**PENNSYLVANIA**

**PUBLIC UTILITY COMMISSION**

**Harrisburg, PA 17120**

|  |  |
| --- | --- |
|  | Public Meeting held January 13, 2022 |
| Commissioners Present:Gladys Brown Dutrieuille, ChairmanJohn F. Coleman, Jr., Vice ChairmanRalph V. Yanora |
| Application of Aqua Pennsylvania Wastewater, Inc., pursuant to 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 Aqua Pennsylvania Wastewater, Inc. to begin to offer or furnish wastewater service to the public in Lower Makefield Township, Bucks County; 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. |  A-2021-3024267 |
|  |  |

**OPINION AND ORDER**

**Table of** **Contents**

[I. Procedural History 1](#_Toc90970697)

[II. Legal Standards 5](#_Toc90970698)

[A. Burden of Proof, 66 Pa. C.S. § 332(a) 5](#_Toc90970699)

[B. Certificate of Public Convenience, 66 Pa. C.S. §§ 1102, 1103 6](#_Toc90970700)

[C. Ratemaking Rate Base Value, 66 Pa. C.S. § 1329 9](#_Toc90970701)

[D. Utility-Municipal Contracts, 66 Pa. C.S. § 507 10](#_Toc90970702)

[E. Settlements in the Public Interest 11](#_Toc90970703)

[F. General Standards 11](#_Toc90970704)

[III. Transaction Overview 12](#_Toc90970705)

[IV. Joint Petition for Partial Settlement 14](#_Toc90970706)

[A. Terms and Conditions of the Partial Settlement 14](#_Toc90970707)

[B. ALJ’s Recommendation on the Partial Settlement 19](#_Toc90970708)

[1. Approval of Application and Acquisition 20](#_Toc90970709)

[2. Tariff 21](#_Toc90970710)

[3. Engineering Assessment 21](#_Toc90970711)

[4. Easements and Other Property Rights 22](#_Toc90970712)

[5. Cost of Service Study 23](#_Toc90970713)

[6. Allowance for Funds Used During Construction, Deferral of Depreciation and Transaction Costs 24](#_Toc90970714)

[7. Long Term Infrastructure Improvement Plan and Distribution System Improvement Charge 24](#_Toc90970715)

[8. Township Rates 25](#_Toc90970716)

[9. Welcome Letter 26](#_Toc90970717)

[10. Legal Fees 26](#_Toc90970718)

[11. Section 507 Approval and Other Approvals, Certificates, Registrations and Relief, if any, under the Code 27](#_Toc90970719)

[C. Public Interest Analysis of the Settlement 27](#_Toc90970720)

[V. Unresolved Issues 28](#_Toc90970721)

[A. Determination of Ratemaking Rate Base 28](#_Toc90970722)

[1. Aqua’s Application 31](#_Toc90970723)

[2. Cost Approach 34](#_Toc90970724)

[a. Positions of the Parties 34](#_Toc90970725)

[b. ALJ’s Recommendation 38](#_Toc90970726)

[c. Aqua Exception No. 3 and Replies 39](#_Toc90970727)

[d. Disposition 43](#_Toc90970728)

[3. Income Approach 45](#_Toc90970729)

[a. Positions of the Parties 48](#_Toc90970730)

[b. ALJ’s Recommendation 58](#_Toc90970731)

[c. Aqua Exception No. 1 and Replies 59](#_Toc90970732)

[d. Aqua Exception No. 2 and Replies 65](#_Toc90970733)

[e. Disposition 66](#_Toc90970734)

[4. Market Approach 70](#_Toc90970735)

[a. Positions of the Parties 71](#_Toc90970736)

[b. ALJ’s Recommendation 72](#_Toc90970737)

[c. Aqua Exception No. 4 and Replies 73](#_Toc90970738)

[d. Disposition 74](#_Toc90970739)

[5. Conclusion – Section 1329 Fair Market Valuation 74](#_Toc90970740)

[a. Positions of the Parties 74](#_Toc90970741)

[b. ALJ’s Recommendation 75](#_Toc90970742)

[c. Aqua’s Exception No. 5 and Replies 75](#_Toc90970743)

[d. Disposition 78](#_Toc90970744)

[B. Income Tax Savings on Repairs Deductions 81](#_Toc90970745)

[1. Positions of the Parties 81](#_Toc90970746)

[2. ALJ’s Recommendation 83](#_Toc90970747)

[3. OCA Exception No. 1 and Replies 85](#_Toc90970748)

[4. Disposition 88](#_Toc90970749)

[VI. Conclusion 90](#_Toc90970750)

**BY THE COMMISSION:**

Before the Pennsylvania Public Utility Commission (Commission) for consideration and disposition are the Exceptions of Aqua Pennsylvania Wastewater, Inc. (Aqua, the Company, or the Applicant) and the Office of Consumer Advocate (OCA), filed on November 29, 2021, to the Recommended Decision (R.D.) of Administrative Law Judge (ALJ) Jeffrey A. Watson, issued on November 17, 2021, in the above-captioned proceeding. Aqua and the OCA filed Replies to Exceptions on December 6, 2021. Also, before the Commission is the Joint Petition for Approval of Partial Settlement (Joint Petition or Partial Settlement) filed by Aqua, the Commission’s Bureau of Investigation and Enforcement (I&E), the OCA, the Office of Small Business Advocate (OSBA), and Lower Makefield Township (LMT or the Township) (collectively, Joint Petitioners), on October 8, 2021. For the reasons stated, *infra*, we shall: (1) grant, in part, and deny, in part, the Exceptions of Aqua; (2) deny the Exceptions of the OCA; (3) adopt the ALJ’s Recommended Decision, as modified, consistent with this Opinion and Order; and (4) approve the Joint Petition, without modification, as being in the public interest.

# Procedural History

On May 14, 2021, Aqua filed an Application under Sections 507, 1102, and 1329 of the Public Utility Code (Code) seeking approval of: (1) the acquisition, by Aqua, of the wastewater system assets of the Township; (2) the right of Aqua to begin to offer, render, furnish and supply wastewater service to the public in the requested territory; and (3) an order approving the acquisition that includes the ratemaking rate base of the Township’s wastewater system assets pursuant to Section 1329(c)(2) of the Code, 66 Pa. C.S. § 1329(c)(2).[[1]](#footnote-2) Application at ¶ 3. Aqua also requested approval of the Asset Purchase Agreement (APA) dated September 17, 2020, as well as other municipal agreements, pursuant to Section 507 of the Code, 66 Pa. C.S. § 507, and requested that the Commission issue an order and Certificate of Public Convenience approving and addressing the items requested in its Application. Application at ¶ 5.

On June 9, 2021, the OSBA filed a Notice of Intervention and Public Statement. On June 16, 2021, I&E filed a Notice of Appearance.

By Secretarial Letter dated June 25, 2021, the Commission conditionally accepted the Application for filing. The Commission required individual notice to be provided to Aqua’s existing water and wastewater customers, that Aqua ensure concurrent notice was 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 30, 2021, Aqua filed a letter with the Commission, with the attached verification, stating that it had complied with the notice requirements.

On June 29, 2021, LMT filed a Petition to Intervene. The OCA filed a Protest and Public Statement on July 2, 2021.

By Secretarial Letter dated August 5, 2021, the Commission informed Aqua that it had accepted the Application for filing. The Commission published a notice of the Application in the August 21, 2021 edition of the *Pennsylvania Bulletin* with a protest deadline of September 7, 2021. 51 *Pa. B*. 5343.

Six protests to the Application were filed by *pro se* individuals.[[2]](#footnote-3)

On September 9, 2021, a Telephonic Prehearing Conference convened, as scheduled, in which Aqua, I&E, the OCA, the OSBA, LMT, Protestant Summers, and Protestant Lachance participated.[[3]](#footnote-4) A litigation schedule was adopted providing for, *inter alia*, the distribution of direct testimony of other parties,[[4]](#footnote-5) rebuttal, surrebuttal and outlines of oral rejoinder testimony, and evidentiary hearings on September 29 and 30, 2021.

A Telephonic Public Input Hearing was held on September 23, 2021, during which three witnesses offered testimony (Protestant Summers, Jeffrey Hall-Gale, and Protestant Lachance).[[5]](#footnote-6) The testimony from the Public Input Hearing is discussed in more detail in the Recommended Decision on pages 50 through 51.

A call-in evidentiary hearing was convened on September 29, 2021, as scheduled. Written testimony was admitted into the evidentiary record by stipulation and cross examination was waived.[[6]](#footnote-7) Oral rejoinder testimony by the Utility Valuation Experts (UVEs) was presented and subject to cross examination.

ALJ Watson approved the Joint Stipulation by Interim Order, dated September 29, 2021, Approving Joint Stipulation for the Admission of Testimony and Exhibits, Providing for the Filing of Objections to Any Settlement and Responses to Objections and Revising Litigation Schedule.

On October 8, 2021, Aqua, I&E, the OCA, the OSBA and LMT filed a Joint Petition for Approval of 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.

On October 8, 2021, Main Briefs were filed by Aqua and the OCA, addressing the two unresolved issues.[[7]](#footnote-8) Reply Briefs were filed by Aqua and the OCA on October 18, 2021, closing the record in this proceeding.

In the Recommended Decision issued on November 17, 2021, ALJ Watson recommended approving the Joint Petition without modification because it is supported by substantial evidence and is in the public interest. R.D. at 1, 98. Concerning the two issues reserved for litigation: (1) ALJ Watson recommended adoption of the OCA’s proposed adjustments to the fair market value (FMV) appraisals of Gannett Fleming and AUS. The effect of the adjustments reduces the ratemaking rate base for the acquired assets by $1,763,741 from the proposed $53,000,000 to $51,236,259, and (2) as to the treatment of income tax savings on repairs deductions, ALJ Watson rejected 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 base rate case. R.D. at 92, 96-99.

As noted above, Aqua and the OCA filed Exceptions on November 29, 2021; Aqua excepting to the recommended reduction of ratemaking rate base from $53,000,000 to $51,236,259, and the OCA excepting to the denial of its proposed recording of the income tax effect of repairs deductions in a regulatory liability account. On December 6, 2021, Aqua and the OCA filed Replies to Exceptions.

# Legal Standards

## Burden of Proof, 66 Pa. C.S. § 332(a)

As the proponent of a rule or order in this proceeding, Aqua has the burden of proof to establish that it is entitled to the relief it is seeking. 66 Pa. C.S. § 332(a). The Applicant must establish its case by a preponderance of the evidence. *Samuel J. Lansberry, Inc. v. Pa. PUC*, 578 A.2d 600 (Pa. Cmwlth. 1990), *alloc. denied*, 529 Pa. 654, 602 A.2d 863 (1992). That is, the Applicant’s evidence must be more convincing, by even the smallest amount, than that presented by any opposing party. *Se‑Ling Hosiery, Inc. v. Margulies*, 364 Pa. 45, 70 A.2d 854 (1950). Additionally, this Commission’s decision must be supported by substantial evidence in the record. More is required than a mere trace of evidence or a suspicion of the existence of a fact sought to be established. *Norfolk & Western Ry. Co. v. Pa. PUC*, 489 Pa. 109, 413 A.2d 1037 (1980).

## Certificate of Public Convenience, 66 Pa. C.S. §§ 1102, 1103

Section 1102(a)(1)(i) of the Code requires a utility to first obtain a Certificate of Public Convenience (Certificate) prior to beginning to offer or supply utility service to a different territory than that previously authorized by the Commission. 66 Pa. C.S. § 1102(a)(1)(i).

Section 1102(a)(3) of the Code requires a utility to first obtain a Certificate from the Commission prior to a utility or an affiliated interest of a utility to acquire or transfer, to any person or corporation by any method, property used or useful in the public service. 66 Pa. C.S. § 1102(a)(3).

Section 1103(a) of the Code establishes the standard for granting a Certificate required under Section 1102:

A certificate of public convenience shall be granted . . . 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*. The commission, in granting such certificate, may impose such conditions as it may deem to be just and reasonable.

66 Pa. C.S. § 1103(a) (emphasis added); *see also Seaboard Tank Lines v. Pa. PUC*,502 A.2d 763, 764-65 (Pa. Cmwlth. 1985).

According to the Pennsylvania Supreme Court, satisfying the standard of Section 1103(a) requires the Commission to find that the proposed transaction will “affirmatively promote the service, accommodation, convenience, or safety of the pubic in some substantial way.” *City of York v. Pa. PUC*, 449 Pa. 136, 141, 295 A.2d 825, 828 (1972) (*City of York*). In establishing this precedent, the Court held that the statute’s clear command is that the Commission must find that the granting of a certificate “will affirmatively benefit the public.” *Id*. (overruling in part, *Northern Pennsylvania Power Co*. *v. Pa. PUC*, 333 Pa. 265, 267, 5 A.2d 133, 134).

The Supreme Court further held:

In conducting the underlying inquiry, the Commission is not required to secure legally binding commitments or to quantify benefits where this may be impractical, burdensome, or impossible; rather, the PUC properly applies a preponderance of the evidence standard to make factually-based determinations (including predictive ones informed by expert judgment) concerning certification matters.

*Popowsky v. Pa. PUC*, 594 Pa. 583, 611, 937 A.2d 1040, 1057 (2007) *(Popowsky).* Further, the Court explained that demonstration of the affirmative public benefit does not require that every customer receive a benefit from the proposed transaction. *Id*. at 617‑618, 937 A.2d at 1061. In addition, “in some circumstances conditions may be necessary to satisfy the Commission that public benefits sufficient to meet the requirement of Section 1103(a) will ensue.” *Id.* at n.21. The Commission can, under Section 1103(a), impose conditions that it deems just and reasonable. 66 Pa. C.S. § 1103(a).

One of the factors that the Supreme Court identified in the *City of York* for the Commission to consider, in determining whether there is an affirmative public benefit is:

[A]t least in a general fashion, the effect that a proposed merger is likely to have on future rates to consumers. Along with the likely effect of a proposed merger upon the service that will be rendered to consumers, the probable general effect of the merger upon rates is certainly a relevant criteria of whether the merger will benefit the public.

*City of York*, 295 A.2d at 829.

In applying this specific factor, the Pennsylvania Commonwealth Court recently held that the Commission must perform “the balancing test required by Section 1102 of the Code to weigh all the factors for and against the transaction, *including the impact on rates*, to determine if there is a substantial public benefit.” *McCloskey v. Pa. PUC*,195 A.3d 1055, 1066-1067 (Pa. Cmwlth. 2018), *appeal denied*,207 A.3d 290 (Pa. 2019) (*McCloskey*) (emphasis added). While *McCloskey* held that rate impact must be addressed, it recognized that “the Commission is charged with deciding whether the impact of rates…is outweighed by … other positive factors that…served [as] a substantial public benefit.” 195 A.3d at 1067.

The Commission and the courts have held that granting a certificate need not be “absolutely necessary” in order to be in the public interest.  *See* *Hess v. Pa. PUC*,107 A.3d 246, 262 (Pa. Cmwlth. 2014). The Commonwealth Court reasoned, “[n]ot only would this approach be impractical and unrealistic, it would actually pose a danger to the health, safety and welfare of the public.” *Id.* In addition, when considering the public interest, the Commission may consider how the benefits and detriments impact “*all affected parties*, and not merely one particular group or geographic subdivision.” *Middletown Twp. v. Pa. PUC*,482 A.2d 674, 682 (Pa. Cmwlth. 1984) (emphasis in original); *see also*, *Dunk v. Pa. PUC*,232 A.2d 231, 234-35 (Pa. Super. 1967), *aff’d*, 252 A.2d 589 (1969) (where public benefit included companies and customers other than the proponent utility).

To obtain a Certificate, the acquiring public utility has the burden, by a preponderance of the evidence, to establish that it is technically, legally, and financially fit to provide the proposed service. *McCloskey*, 195 A.3d at 1058. An existing certificate holder is entitled to a “continuing presumption regarding its fitness to operate,” which includes a presumption that the certificate holder has a propensity to operate legally. *Lehigh Valley Transp. Servs., Inc. v. Pa. PUC*, 56 A.3d 49, 58 (Pa. Cmwlth. 2012) (*Lehigh Valley Transp.*); *South Hills Movers, Inc. v. Pa. PUC*,601 A.2d 1308, 1310 (Pa. Cmwlth. 1992). It is the protestant’s burden to rebut that presumption. *Lehigh Valley Transp.* Where an Applicant is both presumed fit and sets forth affirmative evidence demonstrating fitness, this burden is particularly heavy. *Id.*

## Ratemaking Rate Base Value, 66 Pa. C.S. § 1329

Section 1329 of the Code establishes a process for ratemaking purposes to value the plant of municipal-owned water and wastewater systems to be acquired by certificated public utilities. 66 Pa. C.S. § 1329.[[8]](#footnote-9) Under Section 1329, the value of water and wastewater system assets to be included in the acquiring utility’s rate base for ratemaking purposes will be the lesser of the purchase price negotiated by the acquiring utility and seller or the “fair market value” of the selling utility’s system. 66 Pa. C.S. § 1329(c)(2).

