion is simply incorrect. OCA witness Smith testified as follows:

Q. At page 3 of his rebuttal testimony, Mr. Walker states that Gannett Fleming has applied a capitalization rate concept to estimate the terminal value as part of its Market Value appraisal in sixteen of the Section 1329 fair market value proceedings, and the PA PUC has not adjusted the capitalization rate concept in any of those prior proceedings. Please respond.

A. The facts and evidence presented in each utility-proposed acquisition under Section 1329 vary for each utility. In a number of the Section 1329 acquisitions, settlements resulted. In other cases, adjustments to the Gannett Fleming Income Approach proposed by witnesses for the OCA may have essentially been moot because the ultimate valuation results, after being averaged by the seller's and buyer's UVE, were above the amount of the purchase price, thus, had no discernable impact upon the rate case value to be used for the acquired utility system. Thus, an impression that all sixteen of the previous Gannett Fleming valuations were scrutinized in detail and specifically blessed in every aspect by the Commission in each of those sixteen proceedings would be a bit misleading. Only one specific Section 1329 acquisition case, *Cheltenham*, Docket No. A-2019-3008491, is cited by Mr. Walker on page 7 of his rebuttal testimony, where he claims that the PA PUC rejected the OCA's proposed use of net plant as the terminal value used in the Income Approach.

Q. Please explain why you, as a witness for the OCA, are proposing a terminal value approach for LMT in the current case.

A. 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 12-13. As shown above, Aqua's assertion that Mr. Smith "made no attempt" to distinguish the LMT acquisition from previous Section 1329 acquisitions is without merit.

In response to Aqua's position that, after time period 24 (year 2045) the growth in annual debt free net cash flows is a constant growth rate (Aqua Exc. at 6), 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 R.B. at 10; 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 R.B. at 10; OCA St. 1SR at 14. Mr. Smith, on the other hand, correctly explained that a public utility cannot be sustained under the rate base/rate of return approach to determining revenue requirement if depreciation exceeds capital expenditures as follows:

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

OCA St. 1SR at 14-15.

Aqua claims that Mr. Smith and the ALJ's criticism of Mr. Walker's testimony in regard to taking 1,564 years to use up existing plant is based on a misunderstanding. Aqua. Exc. at 13. Aqua concedes that no LMT plant has a depreciation life that long but argues that the investment dollars in the plant account balance would last 1,564 years. Aqua Exc. at 12-13. This is a distinction without substance because the accumulated depreciation is an offset to the plant account balance. Aqua fails to address the point, which is that whenever depreciation exceeds capital expenditures, utility rate base declines and if the decline continues rate base would eventually

approach zero. As such, OCA witness Smith properly adjusted Gannett Fleming's Income Approach by recalculating the valuation of the terminal value using the amount of Net Plant less ADIT remaining at the end of Year 24. See OCA Exh. RCS-2-SR, page 3.

Also, the OCA submits that Aqua's arguments in regard to the impact of Annual Deferred Income Taxes (ADIT) on the Income Approach, raised in Aqua's Exceptions and previously in its Main Brief, were already rebutted by the OCA's testimony and exhibits. See Aqua Exc. at 14-15; Aqua M.B. at 19-20; OCA R.B. at 10-11; OCA St. 1SR at 15-16; OCA Exh. RCS-2-SR. 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. OCA R.B. at 11; 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. As such, Aqua's point regarding an unreasonable double count of the impact of ADIT on rate base is moot. Aqua's continued argument to the contrary, despite this issue already being addressed, is misleading and inappropriate.

For the reasons stated above and in the OCA's Main Brief, the OCA submits that the Recommended Decision's Income Approach valuation of \$48,462,957 should be adopted in place of Gannett Fleming's proposed amount of \$53,741,785. See OCA R.B. at 11; OCA Exh. RCS-3-SR.

Reply to Aqua Exception No. 2: The Recommended Decision's Adoption of the OCA's Terminal Value Adjustment to AUS's Income Approach Testimony is Reasonable, Appropriate, and Consistent with Ratemaking Principles and Commission Precedent. R.D. at 87-89; OCA M.B. at 17; OCA R.B. at 11-13.

As discussed in the OCA's Main Brief and Reply Brief, Mr. Smith also recommended an adjustment to the terminal value used in the AUS Income Approach. OCA M.B. at 17; OCA R.B. at 11-13. 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 Exc. at 16.