The FMV process under Section 1329 where the acquiring utility and the seller must elect and agree to have the FMV of the seller’s assets established through separate, independent appraisals conducted by UVEs is voluntary. 66 Pa. C.S. § 1329(a). The Commission maintains a list of qualified UVEs from which the acquiring utility and seller must choose their respective appraisers. 66 Pa. C.S. §§ 1329(a)(1), (2).

The UVEs must prepare an appraisal of the seller’s system assets in compliance with the Uniform Standards of Professional Appraisal Practice (USPAP), employing the Cost, Market and Income Approaches. 66 Pa. C.S. § 1329(a)(3). The FMV of the system is defined as the average of the two separate UVE appraisals conducted in compliance with Section 1329(a)(3). 66 Pa. C.S. § 1329(g).

The Applicant must provide to the Commission copies of the appraisals; the purchase price; the ratemaking rate base; the closing costs; and, if applicable, a tariff and rate stabilization plan. 66 Pa. C.S. § 1329(d)(1).

## Utility-Municipal Contracts, 66 Pa. C.S. § 507

Section 507 of the Code provides as follows regarding a utility’s contract with a municipal corporation:

Except for a contract between a public utility and a municipal corporation to furnish service at the regularly filed and published tariff rates, no contract or agreement between any public utility and any municipal corporation shall be valid unless filed with the commission at least 30 days prior to its effective date. Upon notice to the municipal authorities, and the public utility concerned, the Commission may, prior to the effective date of such contract or agreement institute proceedings to determine the reasonableness, legality or any other matter affecting the validity thereof. Upon the institution of such proceedings, such contract or agreement shall not be effective until the Commission grants its approval thereof.

66 Pa. C.S. § 507. Thus, pursuant to Section 507, the Commission has discretionary power to institute proceedings to determine the reasonableness, legality and validity of the contracts between a municipality and a public utility. *Id*.; *see also County of Allegheny v. Pa. PUC*,159 A.2d 227, 233 (Pa. Super. 1960).

## Settlements in the Public Interest

Pursuant to our Regulations at 52 Pa. Code § 5.231, it is the Commission’s policy to promote settlements. A full settlement of all the issues in a proceeding eliminates the time, effort and expense that otherwise would have been used in litigating the proceeding, while a partial settlement may significantly reduce the time, effort and expense of litigating a case. A settlement, whether whole or partial, benefits not only the named parties directly, but, indirectly, all customers of the public utility involved in the case. *Pa. PUC, et al. v. Columbia Gas of Pennsylvania, Inc.*, Docket Nos. R‑2015‑2468056, *et al.* (Order entered December 3, 2015) at 6-7. Despite this policy, the Commission does not simply rubber stamp settlements without determining whether the terms are in the public interest. *Pa. PUC v. Philadelphia Gas Works*, Docket No. M‑00031768 (Order entered January 7, 2004); *Pa. PUC v. CS Water and Sewer Assoc.*, 74 Pa. P.U.C. 767 (1991); *Pa. PUC v. Philadelphia Electric Co.*, 60 Pa. P.U.C. 1 (1985).

## General Standards

In the Recommended Decision, ALJ Watson made twenty-two Findings of Fact and reached thirty-one Conclusions of Law. *See* R.D. at 10-13, 99-105. The Findings of Fact and Conclusions of Law are incorporated herein by reference and are adopted without comment unless they are either expressly or by necessary implication rejected or modified by this Opinion and Order.

As we proceed in our review of the various positions of the Parties in this proceeding, we are reminded that the Commission is not required to consider expressly or at length each contention or argument raised by the parties. [*Consolidated Rail Corp. v. Pa. PUC*,625 A.2d 741 (Pa. Cmwlth. 1993);](file://C:\research\buttonTFLink?_m=69761b6202cb4178e2a6e6fe02f5751b&_xfercite=%3ccite%20cc=%22USA%22%3e%3c!%5bCDATA%5b2000%20Pa.%20PUC%20LEXIS%2067%20%5d%5d%3e%3c\cite%3e&_butType=3&_butStat=242&_butNum=5&_butInline=1&_butinfo=%3ccite%20cc=%22USA%22%3e%3c!%5bCDATA%5b625%20A.2d%20741%5d%5d%3e%3c\cite%3e&_fmtstr=FULL&docnum=5&_startdoc=1&_startchk=1&wchp=dGLSzS-lSlbz&_md5=ad2b02d95c2a9216e83b92a3570d4785) *also see, generally,* [*University of Pennsylvania v. Pa. PUC*, 485 A.2d 1217 (Pa. Cmwlth. 1984).](file://C:\research\buttonTFLink?_m=69761b6202cb4178e2a6e6fe02f5751b&_xfercite=%3ccite%20cc=%22USA%22%3e%3c!%5bCDATA%5b2000%20Pa.%20PUC%20LEXIS%2067%20%5d%5d%3e%3c\cite%3e&_butType=3&_butStat=242&_butNum=6&_butInline=1&_butinfo=%3ccite%20cc=%22USA%22%3e%3c!%5bCDATA%5b485%20A.2d%201217%5d%5d%3e%3c\cite%3e&_fmtstr=FULL&docnum=5&_startdoc=1&_startchk=1&wchp=dGLSzS-lSlbz&_md5=9b1cc8319afd12440738bb82d74455ef) Exceptions that we do not specifically address shall be deemed to have been duly considered and denied without further discussion.

# Transaction Overview

Aqua is a certificated provider of wastewater service, duly organized and existing under the laws of the Commonwealth of Pennsylvania. Aqua provides wastewater service to approximately 45,000 customer accounts in various counties throughout Pennsylvania including parts of Bucks County. Application at ¶ 7.

LMT owns a sanitary wastewater collection system operated by the Municipal Sewer Authority of the Township of Lower Makefield, which provides direct wastewater service to 11,151 customers in the Township. Application at ¶ 8; Aqua St. 2 at 10. LMT does not own a wastewater treatment plant. Wastewater treatment is mainly provided by the Municipal Authority of the Borough of Morrisville and also by Yardley Borough Sewer Authority. Application at ¶ 15.

On September 17, 2020, Aqua and LMT entered into an APA for the sale of substantially all of the assets, properties, and rights related to the Township’s wastewater system at an agreed-upon price of $53,000,000.[[9]](#footnote-10) Thereafter, Aqua and the Township agreed to use the process presented in Section 1329 of the Code to determine the FMV of the wastewater system assets and the ratemaking rate base. As required by Section 1329, Aqua and LMT jointly retained the services of Ebert Engineering, Inc., Consulting Engineers (Ebert) to complete the engineering assessment and original cost estimate of the wastewater system (Assessment of Tangible Property). Aqua St. 1 at 20; Application at ¶ 11. Aqua selected Gannett Fleming, and the Township selected AUS, as their respective UVEs to prepare FMV appraisals of the wastewater system. Application at ¶ 53. Gannett Fleming’s FMV report concluded that the value of the wastewater system was $55,505,000; AUS’ FMV was $54,430,591. Application Exhs. Q and R. Both appraisals were prepared in compliance with the USPAP standards. Application at ¶ 61; Application Exhs. T1 and T2.

In its Application, Aqua proposed a ratemaking rate base of $53,000,000 based on the agreed-to purchase price of $53,000,000. This amount is less than the average of the two UVE appraisals for the wastewater system (($55,505,000 + $54,430,591)/2 = $54,967,796). OCA M.B. at 6; *See* 66 Pa. C.S. § 1329(c)(2).

In addition, Aqua is seeking approval of the APA with LMT. Application Exh. B. The APA requires Aqua to implement rates that are no higher than the Township’s rates in effect at closing. Application Exh. B at Section 7.04. The APA also provides that Aqua intends to bill customers on a monthly basis instead of an annual basis. *Id*. Moreover, in accordance with Section 1102 of the Code, Aqua is requesting a Certificate in order to provide wastewater services to the Township customers. Application at ¶ 5. Separate customer notices were sent to the Township customers and current Aqua customers informing them of the proposed transaction and the potential rate impact.

# Joint Petition for Partial Settlement

## Terms and Conditions of the Partial Settlement

As previously indicated, the Partial Settlement resolves all but two issues raised in this proceeding, which are reserved for litigation: (1) the determination of ratemaking rate base; and (2) the income tax savings on repairs deductions. The Joint Petition contains the Partial Settlement Terms and Conditions. The Statements in Support of Aqua, I&E, the OCA, the OSBA, and the Township are Attachments A through E, respectively, of the Joint Petition. Proposed Findings of Fact, Proposed Conclusions of Law, and Proposed Ordering Paragraphs are attached to the Joint Petition as Attachments F through H, respectively.

The essential terms and conditions of the Partial Settlement are set forth in Section II of the Joint Petition, and are shown below in full as they appear in the Joint Petition:

**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.[[10]](#footnote-11)

**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.

**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 (“LTIIP”) and Distribution System Improvement Charge**

1. If Aqua proposes to modify its LTIIP 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 LTIIPs 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 LTIIP 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, prudency, and basis for such fees.

Joint Petition at 6-9.

In addition to the specific terms and conditions to which the Joint Petitioners have agreed, the Partial Settlement contains other general terms and conditions typically found in settlements submitted to the Commission. Specifically, the Joint Petitioners agreed that the Partial Settlement is conditioned upon the Commission’s approval of all the terms and conditions contained therein without modification. The Joint Petition establishes the procedure by which any of the Joint Petitioners may withdraw from the Partial Settlement and proceed to litigate this case if the Commission should act to modify or reject the Partial Settlement. Additionally, the Joint Petitioners submitted that the Partial Settlement is made without any admission against, or prejudice to, any position which any of the Joint Petitioners might adopt in any subsequent litigation of this proceeding or in future proceedings. Moreover, the Joint Petitioners waived their right to file Exceptions concerning the issues in the Partial Settlement if the ALJ recommended that the Commission adopt the Partial Settlement without modification. *Id*. at 10.

## ALJ’s Recommendation on the Partial Settlement

In the Recommended Decision, the ALJ set forth the terms and conditions of the Partial Settlement and recommended approval of the Joint Petition, without modification, finding that it is supported by substantial evidence and is in the public interest. The ALJ determined that the Partial Settlement complies with the relevant Sections of the Code regarding applications for the acquisition of wastewater system assets and is consistent with the Commission’s Regulations promoting settlements. R.D. at 1, 51-53.

The ALJ reasoned that the Partial Settlement will ensure that the Township’s 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. The ALJ concluded that bringing the Township’s existing customers into Aqua’s customer base will also ensure that the Township’s residents have access to the Commission’s procedures for investigating and enforcing any complaints the residents may have concerning the Township’s wastewater service and that future rate increases will be subject to the Commission’s jurisdiction. R.D. at 51.

The ALJ’s analysis of the essential Partial Settlement terms and recommendation for approval of the Joint Petition, without modification, is summarized as follows:[[11]](#footnote-12)

### Approval of Application and Acquisition

The ALJ determined that the record supports the findings that Aqua is technically, legally, and financially fit to acquire the Township’s wastewater system, and none of the Parties have rebutted these findings through record evidence. R.D. at 23-24. The ALJ also determined that this transaction will provide affirmative public benefits, as fully set forth in Aqua’s direct testimony, which include furthering the goal of regionalizing water systems, better management practices, economies of scale, and greater customer, environmental, and economic benefits. Further, the ALJ determined that the value of the public benefits will be better realized under the Partial Settlement because the Partial Settlement contains numerous terms that protect Aqua’s existing and future ratepayers and will ensure that Aqua’s ratepayers receive the benefit of the bargain that Aqua negotiated without being subject to protracted and expensive litigation. *Id*. at 24. The ALJ noted that the transaction, with the conditions described in the Partial Settlement, benefits all of the stakeholder groups impacted by the transaction: the public-at-large; the Township (as seller of the System); the Township’s existing customers; and Aqua’s existing customers. *Id*. at 25. The ALJ reasoned that the transaction benefits members of the public-at-large and the Township and Aqua’s existing customers because it promotes the Commission’s policy favoring regionalization and consolidation of water and wastewater systems. *Id*. (citing 52 Pa. Code § 69.721(a); Aqua St. 1 at 17).

### Tariff

The ALJ observed that the Joint Petitioners agreed that the *pro forma* tariff Aqua submitted with its Application, as updated in the supplemental information submitted by letter dated June 21, 2021, will become effective upon Closing. The ALJ stated that the *pro forma* tariff will implement the Township’s current rates inclusive of any then-existing miscellaneous fees and charges. The ALJ also stated that the Township currently bills on a quarterly basis. R.D. at 26. Aqua plans to convert certain customers who receive water service from Pennsylvania-American Water Company to monthly billing, and customers that receive water service from the Municipal Authority of the Borough of Morrisville will continue with quarterly billing after closing. *Id*. (citing Aqua Statement in Support at 11). Accordingly, the ALJ concluded that the *pro forma* tariff will accurately include all rates, rules, and regulations regarding the conditions of Aqua’s wastewater service, and this full and accurate disclosure of rates is in the public interest. R.D. at 27.

### Engineering Assessment

The ALJ stated that Aqua agreed in the Partial Settlement 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 also agreed that such designation of the condition shall be limited to whether the categories of system assets appraised are in poor, fair, good, or very good condition. R.D. at 28. The ALJ concluded that the Joint Petitioners agreed to this term 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. *Id*. (citing Joint Petition at 11-12).

### Easements and Other Property Rights

The ALJ observed that under the Partial 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, the OCA, and the OSBA in advance of Closing and a final update before Closing regarding the status of the transfer of real property rights including easements. The Partial Settlement also includes a provision for the establishment of an escrow from the purchase price to ensure transfer of the real property rights. The ALJ noted that I&E explained the public interest would be harmed if Aqua paid a purchase price that assumed that all rights necessary to operate the Township would be transferred, and at the Township’s cost, and such action did not occur. To protect against this possibility, the Partial Settlement includes establishment of an escrow account that would be imposed on the Township to ensure that any right not transferred at closing must be financially accounted for by payment to the escrow account. R.D. at 31. The ALJ found that this Partial Settlement term is in the public interest and, as I&E asserted, provides an additional layer of accountability if Aqua and the Township would mutually decide to waive the applicable sections of the APA that bind it to deliver good and marketable title to all real property necessary for the operation of the acquired system. *Id*. at 31-32 (citing I&E Statement in Support at 9).

The ALJ also found that 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 an effective mechanism to monitor the Township’s progress in meeting its property transfer obligations, and it enables the Statutory Parties 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. R.D. at 32 (citing I&E Statement in Support at 9-10).

### Cost of Service Study

The ALJ explained that the Partial Settlement provides that in Aqua’s first base rate case following closing in which the Company includes the Township’s assets in rate base, Aqua will submit a wastewater cost of service study that removes all costs and revenues associated with the Township system, and the Company will also provide a separate cost of service study for the Township system. The ALJ reasoned that these Partial Settlement terms will provide a mechanism for the parties to use the cost of service data to set rates for the Township’s customers that differ, as appropriate, from rates established for other wastewater customers. The ALJ agreed with I&E’s position that 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. R.D. at 34. The ALJ further agreed with I&E’s position that 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 shift from the wastewater customers to the water customers. *Id*. (citing I&E Statement in Support at 10‑11).

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

The ALJ stated that Aqua agreed in the Partial 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 Township wastewater system assets, and the Joint Petitioners reserve the right to litigate claims for AFUDC, deferral of depreciation, and transaction costs in future rate cases. R.D. at 36. The ALJ noted that as Aqua explained, the Commission has previously directed a similar condition to meet the affirmative public benefit standard. *Id*. (citing *Application of Aqua Pennsylvania Wastewater, Inc. Pursuant to Sections 1102, 1329, and 507 of the Public Utility Code*, Docket No. A-2019-3008491 (Order entered November 5, 2019). The ALJ concluded that 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. R.D. at 36 (citing I&E Statement in Support at 11).

### Long Term Infrastructure Improvement Plan and Distribution System Improvement Charge

The ALJ noted that under the Partial Settlement, the Joint Petitioners agreed that Aqua may apply the DSIC to customers in the Township service area before the first base rate case in which the system’s plant in service is incorporated into rate base pursuant to Section 1329(d)(4) of the Code. R.D. at 38. The Partial Settlement provisions provide that if Aqua proposes to revise its LTIIP to include the Township and related projects, the projects added for the acquired system will be in addition to those that Aqua plans for its existing systems, and are in addition to the projects already included in Aqua’s approved LTIPP. *Id*. at 38-39. The ALJ reasoned that this Partial Settlement term allows Township customers to begin contributing, up to 5% of their total wastewater bill, toward DSIC-eligible capital projects. *Id*. at 39 (citing Joint Petition at 13). The Partial Settlement further provides that if Aqua seeks to modify its LTIIP to include the Township system, Aqua will not reprioritize other existing capital improvements that the Company already committed to undertake in other service areas. R.D. at 39. The ALJ agreed with the Joint Petitioners that 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 Township acquisition. *Id*. (citing Aqua Statement in Support at 14).

### Township Rates

The ALJ observed that the Township indicated that the current average Township residential rate is $74.32 per month, and notice sent to the Township’s customers provided a non-binding estimated incremental rate effect of 28.17% as a result of the proposed rate base addition. R.D. at 41 (citing Township Statement in Support at 7). In the Partial Settlement, the Joint Petitioners agreed to a framework for addressing Township rates in the first base rate proceeding that includes LMT’s wastewater system assets. R.D. at 41-42. The ALJ stated that the framework provides that: (1) Aqua shall propose to move the Township system to its cost of service, based on a separate cost of service study for the Township’s system; provided, however, that Aqua will not be obligated to propose Township 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 the Township’s 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 Township 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 the Township’s customers of a base rate case filing and the level of increase in the first base rate case that includes the Township’s assets; and (5) the OCA, I&E, the OSBA, and the Township reserve their rights to fully address Aqua’s proposal, and to make other rate proposals in the base rate case. R.D. at 42 (citing Joint Petition at 13-14).

### Welcome Letter

The ALJ noted that Aqua has agreed to send a Welcome Letter to Township wastewater customers within thirty days following Closing, and the Letter will include information about the conversion to monthly billing for the Township customers’ sewer service. The ALJ found that this Settlement provision is in the public interest and will ensure that the newly acquired customers are aware of the conversion to monthly billing in a timely manner. R.D. at 43.

### Legal Fees

The ALJ noted that under the Partial Settlement, Aqua has agreed to separately identify legal fees included in its transaction and closing costs pursuant to the APA between Aqua and the Township and to specify amounts Aqua expends on behalf of the Township. Additionally, the Statutory Advocates reserve the right to challenge the reasonableness and basis for these legal fees. R.D. at 45. The ALJ agreed with I&E’s positions that 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 and that the statutory parties will be able to challenge the basis of any claimed Township legal fees. *Id*. (citing I&E Statement in Support at 13-14). The ALJ found that the combined commitments in the Settlement will protect Aqua’s ratepayers from bearing the burden of the Township’s legal fees. R.D. at 45-46.

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

The Partial Settlement provides that the “Commission shall issue any necessary approvals or certificates for the transaction pursuant to 66 Pa. C.S. Section 507.” The ALJ lists the various agreements for which the Joint Petitioners request that the Commission issue Certificates of Filing pursuant to Section 507. *See* R.D. at 48-49; Joint Petition at 15-17. The ALJ noted that there is no opposition to the issuance of the Certificates of Filing for the contracts and directed that Certificates of Filing be issued for the various agreements between Aqua and the Township.[[12]](#footnote-13) *See* R.D. Ordering Paragraph No. 5.

## Public Interest Analysis of the Settlement

Upon review of the record and the Statements in Support of the Joint Petitioners, we determine that the Partial Settlement is in the public interest and should be approved without modification. We concur with the ALJ’s well-reasoned analysis and summary of the extensive public benefits that will result from the Partial Settlement, as set forth in detail above. We also agree with the ALJ that the Partial Settlement will ensure that the Township’s existing customers will receive quality wastewater service from Aqua and, as a result of the transaction, will benefit from the Commission’s protections and procedures for investigating and enforcing any complaints concerning wastewater service as well as the Commission’s jurisdiction over any future rate increases.

Additional affirmative public benefits that will result from the Partial Settlement include the following: furthering the goal of consolidation/regionalization of water and wastewater systems throughout Pennsylvania, enhanced management practices, capital improvements, expense efficiencies, economies of scale, and the resulting customer, environmental, and economic benefits. *See* Aqua Statement in Support at 6-9; Aqua Application, Exhibit U, St. 1 at 13-19; I&E Statement in Support at 7. Through the Partial Settlement, the public benefits will be better realized because the Partial Settlement contains various terms that protect both Aqua’s existing ratepayers and those who will become Aqua’s ratepayers as a result of this transaction.

Moreover, by resolving all but two of the issues in this proceeding, the Partial Settlement reflects a consensus on many of the issues in this proceeding and has reduced the time, effort, and expense of litigating this case in full. This benefits not only the named Parties directly, but, indirectly, benefits customers of the Company, as litigation costs are borne not only by the Company but also by the Company’s customers. For all of these reasons, we shall adopt the ALJ’s recommendation and approve the Joint Petition, without modification.

# Unresolved Issues

## Determination of Ratemaking Rate Base

As a preliminary matter, we shall address the ability of parties to challenge FMV appraisals. Aqua argued that the Commission should not adopt the OCA’s proposed adjustments by arguing that OCA witness, Mr. Ralph Smith, did not perform an appraisal of the Township’s 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.” Aqua M.B. at 10. The OCA countered 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.” OCA R.B. at 4.

ALJ Watson noted this disagreement as to whether the Commission or other parties may challenge the appropriateness of the FMV determinations of the UVEs, finding that Section 1329 does not eliminate the Commission’s authority to determine rate base or prohibit the consideration of the OCA’s testimony on FMV. R.D. at 69-70, 80-81. The ALJ, in agreement with the OCA, noted that 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.” *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 (Order entered June 29, 2017)at 53 (*New Garden*).

The ALJ cited to two subsequent Section 1329 proceedings, in which 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.

R.D. at 70 (citing *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 Limerick Township,* Docket No. A-2017-2605434 (Order entered November 29, 2017) at 36 (*Limerick*)).

[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.

R.D. at 81 (citing *Application of Aqua Pennsylvania Wastewater, Inc. Pursuant to Sections 1102, 1329 & 507 of the Public Utility Code for Approval of its Acquisition of the Wastewater System Assets of Cheltenham Twp. & Contracts between Aqua Pennsylvania Wastewater, Inc. & Cheltenham Twp.*,Docket No. A-2019-3008491 (Order entered November 5, 2019) at 39 (*Cheltenham*)). As such, the ALJ noted that the Commission has already made the determination, as it did in other Aqua Section 1329 acquisitions such as *New Garden*, *Limerick*, and *Cheltenham*, that challenges to appraisals are permissible. R.D. at 70.

No Party filed Exceptions on this issue.[[13]](#footnote-14) Finding the ALJ’s recommendation to be reasonable and supported by substantial evidence in the record, we shall adopt it without further comment. Therefore, we will continue with our discussion and consideration of Aqua’s Exceptions, regarding the ALJ’s recommendation and acceptance of the OCA’s proposed adjustments to several of the UVE appraisal approaches.

### Aqua’s Application

As previously indicated, appraisers, Gannett Fleming and AUS, found appraised values of approximately $55.505 million and $54.431 million, respectively, for an averaged appraised value of approximately $54.968 million. The purchase price of $53 million is below the average appraised value; consequently, Aqua proposed the $53 million purchase price amount be included in rate base, if the transaction is approved. Application at ¶ 21; 66 Pa. C.S. § 1329(c)(2).

The two appraisals provided by Gannett Fleming and AUS were prepared in accordance with the USPAP, employing the Cost, Market, and Income Approaches to arrive at the FMV of the system. Both firms were pre-certified as authorized UVEs. Aqua M.B. at 6-7. In arriving at its estimate, Gannett Fleming considered all three approaches, assigning an equal weight to the result of each approach. While AUS primarily relied on the Cost Approach, with the Income and Market Approaches being utilized to confirm the overall value of the wastewater system’s operation.[[14]](#footnote-15) The results of each are summarized as follows:



*See* Aqua St. 4 at 13. In summary, Gannett Fleming’s Cost Approach utilized the original cost new (OCN) to calculate the trended original cost (TOC) measures, or the reproduction cost of the depreciable assets by multiplying the OCN by specific cost indices. Reproduction cost new was converted to replacement cost new after factoring in obsolescence. Gannett Fleming indicated its use of the TOC method over the reproduction cost or the replacement cost methods was essentially dictated by the mandated use of the Assessment of Tangible Property’s original cost. Its Income Approach considers the results of two types of discounted cash flow (DCF) analyses, the EBIT and EBITDA terminal value model (Market Multiple DCF) and the capitalization of terminal value model (Capitalization DCF) (collectively referred to as the DCF methods).[[15]](#footnote-16) Gannett Fleming’s Market Approach is supported by the market multiples method and selected transaction method. Aqua St. 4 at 16-18, 24.



*See* Aqua St. 5 at 3. In summary, AUS’ Cost Approach is supported by the results from the replacement cost method less accrued depreciation. The results from the DCF method formed the basis for AUS’ Income Approach. AUS’ Market Approach is supported by the comparable sales method. Aqua St. 5 at 6-8, 11.

Even before reviewing the specifics of each consultant’s analyses, as summarized above, the OCA asserted that 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 FMV results for the Township’s system. OCA M.B. at 8-9.

As discussed below, OCA witness Ralph Smith proposed adjustments to several of the UVE appraisal approaches in this proceeding. In summary, the culmination of the OCA’s proposed adjustments to (1) the service life for Gravity Collection Mains utilized in AUS’s Cost Approach; and (2) the Income Approaches utilized by both Gannett Fleming and AUS, results in a $1,763,741 reduction to Aqua’s requested rate base of $53,000,000.[[16]](#footnote-17), [[17]](#footnote-18)

### 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.” OCA St. 1 at 28 (citing *Approaches to Value*. American Society of Appraisers accessed Jan. 27, 2017, <http://www.appraisers.org/Disciplines/Personal-Property/pp-appraiser-resources/approaches-to-value>).

#### Positions of the Parties

The UVEs rely on the Assessment of Tangible Property in performing the cost approach analysis. Using the Assessment of Tangible Property developed by Ebert, Gannett Fleming showed the original cost of LMT’s wastewater system and land to be $32,003,924 with calculated accumulated depreciation of $12,195,650, for a net depreciated original cost of the LMT wastewater assets of $19,808,274.[[18]](#footnote-19) As illustrated in the following table, and noted by OCA witness Smith, the largest single account, by far, in the LMT wastewater system is Account 361.20 – Gravity Collection Mains. OCA St. 1 at 21-22.



AUS witness, Jerome C. Weinert used an 80-year, 80‑R2.5, depreciable life and survivor curve for this account in the AUS Cost Approach. The OCA argued that AUS’ 80-year service life for Account 361.20 is 15 years longer than the 65-year, 65‑R2.5 curve utilized by Gannett Fleming for the same account, and that such a discrepancy could lead to misstated results. OCA St. 1 at 35-36.

The OCA argued 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 Vitrified Clay Pipe (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, which would reduce the AUS Cost Approach by $4,714,148 from $51,414,555 to $46,700,407. OCA St. 1 at 23, 36; OCA M.B. at 12; OCA Exhs. RCS-1 and RCS-1SR, Cols. A, C and E, ln. 1.

In support of its recommendation the OCA explained that this issue was previously addressed in the *Cheltenham* proceeding as follows:

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).

The OCA noted 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 M.B. at 13.

Aqua countered that the OCA’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 submitted, significantly extends the life of existing pipe. Aqua M.B. at 12.

Aqua further pointed out 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 Pennsylvania-American Water Company (PAWC) in their recent base rate proceedings. Aqua explained 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. Aqua M.B. at 12-13.

#### ALJ’s Recommendation

The ALJ provided that a service life of 65 years for gravity collection sewers municipally owned and consisting of a large quantity of VCP is appropriate and supported by the record evidence in this proceeding. The ALJ explained that the record evidence included the engineering assessment provided as Exhibit D to the Application. Exhibit D identified the quantity of VCP in the LMT system. R.D. at 90.

The ALJ explained further that the appropriate service life is dependent on various factors including the materials used in the construction of the collection system. The ALJ noted that Aqua argued the use of CIPP linings has the effect of extending the useful service life of mains and manholes by 50 years thereby extending the useful life of these assets into the low 100-year range. R.D. at 91 (citing Aqua M.B. at 12). The ALJ stated that the problem with this argument is that there is no evidence that LMT has used this technology to extend the service life of its VCP. The ALJ reasoned that the service life applied to the assets 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 a large quantity of VCP installed by developers and the township. R.D. at 91.

The ALJ noted 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 Fleming in this proceeding. The ALJ agreed with the OCA witness Mr. Smith’s recommended adjustment of $4,714,148 to the AUS appraisal to match the 65-year service life utilized by Gannett Fleming. R.D. at 91 (citing OCA Table I at Col. D, ln. 2). The ALJ recommended that the OCA’s proposed 65-year service life for Gravity Collection Mains be adopted. R.D. at 92.

#### Aqua Exception No. 3 and Replies

In its Exception No. 3, Aqua contends that Mr. Weinert offered very clear and convincing support for his use of an 80-year service life for Gravity Collection Mains. Aqua provides that Mr. Weinert explained that an 80-year service life is reflective of the new practice of relining existing pipe and associated manholes with CIPP linings, which extends the useful service life by 50 years thus extending the useful life beyond 80-years into the low 100-year range. Aqua Exc. at 18.

Aqua avers that there is no evidence of record that the OCA witness Mr. Smith considered, or was even aware of, CIPP lining and its significance in the development of service lives within the cost approach. *Id.*

Aqua contends that the Recommended Decision dismisses the significance of CIPP lining stating that there is no evidence that LMT has used this technology to extend the service life of VCP. Aqua provides that there is substantial evidence that LMT has used and is using CIPP lining. Aqua notes that the Chapter 94 Reports submitted with the Application explain that the Township undertook CIPP lining in 2020 as follows:

Lower Makefield Township significantly increased the Township budget to address I/Iissues 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.

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.

Aqua Exc. at 19 (citing Aqua Exh. 1, Application Exh. E2 at 231; Aqua Exh. 1, Application Exh. E1 at 68).

Aqua argues 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 in AUS’ cost approach from 80 to 65 years. Aqua maintains that the Gannett Fleming and AUS appraisals were conducted independently, and it is reasonable and appropriate for the appraisal results to differ. Aqua Exc. at 20.

Aqua submits that Mr. Weinert emphasized that a service life for Gravity Collection Mains in the range of 75 to 80 years is supported by the depreciation studies filed by Aqua and PAWC in their recent general rate proceedings. Aqua maintains that 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. Aqua Exc. at 20 (citing Aqua St. 5-R at 4-5).

Further, Aqua argues that the Commission’s decision in *Cheltenham* cited by the OCA does not support the use of a 65-year service life for Gravity Collection Mains in this proceeding. Rather, the question in *Cheltenham* was whether the Commission should reduce the AUS service life for manholes and laterals from 90 to 75 years and does not support the further reduction here to 65 years. Aqua Exc. at 20 (citing R.D. at 83).

In its Replies to Aqua Exception No. 3, the OCA notes that Aqua argues that use of an 80-year service life is appropriate as Mr. Weinert relied upon depreciation studies prepared for Aqua and PAWC by a recognized firm in the depreciation consulting area, Gannett Fleming. OCA R. Exc. at 7 (citing Aqua Exc. at 20). The OCA points out that Gannett Fleming’s UVE utilized a shorter service life for gravity collection mains in the LMT system. The OCA witness, Mr. 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 R. Exc. at 7 (citing OCA St. 1SR at 18).

While Aqua argues that the comparison of the AUS Market Value appraisal to the Gannett Fleming value is inappropriate, the OCA avers that use of a 65-year service life by Gannett Fleming is not the only reason that using an 80-year service life is not reasonable. OCA R. Exc. at 7-8 (citing Aqua Exc. at 19). The OCA provides that there is a lack of historical records for the LMT system and there is an assumption that the older plant in the Collection Sewers-Gravity Mains plant account for LMT is VCP. OCA R. Exc. at 8 (citing OCA St. 1SR at 18-19). The OCA notes that the Ebert Engineering Report stated that documentation was missing for the age, size and material of the gravity collection mains in the LMT system, but estimates were made using the Township staff’s institutional knowledge that sanitary gravity pipe was assumed to be VCP if constructed before 1980, and SDR-35[[19]](#footnote-20) after 1980. OCA R. Exc. at 8 (citing Application Exh. D at 2).