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 R.B. at 12. 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. Id. To be clear, the terminal value component is \$7.038 million, not zero, which demonstrates 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 beyond 2049, the value should be calculated based on the equivalent of a utility net depreciated plant rate base amount, net of the ADIT offset, recognizing Aqua's ownership as a PUC-regulated public utility. Simply put, the LMT wastewater utility is a rate regulated public utility, not a competitive business. The OCA further notes that extending the Income Approach for an

additional lengthy period, such as for another 40 years as presented by AUS, should be viewed as inherently unreliable. As explained by Mr. Smith, the farther 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 for the LMT wastewater system:

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.¹ 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 R.B. at 12-13; OCA St. 1SR at 9-10.

For the reasons discussed in the OCA's Main Brief, Reply Brief and above, Mr. Smith's recommended adjustment to the AUS Income Approach result to \$48,462,957 is reasonable,

¹ $0.171 / 0.014 = 12.2$ times.

supported, and should be adopted. OCA R.B. at 12; OCA St. 1SR at 10; OCA Exh. RCS-1 SR at Col. G, Ln. 11.

Reply to Aqua Exception No. 3: The Recommended Decision's Adoption of the OCA's Adjustment to AUS's Cost Approach Testimony is Reasonable, Appropriate, and Consistent with Ratemaking Principles and Commission Precedent. R.D. at 82-84, 90-92; OCA M.B. at 17; OCA R.B. at 11-13.

The ALJ adopted OCA witness Smith's recommended adjustments to AUS' Cost Approach from a utilization of an 80-year service life for gravity collection mains to a 65-year service life. R.D. at 82-84, 90-92.

As it pertains to the OCA's adjustments to Mr. Weinert's Cost Approach, Aqua argues 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 Exc. at 20. It is telling, however, that Gannett Fleming's UVE utilized a shorter service life for gravity collection mains in the Lower Makefield Township system. As OCA witness Smith explained:

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

OCA St. 1SR at 18.

Aqua contends that comparison of the AUS fair market value appraisal to the Gannett Fleming fair market value appraisal is inappropriate given that "[o]ne, consequently, would expect input, 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 appraisers.” Aqua Exc. at 19. In response, the OCA points out that use of a 65-year service life by the Gannett Fleming UVE is not the only reason that using an 80-year service life for the largest account in the LMT sewer system is not reasonable.

There is a lack of historical records for the LMT system and an assumption is being made that older plant in the Collection Sewers – Gravity Mains plant account for LMT is vitrified clay pipe. OCA St. 1SR at 18-19. Indeed, the Ebert Engineering report stated 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.

For other Section 1329 acquisitions, Mr. Weinert’s previous appraisals indicated a 75-year service life for its gravity collection mains comprised of vitrified clay pipe (VCP). OCA M.B. at 12-13. 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 (citing Application of Aqua Pennsylvania Wastewater, Inc., A-2019-3008491, Order at 44-45 (Nov. 5, 2019) (Cheltenham)). 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.

See 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.

Aqua argues that there is no evidence of record that OCA witness Smith considered, or was aware of, CIPP lining and its significance in developing service lies within the Cost Approach. Aqua Exc. at 18-19. The OCA notes that while Aqua 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.

Aqua further claims that it was inappropriate for the Recommended Decision to “rely on Gannett Fleming’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.” Aqua Exc. at 19. The Recommended Decision, however, did not solely rely on Gannett’s use of a 65-year service life in its determination. Indeed, the ALJ stated as follows:

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.

R.D. at 91.

As discussed in the Recommended Decision, 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 R.D. at 90-92. The Gravity Mains account is, by far, the single largest utility plant account for LMT, so using an accurate expected useful life for that account is particularly important in arriving at a reasonable valuation for the LMT sewer utility system.

As such, and for the reasons discussed above and contained in the OCA’s Main Brief and Reply Brief, the Recommended Decision properly determined that the 80-year estimated useful life for Gravity Mains proposed by Mr. Weinert has no reasonable basis and should be rejected.

Reply to Aqua Exception No. 4: The ALJ’s Determination to Remove the DELCORA Transaction from the AUS Market Approach is Reasonable, Appropriate, and Consistent with Ratemaking Principles and Commission Precedent. R.D. at 89-90; OCA M.B. at 17-18; OCA R.B. at 13-14.

OCA witness Smith recommended 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 “neither reasonable nor necessary” to remove the DELCORA acquisition from AUS’ comparison group since the comparison used is of a purchase price in the asset purchase agreement to comparability measures, such as customers. Aqua Exc. at 21.

This argument lacks merit. The DELCORA acquisition is an outlier. All of the other acquisitions in the comparison group are closed transactions. Including the DELCORA acquisition and indicating \$276,500,000 as a “final purchase price” for that system is inaccurate and potentially misleading.

As discussed in the OCA’s Reply Brief, 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.² Additionally, the DELCORA customers are not currently customers of Aqua.

For these reasons, the ALJ's determination that Mr. Smith's recommendation to remove the DELCORA acquisition AUS' proxy group for the LMT acquisition is reasonable and should be adopted. See R.D. at 89-90.