The OCA provides that in other Section 1329 acquisitions, Mr. Weinert’s previous appraisals indicated a 75-year service life for VCP gravity collection mains. OCA R. Exc. at 8 (citing OCA M.B. at 12-13). In *Cheltenham*, Mr. Weinert utilized a 90-year service life for all of Cheltenham’s gravity collection mains. The Commission agreed with Gannett Fleming, Aqua’s UVE in the Cheltenham case, and recommended a 75-year life for VCP mains, laterals and manholes. OCA R. Exc. at 8-9 (citing *Cheltenham* at 44-45). The OCA notes that Mr. Weinert acknowledged that he relied on Gannett Fleming’s depreciation studies in formulating the AUS Cost Approach. OCA R. Exc. at 9 (citing Tr. at 77).

While Aqua contends that OCA witness Mr. Smith did not consider CIPP, the OCA indicates that there is no mention of CIPP in either AUS’ appraisal or the engineering report filed with the Application. OCA R. Exc. at 9-10 (citing Application Exhs. D, Q).

The OCA disagrees with Aqua’s contention that it was inappropriate for the Recommended Decision to rely on Gannett Fleming’s use of a 65-year service life. The OCA provides that the Recommended Decision did not rely solely on Gannett Fleming’s 65-year service life estimate, but rather the ALJ stated:

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 [sic] 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.

OCA R. Exc. at 10 (citing R.D. at 91).

The OCA submits that Mr. Weinert failed to provide any reasonable basis to conclude that the 80-year service life that he uses is more appropriate than the 65-year service life for the same collections mains that was used by Gannett Fleming in this proceeding. OCA R. Exc. at 10 (citing R.D. at 90-92). According to the OCA, 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. OCA R. Exc. at 11.

#### Disposition

We note that AUS proposed an 80-year life for the gravity collection mains in LMT, while Gannett Fleming proposed a 65-year life for the same collection mains. AUS based its service life (with an increase of 5 years) on Gannett Fleming’s depreciation studies used in other 1329 cases that proposed a 75-year life. Tr. at 209. While AUS used three depreciation studies previously done by Gannett Fleming for other 1329 proceedings, Gannett Fleming based the 65-year life in its UVE report in this case on more site-specific information about LMT as follows:

Gannett Fleming viewed or observed the Wastewater System’s facilities on April 6, 2021. The functionality of the system assets was determined based on the Engineering Assessment Study, Wastewater System's Chapter 94 Reports, the Wastewater System's Corrective Action Plan, the Wastewater System’s Connection Management Plan, and other information provided by Aqua/LMT. Gannett Fleming determined the average service lives of depreciable assets based on the materials used for construction and how long the depreciable assets are likely to meet service demands. We determined the average service lives of depreciable assets based on our experience of having determined average service lives for numerous other water and wastewater utilities and given the fact the system assets resemble those used by other Pennsylvania wastewater companies.

OCA Hearing Exh. 2 at 1.

Aqua contends that the 80-year life used by AUS is appropriate for VCP that has been lined using CIPP. The OCA provided that CIPP is not mentioned in either the AUS’ appraisal or the engineering report filed with the Application. OCA R. Exc. at 10 (citing Application Exhs. D, Q). While Aqua claimed that the Section 94 report for LMT cited the use of CIPP, we cannot assume CIPP has been widely used throughout the LMT system. The Section 94 reports state that the CIPP program began in 2020 with approximately 2,000 linear feet at a cost of approximately $200,000. Aqua Exc. at 19. The amount of pipe that has been lined according to the Section 94 reports is only a small portion[[20]](#footnote-21) of the total VCP in the system. The remainder of the VCP to be lined and the cost to do so are substantial. As the OCA provided, records are not available for the detailed characterization of the gravity collection mains in the LMT system. We can only assume that pipe constructed before 1980 is VCP and another type after 1980. As the ALJ stated “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 a large quantity of VCP installed by developers and the township.” R.D. at 91. As the Gannett Fleming service life is based on a more site-specific study and only a small portion of the system may be lined VCP, we find that the use of the Gannett Fleming 65-year service life for gravity collection mains is reasonable. The OCA’s recommended adjustment, as adopted by the ALJ, to the AUS Cost Approach to reduce the service life for Gravity Collection Mains from 80-years to 65-years is appropriate. The AUS Cost Approach is adjusted by $4,714,000 from $51,414,555 to $46,700,407. The overall FMV is also adjusted as discussed *infra.* Accordingly, we will deny Aqua Exception No. 3.

### Income Approach

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. The Income Approach is defined as:

A procedure to conclude an opinion of present value by calculating the anticipated monetary benefits (such as a stream of income) for an income-producing property.

OCA St. 1 at 29-30 (citing *Approaches to Value*. American Society of Appraisers accessed March 5, 2020, <http://www.appraisers.org/Disciplines/Personal-Property/pp-appraiser-resources/approaches-to-value>).

There are two commonly used methods of the Income Approach: the DCF approach and the capitalized income approach. Mr. 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 [Operation and Maintenance] 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.

Gannett Fleming’s DCF methods use two different assumptions for LMT system operations over the next twenty-four years: (1) a municipal-owned (MUNI) scenario;[[21]](#footnote-22) and (2) an investor-owned utility (IOU) scenario.[[22]](#footnote-23)

Under the MUNI ownership scenario, the results of the Capitalization DCF show a range of value for the Township’s system of $59.0 million to $60.9 million, and the results of the Market Multiple DCF show a value of $57.1 million.

Under the IOU scenario, results of the Capitalization DCF show a range of value for the Township’s system of $39.0 million to $47.2 million, and the results of the Market Multiple DCF show a range of value of $49.7 million to $58.9 million.

As shown in the following table, the results of Gannett Fleming’s DCF methods based on the MUNI ownership scenario indicated a value of approximately $59.0 million for the Township’s system. The results of its DCF methods based on the IOU scenario indicated a value of approximately $48.5 million for the Township’s wastewater system. Collectively, Gannett Fleming’s DCF methods indicate a value of approximately $53.7 million based on the Income Approach.



*See* OCA Exh. RCS-5.

The Income Approach analysis presented by the Township’s witness, Mr. Weinert from AUS, also utilized the DCF technique. AUS’ income indicator of value was set equal to the sum of the present value of the projected cash flows over nineteen periods, including the present value of period twenty cash flows as if it will continue on indefinitely for future periods. The AUS DCF analysis indicated a value of approximately $57.9 million. Application Exh. R, Narrative Report at 9.

In summary, Gannett Fleming’s Income Approach using the DCF methods resulted in an estimated fair market value of $53,741,785 for the LMT system.[[23]](#footnote-24) The AUS Income approach indicated a value of $57,872,959 for the LMT system.

#### Positions of the Parties

As discussed below, the OCA argued that the fundamental flaw in both the Gannett Fleming and AUS analyses is in the calculation of the terminal values for LMT’s wastewater operations. Aqua explained the “terminal value” as follows:

Simply put, the “terminal value” 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. Within the Discounted Cash Flow analysis, 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. For example, in our Discounted Cash Flow analysis, the growth rate of annual Debt Free Net Cash Flows during time periods 1 through 24 changes multiple times due to the various general assumptions listed in the Gannett Fleming Appraisal Report. After time period 24, the growth in annual Debt Free Net Cash Flows is a constant growth rate. Accordingly, period 24, or year 24, is the “terminal value” year in our DCF method.

Aqua St. 4 at 23-24.

The OCA noted that, in calculating terminal values, both UVEs utilized a “capitalization rate” to project future cash flows in perpetuity. The OCA witness, Mr. 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 M.B. at 14 (citing OCA St. 1 at 31)(emphasis in original).

The OCA contended that it is inappropriate to apply a capitalization rate concept to estimate the terminal value of a regulated utility, as was done by the UVEs in this proceeding. Rather, the OCA proposed adjustments to the Income Approach of the UVEs to recalculate the terminal value using the amount of net plant less accumulated deferred income taxes (ADIT) projected to be remaining at the end of period 24 and 19, respectively. OCA St. 1 at 33, 38. The OCA argued that the approach utilized by the UVEs in quantifying the terminal value fails to recognize that the wastewater assets are for a regulated utility, not a non-regulated business, and therefore, result in a significant overstatement of the terminal value component. The OCA explained 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. According to the OCA, 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. Regarding a regulated utility, the OCA noted that Mr. Smith explained as follows:

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. A utility’s net cash flow can, and will, only grow with increases to its plant investment and rate base*.* The utility recoups these additional investments over time through future depreciation rates. 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.

The OCA pointed out that in both UVEs’ estimation of a terminal value, the capital expenditures in the final year of the model are less than the depreciation expense on existing plant during that year, meaning that LMT would be depreciating and depleting its plant faster and to a higher degree than investments are being made to replace that plant. OCA St. 1 at 32. Accordingly, the OCA asserted that the terminal value approach used by Gannett Fleming and AUS unrealistically overstates the valuation and would result in excessive valuation and return. OCA M.B. at 16.

Conversely, the OCA provided that Mr. Smith’s approach: (1) will ensure that investors will earn a fair rate of return over the life of the plant in service and recoup their initial investment through depreciation; and (2) will not increase rates to provide excessive returns over the life of the plant. OCA M.B. at 16.

The result of the OCA’s recommendation to use net plant less ADIT as the terminal value, in lieu of a capitalization rate concept, is a downward adjustment of $4,024,687 ($53,741,785 - $49,717,098) to the Gannett Fleming Income Approach to value.[[24]](#footnote-25) *See* OCA Exh. RCS-1SR, Col. D, ln. 7.

Consistent with its adjustment to the terminal value for the Gannett Fleming Income Approach, the OCA, likewise, proposed an adjustment to the AUS Income Approach. *See* OCA Exh. RCS-4. The OCA’s adjustment reduced the Income Approach amount in the AUS appraisal by approximately $9.41 million ($57,872,959 - $48,462,957). *See* OCA Exh. RCS-1SR, Col. D, ln. 2; OCA Exh. RCS-4.

Terminal value is an important concept in DCF analyses as it may account for a significant percentage of the total valuation under the Income Approach. The effects of the OCA’s proposed adjustments are summarized below in the following tables.



*See* Application Exh. Q, Gannett Fleming Fair Market Value Appraisal Report, Exhs. 15, 16; OCA Exh. RCS-2SR.

As can be seen from the above table, the OCA’s proposal has the effect of reducing the portion of Gannett Fleming’s DCF analysis attributable to the present value of the terminal value from 41% to 37%. Likewise, as illustrated in the following table, the OCA’s proposal has the effect of reducing the portion of AUS’ DCF analysis attributable to the present value of the terminal value from 28% to 15%.



*See* Application Exh. R, Narrative Report at 9; OCA Exh. RCS-4.

Aqua disagrees with the OCA’s criticism of the Gannett Fleming and AUS terminal values, submitting that as it has been presented in several Section 1329 proceedings and thoroughly rejected by the certified UVEs in each instance. Aqua argued that Mr. Smith’s criticism is flawed because it changes the present value analysis, which is 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, Aqua argued, it is contrary to legislative intent and inconsistent with 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. Aqua M.B. at 14.

Aqua asserted that, in this proceeding, the value of the investment in plant and equipment for the LMT system assets is being determined based upon a fair market value standard instead of an original cost standard. Aqua M.B. at 17 (citing Aqua St. 4-R at 4-5). Aqua further submitted that the OCA’s proposed use of net plant value from time period 24 (or year 2045) as the terminal value in the Income Approach: (1) is not in accordance with accepted valuation practice; (2) is unreasonable; (3) was rejected by the Commission in *Cheltenham*; and (4) is inconsistent with the Commission’s decision in *Limerick*, where the Commission accepted “Aqua’s arguments in support of the 13-year model,” which utilized the Gannett Fleming appraisal.[[25]](#footnote-26) Aqua M.B. at 16, 17 (citing Aqua St. 4-R at 5, 7; *Limerick* at 50).

The Company provided that the Gannett Fleming appraisal lists the current market multiples applicable to the corresponding financial and operating statistics of the LMT system. Aqua M.B. at 17 (citing Aqua Exh. 1, Application Exhs. Q, 17 at 1-3). Aqua stated that its witness, Mr. Walker of Gannett Fleming, provided the following evidentiary analysis demonstrating the market multiples and corresponding financial and operating statistics of the LMT system which were utilized by Mr. Smith:

Table 1



Aqua M.B. at 17-18; Aqua St. 4-R at 6. In referring to the above Table 1, Aqua explained that the indicated future market value in period 24 (year 2045) applicable to each metric range, from $81.664 million to $169.716 million, collectively proves that net plant value (*i.e.* $56.320 million) is not a good measure or proxy for future market value, or sales price, of existing assets because the indicated future market value is about 194% higher than Mr. Smith’s recommendation of $56.320 million. Aqua M.B. at 18 (citing Aqua St. 4-R at 6-7).

Aqua noted that 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 M.B. at 18 (citing Aqua St. 4-R at 7). Regarding the LMT system assets, the Company provided that the value of the investment in plant and equipment is being determined in these proceedings. Aqua further provided that the appraised value estimated by AUS and Gannett Fleming of $54.4 million and $55.5 million, respectively, and the purchase price negotiated by Aqua and LMT of $53.0 million, are higher than the present value of terminal value of the net plant and equipment cost of $28.1 million to $10.0 million used by Mr. Smith. Aqua M.B. at 18 (citing Aqua St. 4-R at 7; OCA Exhs. RCS-1 at 2-3).

Aqua also disagreed with Mr. Smith’s statement that, under the UVE assumptions and modeling techniques, LMT is depreciating and using up its existing plant faster, and to a higher degree, than it is making investments to replace that plant. The Company countered that, over the course of the 24-year DCF model, the depreciation expense totals $48.251 million and the capital expenditures total $53.979 million. In the 24th year (2045), Aqua continued, the depreciation expense of $2.357 million and the capital expenditures of $2.321 million result in a difference of less than 2%. Aqua concluded that, assuming a net plant investment of $56.320 million (year 2045) and a $0.036 million difference between depreciation expense and capital expenditures ($2.357 - $2.321), it would take 1,564 years to use up the existing plant investment ($56.320 / $0.036 = 1,564). Aqua R.B. at 7; Aqua M.B. at 18-19 (citing Aqua St. 4-R at 8).

Additionally, Aqua pointed out that, Mr. Smith acknowledged that he did not properly account for ADIT in his terminal value calculations. Aqua M.B. at 19 (citing OCA St. 1SR at 15; OCA Exh. RCS-2). However, Aqua contended that, despite Mr. Smith’s suggestion that the oversight occurred because Gannett Fleming had not identified ADIT in its valuation support, Mr. Smith had no reason to think that Gannett Fleming’s valuation supporting details were deficient. Aqua M.B. at 19.

Finally, Aqua noted Mr. Walker’s additional observations of Mr. Smith’s use of net plant as the terminal value in the Income Approach, including that: (1) the use of original cost net plant as the terminal value is incorrect; (2) although Gannett Fleming’s analysis used a present value factor of 7.14%, Mr. Smith used a present value factor of 7.61%; (3) although the ratio of ADIT to net plant is never the same for two companies or two income approaches, Mr. Smith’s analysis used a hypothetical value for ADIT; and (4) although the cash flows from the deferred taxes that resulted in the ADIT would offset the negative effect of ADIT, Mr. Smith’s analysis did not include such cash flows. Aqua M.B. at 19-20.

As noted, *supra*, the AUS Income Approach indicated a value for the LMT system of $57,872,959, and Mr. Smith’s adjustment is a downward, or negative, adjustment to the AUS Income Approach value of $9.41 million. Aqua averred that, similar to the Company’s discussion regarding Mr. Smith’s proposed adjustment to the Gannett Fleming Income Approach to value, 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. Aqua M.B. at 20-21.

Aqua provided that, according to Mr. Weinert of AUS, Mr. Smith’s proposed use of net plant as the terminal value is unreasonable because Mr. Smith’s analysis replicates AUS’ DCF analysis with the exception of period 20 and forward, for which a net book value adjusted for ADIT was substituted. Further, Mr. Weinert provided that Mr. Smith’s analysis is incorrect for several reasons, including: (1) the benefits to the owner and customers for operating the property efficiently are eliminated; (2) the fact that the LMT property will continue to remain in service for several years after period 19 of the DCF analysis, which the capitalization of the operation’s cashflows related to periods 20 and beyond is intended to represent, is ignored; and (3) the fact that, during the forecast of future periods cashflows, the capital expenditures that amount to $7.6 million for each of those periods is ignored. Moreover, Mr. Weinert noted that the capital expenditures reflect plant renewal which will allow the LMT property to continue providing service for the LMT customers, thereby providing economic benefit to the property’s owner. Aqua M.B. at 21 (citing Aqua St. 5-R at 9).

Additionally, Aqua noted that, 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, based on Mr. Smith’s methodology, of $57,809,909. Aqua asserted that, when compared to AUS’ original Income Approach value of $57,872,959, Mr. Smith’s adjustment of AUS’ Income Approach to value by a negative $9.41 million to $48,462,957 does not quantify the sum of LMT’s economic returns. Aqua M.B. at 21-22 (citing Aqua St. 5-R at 10-11).

#### ALJ’s Recommendation

The ALJ’s Recommended Decision adopts the OCA’s proposed adjustments to the Income Approach of Gannett Fleming’s and AUS’ UVEs, which recalculates the terminal value using the amount of net plant less ADIT projected to be remaining at the end of period 24 and 19, respectively. ALJ Watson determined that the OCA’s proposal is appropriate in order to properly reflect financial and ratemaking principles under Pennsylvania law. R.D. at 1, 92, and Ordering Paragraph No. 7.

The result of the OCA’s recommendation, adopted by the ALJ, is a downward adjustment of $4,024,687 to the Gannett Fleming Income Approach to value.[[26]](#footnote-27) Likewise, adoption of the OCA’s recommendation on this issue results in a downward adjustment of approximately $9.41 million to the AUS Income Approach to value. *See* OCA Exh. RCS-4.

#### Aqua Exception No. 1 and Replies

In its Exception No. 1, Aqua maintains that the OCA’s proposed adjustments are not in accordance with valuation practice. Further, Aqua disagrees with the ALJ’s acceptance of the OCA’s recommended adjustment to the Gannett Fleming Income Approach. The Company argues that the adjustment proposed by the OCA is inconsistent with Commission precedent and the use of net plant as the terminal value in the Income Approach, which was rejected by the Commission in *Cheltenham*, is inappropriate in this proceeding. Aqua Exc. at 6-7 (citing R.D. at 92; Aqua St. 4-R at 7). Aqua provides that its witness, Mr. Walker of Gannett Fleming, noted that in the instant proceeding, Gannett Fleming utilized the same capitalization rate concept in several prior 1329 proceedings and the concept was not adjusted by the Commission in any of those prior proceedings.[[27]](#footnote-28) Aqua Exc. at 7 (citing Aqua 4-R at 3).

Aqua contends that, contrary to the conclusion of the Recommended Decision, the results and approaches of the OCA’s witness, Mr. Smith, are unreasonable and inconsistent with the Code and the Commission’s analysis in *Cheltenham*. Aqua Exc. at 9. Aqua cites the *Cheltenham* case to note that the basis to determine whether an adjustment to a UVE’s Income Approach is necessary involves a precedent established for “unreasonable approach” and “unreasonable results.” Aqua Exc. at 8 (citing *Cheltenham* at 55, Recommended Decision issued August 1, 2019, at 36-37). The Company explains that, because Gannett Fleming’s Income Approach produced a value that is approximately 99% of the indicated value determined by Gannett Fleming’s Cost Approach, the OCA’s witness, Mr. Smith, did not recommend adjusting Gannett Fleming’s Cost Approach, nor did he claim that Gannett Fleming’s Income Approach was unreasonable or produced unreasonable results. Comparatively, Aqua continues, Mr. Smith recommended an Income Approach value of $49,717,098, which is 91% and 85% of Mr. Smith’s indicated values recommended under the Cost Approach and Market Approach, respectively. Aqua Exc. at 9.

Aqua also claims that, if the Recommended Decision were adopted, then the only method to value assets would be an original cost less depreciation analysis and, therefore, the need to appraise plant assets would be eliminated. The Company maintains that in this proceeding, the determination of the value of the investment in plant and equipment for the LMT assets is based upon a standard of value of fair market value and not a standard of value of original cost. Aqua Exc. at 9-10.

Aqua reiterates its disagreement with the use of net plant to determine terminal value, explaining that such an action is inconsistent with statutory language because it will change the present value analysis, which is essential to the Income Approach, to a hybrid analysis, which incorporates part of a present value Income Approach and part of a future book value Cost Approach. Aqua Exc. at 10. The Company argues that the use of a terminal value within the Income Approach based on something other than a present value analysis is incorrect and inconsistent with Mr. Smith’s statement that the “income approach involves capitalizing and discounting a future income stream to a present value.” Aqua Exc. at 10 (citing OCA St. 1 at 30).

Aqua also repeats that its witness, Mr. Walker, a qualified UVE of Gannett Fleming, explained that the use of net plant from time period 24 as the terminal value in the Gannett Fleming Income Approach is not in accordance with valuation practice and is not a good measure or proxy for future market value.[[28]](#footnote-29) Aqua refers to Mr. Walker’s analysis of market multiples and the corresponding financial and operating statistics of the LMT system provided, which was utilized by Mr. Smith, to criticize Mr. Smith’s recommendation of future net plant value of $56.320 million (year 2045). Aqua Exc. at 11-12 (citing Aqua St. 4-R at 6-7). According to Aqua, the statement that the values in Mr. Walker’s analysis are “grossly excessive” reflects a misapprehension of the purpose of those values, as the values reflect *future* values (year 2045), but the OCA’s comparison of those values to Gannett Fleming’s Income Approach of $53.741 million reflects a *present* value (year 2021). Aqua Exc. at 12 (citing R.D. at 85).

Aqua maintains its disagreement with Mr. Smith’s statement that, under the assumptions and modeling techniques of the UVE, LMT is depreciating and using up its existing plant faster than it is making investments for plant replacement. The Company continues to claim $48.251 million of depreciation expense and $53.979 million of capital expense over the 24-year DCF model and, in the 24th year (2045), the depreciation expenses are $2.357 million and the capital expenditures are $2.321 million, resulting in a difference of less than 2%. Therefore, Aqua concludes that, based on a net plant investment of $56.320 million (year 2045) and a $0.036 million difference between depreciation expense and capital expenditures ($2.357 - $2.321), Mr. Smith was incorrect to suggest that the rate base approaches zero or becomes negative. Aqua Exc. at 12-13 (citing R.D. at 85-87; Aqua St. 4-R at 8). Additionally, Aqua clarifies, based on the $0.036 million difference between depreciation expense and capital expenditures, the $56.320 million plant investment account balance would last 1,564 years. Aqua Exc. at 13.

Aqua also criticizes Mr. Smith’s use of net plant to determine the terminal value. According to the Company, Mr. Smith recommended that net plant is worth at least 1.45x under the Market Approach; however, Mr. Smith claims in his Income Approach that net plant used to determine terminal value is worth 1.00x. Aqua Exc. at 13 (citing OCA St. 1 at 34).

Additionally, Aqua repeats its disagreement regarding the determination of the value of the investment in plant and equipment system assets of LMT. Aqua maintains that the appraised values estimated by AUS and Gannett Fleming of $54.4 million and $55.5 million, respectively, and the purchase price negotiated by Aqua and LMT of $53.0 million, are higher than Mr. Smith’s present value of terminal value of net plant and equipment cost of $28.1 million to $10.0 million. Aqua Exc. at 13-14 (citing Aqua St. 4-R at 7; OCA Exh. RCS-1 at 2-3).

Aqua also reiterates Mr. Walker’s criticisms of Mr. Smith’s use of net plant as the terminal value in the Income Approach, including that: (1) the use of original cost net plant as the terminal value is incorrect; (2) although Gannett Fleming’s analysis used a discount rate of 7.14%, Mr. Smith used an incorrect discount rate of 7.61%; (3) although the ratio of ADIT to net plant is never the same for two companies or two Income Approaches, Mr. Smith’s analysis used a hypothetical value for ADIT; and (4) although the cash flows from the deferred taxes that resulted in the ADIT would offset the negative effect of ADIT, Mr. Smith’s analysis did not include such cash flows. Aqua Exc. at 14.

Finally, Aqua notes that the effect of the OCA’s proposed adjustment to the Income Approach would result in double counting the impact of ADIT on ratemaking rate base. The Company explains that, in the determination of rate base during a base rate case, subtracting ADIT from net plant gives effect to ADIT and, in this proceeding and in a subsequent rate case, the effect would be double counted. Aqua explains that, 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 and, in the next rate case, the ratemaking rate base of $90 would again be reduced by ADIT of $10, thereby resulting in a ratemaking rate base of $80 and a double counted ADIT. Aqua Exc. at 14-15.

In its Replies to Aqua’s Exception No. 1, the OCA counters that the adjustment to the terminal value of the Gannett Fleming Income Approach is reasonable, appropriate, and consistent with ratemaking principles. The OCA maintains that the assumptions used by the Company’s witness, Mr. Walker of Gannett Fleming, are flawed and inconsistent with ratemaking principles. OCA R. Exc. at 1 (citing OCA R.B. at 8-11; OCA M.B. at 14-17). Accordingly, the OCA submits that, in place of Gannet Fleming’s proposed amount of $53,741,785, the Recommended Decision’s Income Approach valuation of $48,462,957 should be adopted. OCA R. Exc. at 4 (citing OCA R.B. at 11; OCA Exh. RCS-3SR).

The OCA contends that, based on the traditional concepts of cost-based utility regulation, the focus of an approach to terminal value for a rate-regulated public utility should be the remaining amount of net plant and not a “perpetual capitalization of prospective earnings.” OCA R. Exc. at 1 (citing OCA St. 1SR at 19). The OCA further argues that the present value of the future cash flow for a firm that is expected to earn a return on investment at its cost of capital and recover its depreciation expense is equal to the present value of the firm’s investment. OCA R. Exc. at 1-2 (citing OCA St. 1SR at 13).

In responding to the Company’s assertion that its witness, Mr. Smith, did not attempt to distinguish the LMT acquisition from previous Section 1329 acquisitions and the Commission’s determinations in prior cases, the OCA cites the testimony of Mr. Smith to discount Aqua’s assertion as meritless. OCA R. Exc. at 2-3 (citing Aqua Exc. at 7; OCA St. 1SR at 12-13). Further, in response to Aqua’s position that the annual debt free net cash flows is a constant growth rate after time period 24 (year 2045), the OCA asserts that each of the values presented by Mr. Walker in his “Market Multiples Valuation” are excessive, even in comparison to his own recommended Income Approach result of $53,741,785. OCA R. Exc. at 3 (citing Aqua Exc. at 6; OCA R.B. at 10; Aqua St. 4-R at 6). The OCA asserts that, Mr. Smith correctly explained that, if depreciation exceeds capital expenditures, a public utility cannot be sustained under the rate base or rate of return approach to determine revenue requirement. *Id.* (citing OCA St. 1SR at 14-15).

Regarding the depletion of existing plant, the OCA argues that, although no LMT plant has a depreciation life that will last 1,564 years, the investment dollars in the plant account balance would last 1,564 years and the accumulated depreciation is an offset to the plant account balance. OCA R. Exc. at 3 (citing Aqua Exc. at 12-13). The OCA avers that, Aqua fails to address that whenever depreciation exceeds capital expenditures, utility rate base declines and, if the decline continues, rate base would eventually approach zero. Accordingly, the OCA asserts that, by recalculating the valuation of the terminal value using the amount of net plant less ADIT remaining at the end of year 24, Mr. Smith properly adjusted Gannett Fleming’s Income Approach. OCA R. Exc. at 3-4 (citing OCA Exh. RCS-2SR at 3).

The OCA notes that Aqua’s arguments regarding an unreasonable double count of the impact of ADIT on rate base is misleading, inappropriate and moot. OCA R. Exc. at 4 (citing 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-2SR). The OCA explains that, in response to the Company’s claim 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. *Id.* (citing OCA R.B. at 11; OCA St. 1SR at 15; OCA Exh. RCS-2SR). The OCA also notes that AUS also reflected a deduction for ADIT in its Income Approach and that Mr. Smith agreed with both UVEs that ADIT should be deducted from utility net plant for the investor ownership scenarios in the Income Approach. *Id.* (citing OCA R.B. at 11).

#### Aqua Exception No. 2 and Replies

In its Exception No. 2, Aqua avers that, similar to the Company’s disagreement regarding Mr. Smith’s proposed adjustment to the Gannett Fleming Income Approach to value, Mr. Smith’s proposed use of net plant less ADIT as the terminal value in the AUS Income Approach to value should be denied and rejected for the same reasons. Aqua Exc. at 15-16.

Aqua repeats the observation offered by its witness, Mr. Weinert of AUS, that Mr. Smith’s analysis, with the exception of period 20 and forward, replicates AUS’ DCF analysis for which a net book value adjusted for ADIT was substituted. The Company also reiterates Mr. Weinert’s reasons that Mr. Smith’s analysis is not accurate, including: (1) the benefits of efficient property operations are eliminated; (2) the continued operation and capitalization of the LMT operation’s cashflows, related to periods 20 and beyond, is ignored; and (3) the capital expenditures, which amount to an estimated $7.6 million for the future periods cashflows and will allow the LMT property to continue providing service for the LMT customers, is ignored. Aqua Exc. at 16 (citing Aqua St. 5-R at 9).

Additionally, Aqua maintains that, if the AUS DCF forecast period is increased from 20 periods to 60 periods, then the impact of ADIT will decline from $4,871,174 to $948,406, with a corresponding present worth of cash flows, based on Mr. Smith’s methodology, of $57,809,909, in comparison to AUS’ original Income Approach value of $57,872,959. The Company concludes that Mr. Smith’s recommended adjustment to AUS’ Income Approach to value does not quantify the sum of LMT’s economic returns. Aqua Exc. at 17 (citing Aqua St. 5-R at 10-11).

In its Replies to Aqua’s Exception No. 2, the OCA maintains that Mr. Smith’s recommended adjustment to the AUS Income Approach is reasonable, supported, and should be adopted. OCA R. Exc. at 6-7 (citing OCA R.B. at 12; OCA St. 1SR at 10; OCA Exh. RCS-1SR). The OCA counters that the benefits to the owner at the end of the valuation period are not eliminated by the terminal value approach. The Company elaborates that the terminal value calculates the remaining benefit in a reasonable manner and reflects that LMT, under Aqua’s ownership, is a regulated public utility and not a competitive business. Aqua also clarifies that, at the end of the valuation period for the Income Approach, a terminal value provides a benefit to the owner of the system of $7.038 million, thereby demonstrating that the benefit to the owner at the end of the valuation period is not eliminated. OCA R. Exc. at 5 (citing OCA R.B. at 12).

Additionally, the OCA notes that the value of the LMT utility property, which is a rate regulated public utility and not a competitive business, should be calculated based on the equivalent of a utility net depreciated plant rate base amount, net of the ADIT offset. Furthermore, the OCA cites the testimony of Mr. Smith to note that extending the Income Approach an additional 40 years, as presented by AUS, is “inherently unreliable.” OCA R. Exc. at 5-6 (citing OCA R.B. at 12-13; OCA St. 1SR at 9-10).

#### Disposition

Upon review of the record, the Recommended Decision, and the Parties’ Exceptions and Replies thereto, we shall grant the first and second Exceptions filed by Aqua. In our view, the discussion and subsequent recommendation in the Recommended Decision regarding the inclusion of the appropriate terminal value, following the period of explicit net cash flow forecasts, in the valuation under the Income Approach conflict with one another. Although Section 1329 is a relatively new statute, the OCA’s approach as adopted in the Recommended Decision conflicts with prior Commission precedent. Notably, in *Cheltenham*, the ALJ and the Commission rejected the use of net plant as the terminal value in the Income Approach. The *Cheltenham* Order noted the following in regard to the UVEs’ terminal values 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.

*Cheltenham* at 56. In this proceeding, the Recommended Decision nonetheless recommended that the terminal values be calculated based on the equivalent of net plant less ADIT, as proposed by the OCA,[[29]](#footnote-30) finding the OCA’s recommended adjustments to be “…reasonable…,” and “…consistent with the Public Utility Code and precedent….” R.D. at 92.

The ALJ in *Cheltenham* explained as follows:

OCA advocates for using revised revenues sufficient to earn a return on rate base typically authorized by the Commission and a revised terminal value. OCA bases its revised revenues off of its proposed [depreciated original cost (DOC)] rate base. OCA MB at 27. OCA bases its terminal value off of the value of the CT system’s net investment in the 20th year. *Id*. at 30.

[Aqua, herein “APW”] also agrees that the ratemaking required return is the correct return to apply to the Commission-determined rate base in calculating the system’s revenue requirements. APW MB at 57. APW notes accepting DOC as the terminal value eliminates the need to appraise plant assets since the indicated value of DOC is DOC. APW MB at 53. I find the following testimony of OCA witness Watkin’s particularly compelling,

[I]f 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. 2 at 16-17.