Reply to Aqua Exception No. 5: 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. R.D. at 80-84; OCA M.B. at 9-10; OCA R.B. at 3-6.

Aqua argues that the ALJ's determination to adjust the UVE appraisals is not supported by the record and is inconsistent with the Code and precedent. Aqua Exc. at 22. Aqua further disagrees with the ALJ's adjustment to the appraisals as being made "on a basis other than USPAP – specifically, the application of 'financial and ratemaking' principles to support the adjustments." Aqua Exc. at 22-23. As discussed below, these arguments ignore applicable law and Commission precedent.

Section 1329 creates a valuation process, which begins with two UVEs providing individual appraisals of "fair market value." 66 Pa. C.S. § 1329(a)(3). The statute anticipates that these appraisals will differ and provides for the appraisals to be averaged. 66 Pa. C.S. § 1329(g). The fact that two UVEs, who both must comply with the Uniform Standards of Professional Appraisal Practice (USPAP) and employ the Cost, Market, and Income approaches, may

² As discussed in the OCA's Main Brief and Reply Brief, the DELCORA acquisition has not been approved by the Commission. The initial Recommended Decision denied the Application for acquisition. Application of Aqua Pennsylvania Wastewater, Inc., A-2017-2606103, Recommended Decision (Jan. 12, 2021). The matter is currently on remand, which has been stayed since March 2021. Application of Aqua Pennsylvania Wastewater, Inc., A-2017-2606103, ALJ Order Staying Proceeding (Apr. 16, 2021).

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. Thus, the consumer interest can only be protected if the Commission may consider evidence regarding errors and unsupported adjustments in the UVE appraisals.

The Commission has previously ruled on Aqua’s argument on whether compliance with the USPAP is the sole standard of review for the ratemaking rate base valuation in a Section 1329 Application. See Cheltenham at 34-40. Indeed, the Commission previously viewed Aqua’s argument as an “attempt to unreasonably tie the Commission’s hands to an unreasonably narrow standard by which the Commission can review a UVE’s valuation of utility property for determining the ratemaking rate base – that is, whether a UVE’s valuation of utility property is compliant with USPAP.” Cheltenham at 36-37. The Commission further stated that Aqua’s position represents a very narrow construction of Section 1329 that would support the proposition that Section 1301’s mandate for just and reasonable rates be given *no effect*. Id. Following a lengthy discussion on the issue, the Commission concluded as follows:

Therefore, we agree with the OCA and the ALJ that the statutory appraisal process is not simply a formulaic mathematical exercise, nor is the Commission acting as some type of USPAP-compliance board. We agree that review of the appraisals provided by Aqua and Cheltenham UVEs shows that there are judgments made in each type of analysis as well as in how much weight is to be given to each approach. We also agree that it would be inconsistent with the requirements of the 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 based solely upon the judgments of the UVEs, and to not permit any review or challenges of those inputs, methods or judgments.

Cheltenham at 40 (see full discussion by the Commission on pages 36 to 40). Moreover, in Limerick, the Commission was clear that the USPAP is not the controlling text for Section 1329

valuations involving regulated utilities. See Application of Aqua Pennsylvania Wastewater, Inc., A-2017-2605434, Order at 58 (Nov. 29, 2017) (Limerick).

The OCA submits that non-UVEs are permitted to recommend adjustments as there is no prohibition on the ability of the parties to recommend adjustments in order to ensure that proposed transactions under Section 1329 comply with Pennsylvania law and result in just and reasonable rates. As discussed above, Mr. Smith is highly qualified to review the appraisals and present his critiques. Unlike the UVEs, Mr. Smith employed standard financial and regulatory principles to make recommendations as to how to adjust for assumptions within the UVE appraisals that are unreasonable or inconsistent with utility practice. The analyses of the UVE appraisals conducted by Mr. Smith derived from standard financial and business concepts properly based on his financial and utility ratemaking expertise.

The law is clear that the Commission has the authority to make adjustments to the appraisal results of the UVEs in order to establish the fair market value. Aqua's position has been previously rejected by the Commission and should be rejected in this proceeding as well. The OCA's recommendations regarding errors and unsupported adjustments in the UVE appraisals are fully supported by the record as discussed in the OCA's Main Brief, Reply Brief, and herein.

III. CONCLUSION

For the reasons stated above and in the OCA's Main Brief and Reply Brief, if the Commission approves the application under Sections 507, 1102 and 1329, the Office of Consumer Advocate's proposed conditions should be adopted, including the OCA's proposed adjustments to the appraisals and the Recommended Decision should be adopted except as set forth in OCA's Exception.

Respectfully Submitted,

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