As previously discussed, I disagree with OCA’s contention that the RCNLD rate base used by AUS is unreasonable. However, I find no fault in OCA’s argument; the reasonable result of AUS’s income approach is inevitable. Because the Commission would not reasonably permit a utility to earn an excessive return on its rate base, AUS’s income approach must be adjusted to be equal to AUS’s initial RCNLD rate base, as adjusted.

OCA also contends the capital structure and cost of equity employed by AUS are unreasonable. OCA MB at 25. APW posits that AUS’s assumptions regarding the capital structure used to finance the acquisition and to earn a required return on rate base are reasonable. APW RB at 11-12. Based upon the record, I find that OCA has not adequately shown that the capital structure and cost of equity values used by AUS in its RCNLD model would result in excessive returns for a potential buyer.

*Cheltenham* R.D. at 37-38.

Here, we agree with Aqua that the OCA’s reasoning for a downward adjustment of the respective UVEs’ Income Approaches, based on the use of net plant less ADIT as the terminal value, is not well founded in Commission precedent. The Recommended Decision, therefore, strays from prior Commission precedent, and makes no attempt to distinguish Aqua’s acquisition of LMT’s wastewater assets from *Cheltenham* or explain why the use of net plant less ADIT, previously rejected by the Commission, is appropriate in this proceeding.

Furthermore, we find persuasive Aqua’s argument that the OCA’s proposal 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. Aqua M.B. at 14; Aqua R.B. at 5-6.

Historically, regulated utilities under the Commission’s jurisdiction have predominantly followed a standard and practice of using depreciated original cost value (with various adjustments) as the rate base in which they may recover their capital investment and earn a rate of return on the unrecouped asset value or rate base. However, Section 1329 establishes fair market value, not original cost, as the ratemaking rate base for municipal transactions. Under Section 1329, it is fair value, ratemaking rate base that, ultimately, will be used for ratemaking purposes, rather than being constrained by depreciated original cost value. As indicated by Aqua, “[t]he OCA’s proposed adjustments to the Income Approach are also contrary to the language in *McCloskey* where the Commonwealth Court clearly stated that ‘Section 1329 allows a private utility to acquire a government utility’s assets at its fair market value *rather than at the original cost of assets minus the accumulated depreciation* and then add that amount to rate base.’” Aqua R.B. at 6 (citing *McCloskey*,195 A.3d at 1055).

As previously indicated, the Income Approach is based on the premise that the value of a property is the present value of the future net benefits of owning the property. This approach is relevant when the property being valued generates or is anticipated to generate net income. For regulated utility properties, benefits originate from the cooperative effort of a group of integrated assets functioning as a single unit. Income arises in the aggregate and is not known or recorded on an asset-by-asset basis. Each asset required for the system operation makes an implicit contribution to income through its beneficial use regardless of whether it is included in or excluded from a rate base calculation used in establishing revenue requirements.

As such, Aqua makes a compelling argument that the OCA’s adjustments are contrary to legislative intent and inconsistent with clear statutory language that requires a fair market value appraisal reflective of an Income Approach to valuation - not a hybrid Income Approach / Cost Approach to valuation, wherein 37% of Gannett Fleming’s DCF analysis and 15% of AUS’ DCF analysis would be attributable to the present value of a projected net plant less ADIT balance (*i.e*., the OCA’s proposed terminal values).

Although the OCA acknowledged the Company’s reliance on *Cheltenham*, there has been no effort by the OCA to distinguish the prior precedent, or to persuasively argue that we should depart from our prior determination on this issue in this proceeding.

Accordingly, we find no support for the conclusion in the Recommended Decision that the OCA’s proposal to modify the terminal value used in the Income Approach is reasonable and consistent with the Code and prior Commission Orders. Therefore, we shall grant Aqua’s Exception Nos. 1 and 2, and reverse the ALJ’s Recommended Decision, in part, consistent with the discussion in this Opinion and Order.

### Market Approach

The Market Approach (called the Sales Comparison Approach by The American Society of Appraisers) is defined by The American Society of Appraisers as follows:

A procedure to conclude an opinion of value for a property by

comparing it with similar properties that have been sold or are for sale in the relevant marketplace by making adjustments to prices based on marketplace conditions and the properties’ characteristics of value.[[30]](#footnote-31)

#### Positions of the Parties

The Gannett Fleming valuation produced a Market Approach result of $58.24 million. The AUS valuation shows a Market Approach result of $55.741 million. AUS included the Delaware County Regional Water Quality Authority (DELCORA) in its comparison group and indicated a final purchase price of $276,500,000 for DELCORA. OCA M.B. at 17 (citing OCA St. 1 at 38-39; Application Exh. R at 10). The OCA recommended that the DELCORA acquisition be removed from AUS’ comparison group. The adjustment has no impact on the AUS Market Approach valuation. AUS witness, Mr. Weinert explained that it is not necessary to exclude the Aqua-DELCORA wastewater acquisition as a comparable, as the purchase price used in the AUS 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, customer, and cash flows (EBITDA). Aqua M.B. at 22 (citing Aqua St. 5-R at 11-12).

The OCA contended that the Aqua-DELCORA acquisition is an ongoing matter and has not closed. The OCA explained that 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 been stayed. OCA M.B. at 18 (citing *Application of Aqua Pennsylvania Wastewater, Inc.*, A‑2017-2606103, ALJ Order Staying Proceeding (April 16, 2021)). The OCA argued that including the DELCORA acquisition and indicating $276,500,000 as the “final purchase price” for the DELCORA system is inaccurate and potentially misleading. OCA M.B. at 18.

The OCA provided that the *FSIO[[31]](#footnote-32)* 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.

OCA M.B. at 18 (citing *FSIO* at 87-88 (emphasis in original)).

The OCA witness, Mr. Smith recommended that the Aqua-DELCORA acquisition be removed from AUS’ comparison group as the DELCORA system has not been purchased and there is no final purchase price for the system. OCA M.B. at 18 (citing OCA St. 1 at 39). The OCA also explained that the DELCORA customers are not currently customers of Aqua. According to the OCA, eliminating the DELCORA acquisition from the comparison group did not impact the final resulting valuation under the AUS Market Approach but it is reasonable to make the elimination. *Id.*

#### ALJ’s Recommendation

The ALJ found the OCA witness Mr. Smith’s adjustment to the AUS Market Approach comparison group to be reasonable. The ALJ provided that whether the DELCORA acquisition will close and have a final purchase price of $276,500,000 is speculative. Further, the ALJ noted that the DELCORA customers are not currently customers of Aqua. R.D. at 89-90.

#### Aqua Exception No. 4 and Replies

In its Exception No. 4, Aqua argues that the removal of the DELCORA transaction from the AUS Market Approach is neither reasonable nor necessary. Aqua provides that Mr. Weinert explained that although the DELCORA acquisition has not been finalized, it is not necessary to exclude it as a comparable. Aqua explains that the comparison used is of a purchase price in the original asset purchase agreement comparability measures. Aqua avers that the OCA’s criticism of the AUS Market Approach and the proposed removal of the Aqua-DELCORA transaction from the AUS comparables should be rejected. Aqua Exc. at 21.

In its Replies to Aqua Exception No. 4, the OCA argues that the $276,500,00 “final purchase price” for DELCORA from AUS’ comparison price should be removed because the DELCORA system has not been purchased. OCA R. Exc. at 11 (citing OCA M.B. at 18-19; OCA St. 1 at 39). The OCA disagrees with Aqua’s assertion that the DELCORA acquisition should remain since the comparison is of a purchase price in the asset purchase agreement to comparability measures, such as customers. OCA R. Exc. at 11 (citing Aqua Exc. at 21). According to the OCA, the DELCORA acquisition is an outlier. All of the other acquisitions in the comparison group are closed transactions. The OCA explains that including the DELCORA acquisition and indicating $276,500,000 as a “final purchase price” for that system is inaccurate and potentially misleading. OCA R. Exc. at 11.

#### Disposition

The Aqua-DELCORA acquisition is not final and should not be used in the AUS comparison group. The “final purchase price” is not known at this time. The proposed Aqua-DELCORA acquisition is indeed an “outlier” as the OCA argued, as it is the only acquisition in the AUS comparison group that is not finalized. Use of the proposed Aqua-DELCORA transaction in the AUS comparison group is speculative. For these reasons, Aqua Exception No. 4 is denied.

### Conclusion – Section 1329 Fair Market Valuation

#### Positions of the Parties

Aqua submitted that the ratemaking rate base of the LMT wastewater system, determined pursuant to Section 1329(c)(2), is $53,000,000, the lesser of the negotiated purchase price of $53,000,000 and the average of the UVE appraisals of $54,967,796. Aqua averred that the OCA’s criticisms of the appraisals should be rejected and given no weight. Aqua M.B. at 22.

The OCA provided that the 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 $54,163,000 and the adjusted AUS appraisal result would be $48,309,516, in order to properly reflect financial and ratemaking principles.[[32]](#footnote-33) OCA R.B. at 14 (citing OCA Exh. RCS-1SR at Col. G, lns. 5, 10). The OCA averred that Mr. Smith’s recommended adjustments are reasonable, consistent with the Code and precedent, and should be adopted by the Commission in this proceeding. OCA R.B. at 14.

#### ALJ’s Recommendation

The ALJ adopted the OCA’s recommendation to adjust the Income Approach values of both the Gannett Fleming and AUS appraisals. The ALJ also adopted the OCA’s recommendation to use the 65-year service life for Gravity Collection Mains in the AUS Cost Approach. The resulting recalculated average of the two appraisal results is $51,236,259, which the ALJ recommended for establishing rate base under Section 1329 rather than the $53,000,000 proposed by Aqua. R.D. at 92; *see also* OCA Exh. RCS-1SR at Col. G, lns. 5, 10.

#### Aqua’s Exception No. 5 and Replies

In its Exception Nos. 1, 2, and 3, Aqua excepts to the individual adjustments to the Gannett Fleming Income Approach and to the AUS Cost and Income Approaches that reduce the ratemaking rate base. In Exception No. 5, Aqua excepts to the end result of those adjustments that reduce the ratemaking rate base from $53,000,000 to $51,236,259. Aqua Exc. at 22.

Additionally, Aqua disagrees with the Recommended Decision and the adjustment of the appraisals on a basis other than the USPAP – specifically, the application of “financial and ratemaking” principles to support the adjustments. Aqua contends that the statutory standard is “fair market value in compliance with the USPAP employing the cost, market, and income approaches.” Aqua Exc. at 22 (citing 66 Pa. C.S. § 1329(a)(3)).

Aqua maintains that this was affirmed in *New Garden*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.” Aqua Exc. at 23 (citing *New Garden* at 14).

Aqua states that it is not suggesting that the determination of ratemaking rate base must be “formulaic” or that the Appraisals cannot be challenged. Aqua submits that the UVE appraisals are prepared and sponsored by certified UVEs who are qualified by statute and Commission sanction. Aqua Exc. at 23. Aqua holds that 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 UVE appraisals of $54,967,796. Aqua avers that the Gannett Fleming and AUS appraisals are supported by the evidence of record and consistent with the Code and precedent. *Id.*

In its Replies to Aqua Exception No. 5, the OCA explains that Section 1329 creates a valuation process, which begins with two UVEs providing individual appraisals of “fair market value.” OCA R. Exc. at 12 (citing 66 Pa. C.S. § 1329(a)(3)). The OCA explains further that the statute anticipates that these appraisals will differ and provides for the appraisals to be averaged. OCA R. Exc. at 12 (citing 66 Pa. C.S. § 1329(g)).

The OCA avers that the two UVEs, who both must comply with the USPAP and employ the Cost, Market, and Income Approaches, may recommend different fair market values establishes that the appraisal process is not simply a “formulaic” mathematical exercise. OCA R. Exc. at 12-13.

According to the OCA, the UVEs are required to make judgments in each type of analysis and in how much weight is given to each approach. The OCA reasons that the consumer interest can only be protected if the Commission may consider evidence regarding errors and unsupported adjustments in the UVE appraisals. *Id.*

The OCA notes that 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. OCA Exc. at 13 (citing *Cheltenham* at 34-40). According to the OCA, 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.” OCA R. Exc. at 13 (citing *Cheltenham* at 36-37). The OCA provides that 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.* The OCA states that 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.

OCA R. Exc. at 13 (citing *Cheltenham* at 40, *see also* the full discussion at *Cheltenham* at 36-40).

Further, the OCA argues, in *Limerick[[33]](#footnote-34)*, the Commission was clear that the USPAP is not the controlling text for Section 1329 valuations involving regulated utilities. OCA R. Exc. at 12-13.

The OCA argues 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 OCA avers that Mr. Smith is highly qualified to review the appraisals and present his critiques. OCA R. Exc. at 14.

#### Disposition

We disagree with Aqua’s argument regarding *New Garden*, that the Commission’s review is constrained to compliance with USPAP. While Aqua cited to *New Garden[[34]](#footnote-35)* as reason to disagree with the Recommended Decision and the adjustment of the Appraisals on a basis other than the USPAP, the very next paragraphs in *New Garden* explain that the Commission in *New Garden* is not recommending that the Commission’s review focus only on the USPAP compliance as follows:

There is no language in Section 1329 abrogating or repealing the Commission’s authority under Section 505 to conduct an inquiry into the value of the assets that Aqua seeks to acquire. Likewise, because the Application proceeding includes the determination of whether a Certificate should be granted, the Commission retains the authority under Section 1103(b) to “make such inquiries, physical examinations, valuations, and investigations, and may require such plans, specifications, and estimates of cost, as it may deem necessary or proper in enabling it to reach a finding or determination.” 66 Pa. C.S. § 1103(b). Section 1329 does not contain language invalidating the General Assembly’s delegation of investigatory authority to the Commission under Section 1103.

We agree with I&E that Section 1329, despite being a later enacted statute, is reconcilable with Sections 505 and 1103(b). Thus, consistent with 1 Pa. C.S. § 1971(c), we do not believe the General Assembly intended to repeal the earlier enacted provisions under Sections 505 and 1103(b) of the Code. *See also*, *Royal Indem. Co. v. Adams*, 455 A.2d 135, 141 (Pa. Super. 1983) (“When interpreting statutes, they should be interpreted as being in harmony with each other and construed as a component of the whole statutory structure.”). 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.

*New Garden* at 34-35, footnote omitted.

As the ALJ in this proceeding noted, *Cheltenham* has addressed this very issue 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.

R.D. at 81 (citing *Cheltenham* at 39).

*Cheltenham* has further clarified that “the statutory appraisal process is not simply a formulaic mathematical exercise, nor is the Commission acting as some type of USPAP-compliance board.” *Cheltenham* at 40.

As discussed *supra*, we agree with the ALJ that OCA’s proposed adjustment to the AUS Cost Approach is reasonable and appropriate. We disagree with the OCA’s adjustment to the Gannett Fleming and AUS Income Approaches. We have adopted the ALJ’s recommendations to adjust the AUS Cost Approach and rejected the ALJ’s recommendations to adjust the Income Approaches and modified the ALJ’s recommendation to the UVE appraisal values. The Gannett Fleming Appraisal is unchanged at $55,505,000 from that proposed by Gannett Fleming. The AUS Appraisal is modified by reducing the Cost Approach from $51,414,555 to $46,700,407, a reduction of $4,714,148 to reflect the change in service life for Gravity Collection Mains from 80 to 65 years. The recalculated AUS Appraisal result is $52,073,517. The recalculated average of the Gannett Fleming Appraisal result and the adjusted AUS Appraisal result is $53,789,258, as follows:



The FMV is the lesser of the purchase price and the average of the appraisal results, or $53,000,000. For the reasons above, we shall adopt, in part, and deny, in part, Aqua Exception No. 5.

## Income Tax Savings on Repairs Deductions

### Positions of the Parties

The OCA submitted that, if the Commission approves the acquisition of LMT by Aqua, then the impact on income tax expense experienced from repairs deductions claimed by the Company for LMT system assets should be: (1) recorded in a regulatory liability account; and (2) addressed in Aqua’s first base rate case that includes rates for the acquired LMT customers. OCA M.B. at 19 (citing OCA St. 1 at 41).

The OCA explained that the Company is expected to have federal income tax deductions for repairs to the acquired LMT wastewater system and, as such, Aqua can take advantage of tax deductions for the repairs, including where the accounting treatment results in the costs for the repairs being capitalized for book purposes. The OCA noted that the repairs deductions can be substantial and result in a reduction to income tax expense. Further, the OCA noted that its witness, Mr. Smith, stated that the Company has treated federal income tax deductions for repairs for regulatory purposes by applying flow-through accounting for the impact of those deductions. Mr. Smith, therefore, anticipated that upon the completion of a property assessment relative to the Internal Revenue Service (IRS) tangible property regulations, Aqua would attempt to utilize flow-through accounting for the impact of repair deductions related to the assets of LMT. OCA M.B. at 19-20 (citing OCA St. 1 at 40).

The OCA detailed that the federal income tax repairs deductions for the acquired LMT system are related to the Company’s ownership of LMT and represent a potentially significant benefit to Aqua’s ratepayers that could help offset the estimated rate increases projected by the Company. Further, the OCA noted that not requiring deferred accounting would allow income tax savings from repairs deductions for the LMT system, from the acquisition date through Aqua’s next base rate case that includes LMT, to be retained by the Company for its investors. Accordingly, the OCA recommended that Aqua be required to account for the impact of the tax savings resulting from claimed repairs deductions in a regulatory liability account that would be addressed in the Company’s next base rate case that includes the LMT system. OCA M.B. at 20-21 (citing OCA St. 1SR at 6).

In opposition, Aqua stated Mr. Smith’s proposal to defer one cost of service component and conditionally create a regulatory liability account is unreasonable and inappropriate. Aqua M.B. at 23-24. The Company explained that at its existing rates, the LMT system has a deficiency in revenue requirement and, given that it will be a few years until the LMT system is presented in a base rate case, Aqua will carry the deficiency in revenue requirement as regulatory lag without deferral. Further, Aqua asserted that, if the Company does yield a tax repair benefit, then during the time leading up to the rate case that would include the LMT system, the revenue requirement deficiency would be offset by the benefit. Aqua M.B. at 23 (citing Aqua St. 1-R at 10). Moreover, Aqua averred that when the Company does present itself before the Commission in a base rate case, any repair benefits will accrue to customers at that time and going forward. Additionally, Aqua stated that, IRS 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 those assets. Aqua M.B. at 23. The Company averred that because the wear and tear on the system assets has been under the ownership of LMT and not Aqua, it is unlikely that a material repair benefit would be realized. Accordingly, Aqua disagrees with the OCA’s proposed condition and creation of a regulatory liability account. Aqua M.B. at 23-24.

### ALJ’s Recommendation

In his Recommended Decision, the ALJ recommended 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. The ALJ explained that, in order to direct the use of a regulatory liability for repairs tax reductions, the Commission is required to determine that such amounts are, or appear to be, extraordinary, substantial, and non-recurring. Accordingly, the ALJ found that the OCA failed to demonstrate that such repairs tax reductions are, or appear to be, substantial. R.D. at 96-97.

The ALJ provided that, in the case of a utility seeking Commission authorization to defer and record specific expenses as a regulatory asset, the Commission found that the standard that must be met to secure 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).” R.D. at 96 (citing *Petition of Pennsylvania American Water Company*, P-2012-2308982 (Order entered August 30, 2012) (*PAWC 2012*)). The ALJ noted that, in *PAWC 2012*, 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. The ALJ found that, in the instant case, it appears reasonable to apply a similar standard. R.D. at 96.

The ALJ reasoned that the 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. Therefore, the ALJ concluded that, based on the record, the OCA did not present sufficient evidence to determine that repairs tax reductions are an Eligible Deferral Item and, accordingly, the ALJ did not recommend that the Commission approve the creation of a regulatory liability at this time. R.D. at 96.

Additionally, the ALJ noted that, notwithstanding whether repairs tax reductions are an Eligible Deferral Item, the OCA’s recommendation necessitates the Commission directing, rather than allowing, deferral accounting. The ALJ referenced the *Tax Cuts and Jobs Act of 2017*, Docket No. M-2018-­2641242 (Order entered May 17, 2018) (*TCJA 2017*) to note that, 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. R.D. at 96.

### OCA Exception No. 1 and Replies

In its Exception No. 1, the OCA challenges the ALJ’s recommendation that the Commission deny the OCA’s recommendation that, if the Commission approves the transaction, then the impact of the income tax expense savings resulting from claimed repairs deductions claimed by Aqua for LMT system assets should be recorded in a regulatory account and addressed in the Company’s first base rate case that includes the acquired LMT system. Specifically, the OCA disagrees with the ALJ’s conclusion that the OCA failed to demonstrate that the tax repairs deductions are, or appear to be, substantial. OCA Exc. at 3 (citing R.D. at 96-97). The OCA asserts that, given the size of the proposed transaction and the potential benefits of utilizing tax repairs, requiring the Company to defer the tax savings for later review is reasonable and appropriate. Accordingly, the OCA requests that the Commission include the recommendation of the OCA’s witness, Mr. Smith, regarding the treatment of tax repairs deductions as part of its Order in this proceeding. OCA Exc. at 5.

The OCA notes that, although Aqua asserted that the size of the repairs deductions is currently unknown, the OCA witness, Mr. Smith testified that repairs deductions can be substantial and result in reducing income tax expense. OCA Exc. at 3‑4 (citing OCA St. 1 at 40; Aqua St. 1-R at 9-10; OCA St. 1SR at 6). The OCA also argues that Aqua did not provide evidence demonstrating that the costs are insubstantial and that, as a result of the proposed transaction, Aqua is expected to have federal income tax deductions for repairs for the acquired LMT system. OCA Exc. at 4 (citing OCA M.B. at 20-22; OCA St. 1 at 40-42). Accordingly, the OCA avers that, where the accounting treatment results in the repairs costs being capitalized for book purposes, Aqua can avail itself of tax deductions for repairs. OCA Exc. at 4

The OCA notes that its witness, Mr. Smith recommended that the Company 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 Exc. at 4 (citing OCA St. 1SR at 7). Further, the OCA contends that, although the OCA does not bear the burden of proof in this proceeding, Aqua posits an unsupported expectation that repairs deductions will be relatively small and such an expectation is not sound reasoning against the recommendation of deferred accounting. *Id.* (citing Aqua St. 1-R at 10). Moreover, the OCA notes that it is not possible to determine the size of future tax repairs deductions and a deferral account would preserve the issue so that the tax repairs deductions are able to be addressed in the first base rate case that includes LMT. Furthermore, the OCA maintains that such deferred accounting would allow the income tax savings from repairs deductions for the LMT system, from the acquisition date through Aqua’s next base rate case including LMT, to be retained by the Company for its investors. *Id.* (citing OCA R.B. at 16; OCA St. 1SR at 6). The OCA adds that the savings in setting rates in the next rate case that includes the acquired LMT system would not be experienced by Aqua’s ratepayers. *Id.*

The OCA notes that accounting for Aqua’s repairs deductions for the acquired LMT system, from the date of the acquisition through the test year being used in the Company’s next base rate case, in a deferred regulatory liability account will preserve the issue for Aqua’s next rate case. Further, the OCA notes that, at this point and in the context of a base rate case, the actual tax repairs deductions that the Company receives can be reviewed by the OCA, the Parties, and the Commission. Moreover, the OCA is not requesting that retroactive ratemaking treatment be given to unknown tax repairs deductions, as requiring the accounting of the impact of the tax savings resulting from claimed repairs deductions in a regulatory liability account addresses any retroactive ratemaking concern by preserving the issue so that it could be addressed in Aqua’s next base rate case that includes the acquired LMT system. Furthermore, the OCA notes that, if Aqua believes that the amounts accumulated in the regulatory liability account for LMT repairs deductions should not be used to offset rate increases in that case, the Company would have the opportunity to present its reasoning in that future rate case. OCA Exc. at 4-5.

In its Replies to the OCA’s Exception No. 1, Aqua counters that the OCA’s claim that repairs deductions could be substantial is an insufficient basis to conclude that the deductions are an Eligible Deferral Item, as the same claim could be made by the OCA or a utility for any utility cost component. Aqua asserts that the Recommended Decision properly concluded that the OCA did not present sufficient evidence to determine that repairs tax reductions are an Eligible Deferral Item. Further, the Company questions the OCA’s statement that it is not requesting retroactive ratemaking treatment, adding that the OCA’s proposal indicates otherwise. Aqua R. Exc. at 3, 5.

Aqua argues that deferral accounting is an exception to the rule against retroactive recovery of expenses and, in the instant case, the OCA does not support its claim that repairs tax deductions should be allowed. The Company notes that the OCA does not cite one instance where the Commission has required, as a condition for approval of a fair market value transaction, the creation of a regulatory liability account. Further, Aqua notes that, contrary to the OCA’s contention, there is no evidence that the repairs tax deductions will ultimately be substantial. The Company notes that its witness, Mr. Packer, testified that in the first five years of the Company’s ownership prior to the inclusion of the LMT system in an Aqua rate case, the likelihood of repairs deductions being realized or availed to Aqua is remote. Aqua R. Exc. at 3 (citing Aqua St. 1-R at 9).

Aqua maintains that it is unlikely that any meaningful repair benefit would be realized. Aqua also reiterates that, Mr. Packer testified that IRS regulations require that the “wear and tear” on the utility assets acquired must have occurred during the taxpayer's use of the assets and, to date, wear and tear on the LMT system has been under LMT ownership. Aqua R. Exc. at 4 (citing Aqua St. 1-R at 9-10).

Further, Aqua submits that, although the Company has the burden of proof to support its request for an order granting the Application and issuance of certificates of public convenience, the Company does not have the burden to disprove a deferred accounting proposal submitted by the OCA’s witness. The Company also submits that, consistent with the reasoning presented in the Recommended Decision, the OCA is obligated to present sufficient evidence to determine that repairs tax reductions are an Eligible Deferral Item and that the amounts involved are substantial. Aqua R. Exc. at 4.

Moreover, Aqua points out that the OCA’s proposal is one-sided and repeats that, given LMT’s existing rates and the amount of time before the LMT system is presented in a base rate case, the deficiency in revenue requirement will be borne by the Company as a regulatory lag. Aqua also emphasizes that the Company is not requesting that the revenue deficiency be deferred and any tax repair benefit yielded by Aqua would be offset the revenue deficiency. Aqua R. Exc. at 4 (citing Aqua St. 1-R at 10).

Aqua repeats that when the Company presents itself before the Commission in a base rate case, any repair benefits will accrue to customers at that point and going forward. Furthermore, Aqua notes that the OCA’s proposed treatment of income tax savings on repairs deductions ignores other costs of providing service that are likely to increase and be borne by the Company as regulatory lag until the LMT system is included in the rate case. Aqua R. Exc. at 4.

### Disposition

We agree with the ALJ’s recommendation to deny the OCA’s proposal that, as a condition for approval of the LMT transaction, the accumulation of the income tax effect of repairs deductions be accounted for in a regulatory liability account. The OCA claims that after the Company’s acquisition of LMT, Aqua will have potentially large federal income tax deductions for repairs to the LMT wastewater system. Although the OCA argues that repairs deductions “can be” substantial, the record evidence does not demonstrate that repairs deductions for the LMT wastewater system *will* be substantial. OCA Exc. at 3 (citing OCA St. 1 at 40). Indeed, as discussed by the ALJ, the OCA, as the advocate for deferral accounting, must demonstrate that deductions for repairs are, or appear to be, substantial. R.D. at 96.

Nevertheless, the OCA contends that, based on the possibility of substantial repairs deductions that can result in a reduction to income tax expense, Aqua should be required to account for the resulting impact on income tax expense in a regulatory liability account. We agree with the ALJ’s reasoning that directing, rather than allowing, Aqua to defer and record specific expense reductions in a regulatory liability account requires the Commission to determine that such expense reduction amounts “are, or appear to be, extraordinary, substantial, and non-recurring.” R.D. at 96 (citing *TCJA 2017*). Given that the record evidence does not support a finding that the repairs deductions for the LMT system will be substantial, we conclude that the OCA’s proposal that, as a condition of the LMT acquisition, the Company be required to account for the tax savings effect resulting from claimed repairs to the LMT system in a regulatory liability account, be denied. [[35]](#footnote-36)

# Conclusion

Based on the foregoing discussion, we shall: (1) grant, in part, and deny, in part, the Exceptions of Aqua; (2) deny the Exceptions of the OCA; (3) adopt the ALJ’s Recommended Decision, as modified, consistent with this Opinion and Order; and (4) approve the Joint Petition, without modification, as being in the public interest, consistent with this Opinion and Order; **THEREFORE,**

**IT IS ORDERED:**

1. That the Exceptions of Aqua Pennsylvania Wastewater, Inc. filed on November 29, 2021, to the Recommended Decision of Administrative Law Judge Jeffrey A. Watson, issued on November 17, 2021, are granted, in part, and denied, in part, consistent with this Opinion and Order.

2. That the Exception of the Office of Consumer Advocate filed on November 29, 2021, to the Recommended Decision of Administrative Law Judge Jeffrey A. Watson, issued on November 17, 2021, is denied, consistent with this Opinion and Order.

3. That the Recommended Decision of Administrative Law Judge Jeffrey A. Watson, issued on November 17, 2021, is adopted as modified, consistent with this Opinion and Order.

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

5. That the Application of Aqua Pennsylvania, Inc., filed on May 14, 2021, seeking approval of: (1) the acquisition, by Aqua Pennsylvania Wastewater, Inc., of the wastewater system assets of Lower Makefield Township situated within the Township of Lower Makefield and Yardley Borough, Bucks County, Pennsylvania, pursuant to 66 Pa. C.S. § 1102(a)(3); (2) the right of Aqua Pennsylvania Wastewater, Inc. to begin to offer, render, furnish, and supply wastewater service to the public in Lower Makefield Township, pursuant to 66 Pa. C.S. § 1102(a)(1); (3) certain contracts in connection with the proposed acquisition, including the assignments of certain contracts, pursuant to 66 Pa. C.S. § 507; and (4) an order establishing the ratemaking rate base of Lower Makefield Township’s wastewater system assets pursuant to 66 Pa. C.S. § 1329(c)(2), is approved subject to the following conditions in (a) through (p) below, and subject to Ordering Paragraph Nos. 6, 7, 8 and 11, below:

1. The pro forma tariff submitted with the Application, as amended in Aqua Pennsylvania Wastewater, Inc.’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.
2. On a going forward basis, Aqua Pennsylvania Wastewater, Inc. shall 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.
3. Aqua Pennsylvania Wastewater, Inc. and Lower Makefield Township shall 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 Pennsylvania Wastewater, Inc. 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 Pennsylvania Wastewater, Inc. shall provide an update to the Bureau of Investigation & Enforcement, the Office of Consumer Advocate, and the Office of Small Business Advocate approximately thirty (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.
4. In the first base rate case that includes Lower Makefield Township wastewater system assets, Aqua Pennsylvania Wastewater, Inc. shall submit a wastewater cost of service study that removes all costs and revenues associated with the operation of the Lower Makefield Township wastewater system.
5. In the first base rate case that includes Lower Makefield Township wastewater system assets, Aqua Pennsylvania Wastewater, Inc. shall also provide a separate cost of service study for the Lower Makefield Township wastewater system. Aqua Pennsylvania Wastewater, Inc. shall file a Cost of Service Study separately for the Lower Makefield Township wastewater 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.
6. Any claims for Allowance for Funds Used During Construction and deferred depreciation related to post-acquisition improvements not recovered through the Distribution System Improvement Charge for book and ratemaking purposes, shall be addressed in Aqua Pennsylvania Wastewater, Inc.’s first base rate case which includes Lower Makefield Township wastewater system assets.
7. Regarding future claims for Allowance for Funds Used During Construction, 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 shall not be construed to operate as its preapproval of Aqua Pennsylvania Wastewater, Inc.’s requests.
8. If Aqua Pennsylvania Wastewater, Inc. proposes to modify its Long-Term Infrastructure Improvement Plan to include the Lower Makefield Township wastewater system, the projects added for Lower Makefield Township shall be in addition to those that Aqua Pennsylvania Wastewater, Inc. plans for its existing systems.
9. In future Long-Term Infrastructure Improvement Plans or Annual Asset Optimization Plans that include the Lower Makefield Township wastewater system, Aqua Pennsylvania Wastewater, Inc. shall not reprioritize other existing capital improvements that the Company already committed to undertake. This section does not limit Aqua Pennsylvania Wastewater, Inc’s current practice and ability to allocate projects as needed for its capital program.
10. Upon approval of the Commission of a modification to its Long-Term Infrastructure Improvement Plan which includes the Lower Makefield Township wastewater system, Aqua Pennsylvania Wastewater, Inc. shall be permitted to collect a Distribution System Improvement Charge related to the Lower Makefield Township wastewater system prior to the first base rate case in which the Lower Makefield Township wastewater assets are incorporated into rate base.
11. The current average Lower Makefield Township 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 Township customers in this proceeding (Application Exhibit I2), Aqua Pennsylvania Wastewater, Inc. provided a non-binding, estimated incremental rate effect of the proposed rate base addition on Lower Makefield Township wastewater customers of 28.17%.
12. 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 Township customers that are in excess of the restrictions contained in Section 7.03 of the Asset Purchase Agreement.
13. At the time of Aqua Pennsylvania Wastewater, Inc.’s first base rate case that includes the Lower Makefield Township wastewater system, Aqua Pennsylvania Wastewater, Inc. shall propose the timing of the rate effect consistent with the terms of Section 7.03 of the Asset Purchase Agreement. All Parties reserve their rights to address Aqua Pennsylvania Wastewater, Inc.’s proposal.
14. In the first base rate proceeding filed by Aqua Pennsylvania Wastewater, Inc. that includes Lower Makefield Township’s wastewater system assets, Aqua Pennsylvania Wastewater, Inc. shall propose to move the Lower Makefield Township system to its cost of service, based on a separate cost of service study for Lower Makefield Township’s wastewater system; provided, however, that Aqua Pennsylvania Wastewater, Inc. shall not be obligated to propose Lower Makefield Township wastewater rates in excess of Aqua Pennsylvania Wastewater, Inc.’s proposed Rate Zone 1 system-average rates. The Joint Petitioners acknowledge, however, that Aqua Pennsylvania Wastewater, Inc. may agree to rates other than those proposed for Lower Makefield Township customers in the context of a settlement of the base rate case. The Office of Consumer Advocate, the Commission’s Bureau of Investigation and Enforcement, the Office of Small Business Advocate and Lower Makefield Township 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 Pennsylvania Wastewater, Inc. shall provide written notice to Lower Makefield Township customers of the rate filing and the level of increase, if any, resulting from this provision
15. Aqua Pennsylvania Wastewater, Inc. shall send a welcome letter to Lower Makefield Township wastewater customers within thirty (30) days following Closing which shall include information regarding the conversion to monthly billing for their sewer service.
16. In its next base rate case, Aqua Pennsylvania Wastewater, Inc. shall separately identify any legal fees included in its transaction and closing costs pursuant to the Asset Purchase Agreement between Aqua Pennsylvania Wastewater, Inc. and Lower Makefield Township and specify amounts expended by Aqua Pennsylvania Wastewater, Inc. on behalf of Lower Makefield Township. The Commission’s Bureau of Investigation and Enforcement, the Office of Consumer Advocate and the Office of Small Business Advocate reserve the right to challenge the reasonableness, prudency, and basis for such fees.

6. That, pursuant to 66 Pa. C.S. § 1329(c)(2), the ratemaking rate base of the Lower Makefield Township wastewater system assets is $53,000,000.

7. That the Office of Consumer Advocate’s 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.

8. That the Office of Consumer Advocate’s proposed income tax expense from repairs deduction and request that Lower Makefield Township wastewater utility system assets be recorded in a regulatory liability account and addressed in Aqua Pennsylvania Wastewater, Inc.’s first base rate proceeding in which rates for the acquired Lower Makefield Township wastewater utility customers are included is denied.

9. That the Commission’s Secretary shall issue a Certificate of Public Convenience evidencing Aqua Pennsylvania Wastewater, Inc.’s right under Sections 1102(a)(1), 1102(a)(3) and 1329(c)(2) of the Pennsylvania Public Utility Code, 66 Pa. C.S. §§ 1102(a)(1), 1102(a)(3) and 1329(c)(2), subject to the conditions set forth in this Opinion and Order, to: (a) acquire, by sale, the wastewater system assets of Lower Makefield Township; (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; and (c) allow Aqua Pennsylvania Wastewater, Inc. to incorporate the ratemaking rate base of $53,000,000 for the Lower Makefield Township wastewater system assets in its next base rate case pursuant to 66 Pa. C.S. § 1329(c)(2).

10. That the Commission’s Secretary shall issue a Certificate of Filing under Section 507 of the Public Utility Code, 66 Pa. C.S. § 507, for each of the following agreements:

1. Asset Purchase Agreement between the Township of Lower Makefield (as Seller) and Aqua Pennsylvania Wastewater, Inc. (as Buyer), dated as of September 17, 2020, as attached to the Application as Exhibit B.
2. 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, attached to the Application as Exhibit F1.
3. 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, attached to the Application as Exhibit F2.
4. 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, attached to the Application as Exhibit F3.
5. 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, attached to the Application as Exhibit F4.
6. 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, attached to the Application as Exhibit F5.
7. 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, attached to the Application as Exhibit F6.
8. 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, attached to the Application as Exhibit F7.
9. 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, attached to the Application as Exhibit F8.
10. Agreement, dated April 18, 1996, by and between the Township of Falls, the Township of Lower Makefield, and the Lower Makefield Township Sewer Authority, attached to the Application as Exhibit F9.
11. 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, attached to the Application as Exhibit F10.
12. 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, attached to the Application as Exhibit F11.
13. 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, attached to the Application as Exhibit F12.
14. 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, attached to the Application as Exhibit F13.
15. Supplemental Agreement Neshaminy Interceptor, dated February 7, 2018, by and between the Bucks County Water and Sewer Authority and the Township of Lower Makefield, attached to the Application as Exhibit F14.
16. 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, attached to the Application as Exhibit F15.
17. 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, attached to the Application as Exhibit F16.
18. Agreement, dated September 14, 1987, by and between Newtown Joint Municipal Authority and the Municipal Sewer Authority of the Township of Lower Makefield, attached to the Application as Exhibit F17.
19. Water Service Termination Agreement, dated March 17, 2005, by and between Lower Makefield Township and the Municipal Authority of the Borough of Morrisville, attached to the Application as Exhibit F18.

11. That Aqua Pennsylvania Wastewater, Inc., within ten (10) days after closing of the acquisition, shall file with the Commission a compliance tariff supplement to be effective on one day’s notice, consistent in form and content with the Tariff Supplement attached to the Application, filed on May 14, 2021, as amended in Aqua Pennsylvania Wastewater, Inc.’s supplemental information filed by letter dated June 21, 2021, implementing rates for Lower Makefield Township customers post-closing.

12. That the Commission’s Secretary, upon the receipt of written notice from Aqua Pennsylvania Wastewater, Inc. filed with the Secretary’s Bureau notifying the Commission of the closing of the acquisition and upon the completion of Ordering Paragraph No. 11 above, mark this docket closed.

**BY THE COMMISSION,**

Rosemary Chiavetta

Secretary

(SEAL)

ORDER ADOPTED: January 13, 2022

ORDER ENTERED:January 13, 2022

1. Under 66 Pa. C.S. § 1329, *inter alia*, Aqua sought to establish a ratemaking rate base of $53 million for LMT’s wastewater system assets based on the negotiated purchase price, as the negotiated purchase price of $53 million is less than the average of the fair market value appraisals, which are $54,967,796 (determined by $55,505,000 presented in the appraisal of Gannett Fleming Valuation and Rate Consultants, LLC (Gannett Fleming) and $54,430,591 presented in the appraisal of AUS Consultants, Inc. (AUS)). Application at 17. [↑](#footnote-ref-2)
2. Protests were filed by John Char on August 2, 2021, Barry Summers (Protestant Summers) on August 5, 2021, Kevin and Beth Cauley on August 13, 2021, Jaan Pesti on August 25, 2021, and Peter A. Lachance (Protestant Lachance) on August 27, 2021. An additional protest was filed after the protest deadline of September 7, 2021 by Keisha Jackson-Spence on September 10, 2021. [↑](#footnote-ref-3)
3. Subsequent to the Prehearing Conference, ALJ Watson issued an Initial Decision, entered September 20, 2021, dismissing the Protest of Protestant Lachance for lack of standing. Aqua and the Township had opposed Protestant Lachance’s participation in the proceeding, filing preliminary objections seeking dismissal of the protest on September 8, 2021 and September 10, 2021, respectively. [↑](#footnote-ref-4)
4. Aqua included the direct testimony of William C. Packer, Mark J. Bubel, Sr., Kurt M. Ferguson, Harold Walker, III, and Jerome C. Weinert as Aqua Exhibits U, V, W, X, and Y, respectively, to its Application filed May 14, 2021. [↑](#footnote-ref-5)
5. Protestant Summers elected to withdraw his written direct and surrebuttal testimonies served on September 10, 2021 and September 22, 2021, respectively. R.D. at 6. Additionally, on September 23, 2021, an Interim Order was entered granting the Motion of Aqua to strike the written testimony of Protestant Lachance. R.D. at 5. [↑](#footnote-ref-6)
6. Prior to the start of the hearing on September 29, 2021, Aqua, I&E, the OCA, the OSBA, and LMT submitted a Joint Stipulation for Admission of Testimony and Exhibits (Joint Stipulation) to ALJ Watson providing, *inter alia*, for the stipulation of written testimony and exhibits into the evidentiary record and the waiver of cross examination of each other’s written testimony. Protestant Summers joined in the Joint Stipulation during the course of the hearing. [↑](#footnote-ref-7)
7. On October 8, 2021, the Township filed a letter in support of Aqua’s Main Brief regarding the ratemaking rate base for the Township’s system. [↑](#footnote-ref-8)
8. Governor Wolf signed into law Act 12 of 2016 (Act 12) on April 14, 2016. This Act amended Chapter 13 of the Code by adding a new section, Section 1329, which became effective on June 13, 2016. 66 Pa. C.S. § 1329. [↑](#footnote-ref-9)
9. All assets are located in the Township except for a portion of a main that collects wastewater from a small segment of residents in Yardley Borough. The main is located on University Blvd. and is owned by LMT which loops into, then out of, Yardley Borough. The residents in Yardley Borough that are connected to this main are billed by Yardley Borough. Application at 3. [↑](#footnote-ref-10)
10. The OCA does not join in this Subparagraph A(2) but does not oppose Aqua’s request. [↑](#footnote-ref-11)
11. The ALJ also provides a detailed summary of the Joint Petitioners’ positions on each of the essential Settlement terms as set forth in their respective Statements in Support. *See* R.D. at 22-47. [↑](#footnote-ref-12)
12. We note that the Parties appear to have inadvertently excluded Exhibit F18: Water Service Termination Agreement, by and between Lower Makefield Township and the Municipal Authority of the Borough of Morrisville, from the Settlement and the Proposed Ordering Paragraphs.  The ALJ utilized the Proposed Ordering Paragraphs and thus also excluded Exhibit F-18 from the Ordering Paragraphs in the Recommended Decision.  Although the Parties did not note this apparent error in the Recommended Decision, it is clear that the Agreement (Aqua Exh. No. 1 with Exhibits A through AA2, and thus including F-18) were admitted into the evidentiary record.  We have included Exhibit F-18 in Ordering Paragraph No. 10 *infra.* See Tr. at 161.  [↑](#footnote-ref-13)
13. It should be noted that, while no Party disagreed that challenges to appraisals are permissible, Aqua’s Exception No. 5, discussed *infra*, contends that the Commission’s review is constrained to compliance with USPAP. *See* Aqua Exc. at 22‑23. [↑](#footnote-ref-14)
14. In preparation of their FMV estimates, specifically in the cost approach, Gannett Fleming and AUS utilized the Assessment of Tangible Property provided by Ebert. Aqua St. 4 at 16; Application Exh. R, Narrative Report at 2. [↑](#footnote-ref-15)
15. EBIT is earnings before interest and taxes and EBITDA is earnings before interest, tax, depreciation, and amortization. [↑](#footnote-ref-16)
16. The OCA also proposed an adjustment to the AUS Market Approach; however, this adjustment has no impact on the determination of ratemaking rate base. [↑](#footnote-ref-17)
17. The OCA calculated that the adjusted Gannett Fleming appraisal result would be $54,163,000, and the adjusted AUS appraisal result would be $48,309,516, in order to properly reflect financial and ratemaking principles. OCA Exh. RCS-1SR, Col. G, lns. 5 and 10. The recalculated average of the two appraisal results is $51,236,259, which is the amount the OCA recommended be used by the Commission for establishing rate base under Section 1329 rather than the $53,000,000 proposed by Aqua. OCA Exh. RCS-1SR, Col. G, ln. 13; OCA M.B at 9. [↑](#footnote-ref-18)
18. Application Exh. Q, Fair Market Value Appraisal Report as of March 22, 2021 for Aqua prepared by Gannett Fleming, Exh. 7 at 1. [↑](#footnote-ref-19)
19. SDR-35 is a type of PVC (*i.e*., plastic) pipe that is used for sewer main pipe and for storm drainage purposes. OCA St. 1 at 23. [↑](#footnote-ref-20)
20. The Ebert Engineering report estimated the amount of VCP of the Gravity Collection Mains in the LMT system as approximately 300,000 linear feet of VCP. OCA Exh. 1 at 7. [↑](#footnote-ref-21)
21. Application Exh. Q, Gannett Fleming Fair Market Value Appraisal Report, Exh. 15 at 7. [↑](#footnote-ref-22)
22. Application Exh. Q, Gannett Fleming Fair Market Value Appraisal Report, Exh. 16 at 6. [↑](#footnote-ref-23)
23. Mr. Walker of Gannett Fleming allocated 33.33% to the Income Approach which gave it a weighted value of $17,912,137. AUS allocated 40% weight to the Income Approach which gave it a weighted value of $23,149,184. [↑](#footnote-ref-24)
24. As shown on OCA Exhibit RCS-2SR, OCA witness, Mr. Smith, recalculated the valuation of the terminal value using the amount of net plant less ADIT remaining at the end of year 24. Page 2 of OCA Exhibit RCS-2SR shows the calculations under Gannett Fleming’s MUNI scenario, with an indicated value result of $59,186,879. Page 3 shows the calculations under Gannett Fleming’s IOU scenario with an indicated value result of $40,247,316. The two indicated value results are averaged, as shown on page 1 of Exhibit RCS-2SR, for an adjusted Income Approach value of $49,717,098. [↑](#footnote-ref-25)
25. It should be noted that, regarding *Limerick*, the OCA proposed a 50-year model *without* a terminal value, in lieu of Gannett Fleming’s 13-year model, which included a terminal value. *See Limerick* at 46-50. [↑](#footnote-ref-26)
26. Although pages 78 and 87 of the Recommended Decision presented the OCA’s adjustment to the Gannett Fleming Income Approach as $5,278,828 and the adjusted Gannett Fleming Income Approach value as $48,462,957, the OCA’s proposed adjustment to the Gannett Fleming Income Approach as presented in the surrebuttal testimony of OCA witness Smith is $4,024,687 and the OCA’s adjusted Gannett Fleming Income Approach value is $49,717,098. OCA Exh. RCS-1SR, ln 7. [↑](#footnote-ref-27)
27. It should be noted that Aqua does not provide citations to the “sixteen proceedings” that they reference. [↑](#footnote-ref-28)
28. As previously discussed, Aqua notes that the use of a terminal value in the DCF model is a “mathematical shortcut to avoid having to show and / or calculate Debt Free Net Cash Flows for hundreds of time periods.” Aqua Exc. at 11. [↑](#footnote-ref-29)
29. The OCA witness, Mr. Smith, acknowledged that the Commission rejected the use of net plant as the terminal value in *Cheltenham*. OCA St. 1SR at 13. [↑](#footnote-ref-30)
30. OCA St. 1 at 28 (citing *Approaches to Value*. American Society of Appraisers accessed March 5, 2020, http://www.appraisers.org/Disciplines/Personal-Property/pp-appraiser-resources/approaches-to-value). [↑](#footnote-ref-31)
31. *Implementation of Section 1329 of the Public Utility Code*, Docket No. M‑2016-2543193, Final Supplemental Implementation Order (Order entered February 28, 2019) (*FSIO*). [↑](#footnote-ref-32)
32. We note that the OCA Reply Brief transposed the values for the Gannett Fleming and AUS appraisal adjusted amounts. The values used in OCA Exh. RCS-1SR are correct and are used here. [↑](#footnote-ref-33)
33. *Limerick* at 58. [↑](#footnote-ref-34)
34. “[W]hen 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 UVE’s analyses.” Aqua Exc. at 23 (citing *New Garden*, slip op. at 14). [↑](#footnote-ref-35)
35. We note that, similarly, there is a lack of evidentiary support for a finding that the proposed expense reduction would also be extraordinary and non-recurring, or that it is within the scope of the type of items that the Commission has allowed as an exception to the general rule against retroactive recovery, particularly within the context of a Section 1329 proceeding. *See, e.g*., *Petition of Pennsylvania-American Water Company for Authorization to Defer, and Record as Regulatory Assets for Future Recovery: (1) Incremental Expenses Incurred Because of the Effects of the COVID-19 Emergency; (2) Revenue Reductions Attributable to the Effects of the COVID-19 Emergency; and (3) Carrying Charges on the Amounts Deferred*, Docket No. P‑2020‑3022426 (Order entered September 15, 2021). [↑](#footnote-ref-36)