


COMMONWEALTH OF PENNSYLVANIA



OFFICE OF CONSUMER ADVOCATE

555 Walnut Street, 5th Floor, Forum Place
Harrisburg, Pennsylvania 17101-1923
(717) 783-5048
800-684-6560

 @pa_oca

 /pennoca

FAX (717) 783-7152
consumer@paoca.org

April 15, 2022

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

Re: Application of Aqua Pennsylvania Wastewater, Inc.
pursuant to Sections 507, 1102 and 1329 of the Public
Utility Code for Approval of its Acquisition of the
Wastewater System Assets of East Whiteland Township
Docket No. A-2021-3026132

Dear Secretary Chiavetta:

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

Copies have been served per the attached Certificate of Service.

Respectfully submitted,

/s/ Harrison W. Breitman
Harrison W. Breitman
Assistant Consumer Advocate
PA Attorney I.D. # 320580
E-Mail: HBreitman@paoca.org

Enclosures:

cc: The Honorable Marta Guhl (**email only**)
Athena DelVillar (**email only**: sdelvillar@pa.gov)
Office of Special Assistants (**email only**: ra-OSA@pa.gov)
Certificate of Service

*326995

CERTIFICATE OF SERVICE

Re: Application of Aqua Pennsylvania Wastewater, :
Inc. pursuant to Sections 1102, 1329, 507, and :
2102 of the Public Utility Code for Approval of its : Docket No. A-2021-3026132
Acquisition of the Wastewater System Assets :
of East Whiteland Township :

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

Dated this 15th day of April 2022.

SERVICE BY E-MAIL ONLY

Carrie B. Wright, Esquire
Bureau of Investigation & Enforcement
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street, 2nd Floor
Harrisburg, PA 17120
carwright@pa.gov

Erin K. Fure, Esquire
Office of Small Business Advocate
555 Walnut Street
1st Floor, Forum Place
Harrisburg, PA 17101-1923
efure@pa.gov

Thomas T. Niesen, Esquire
Thomas, Niesen & Thomas, LLC
212 Locust Street
212 Locust Street
Harrisburg, PA 17101
tniesen@tntlawfirm.com
Counsel for Aqua PA Wastewater, Inc.

Alexander R. Stahl, Esquire
Kimberly A. Joyce, Esquire
Aqua Pennsylvania, Inc.
762 West Lancaster Avenue
Bryn Mawr, PA 19010
astahl@aquaamerica.com
kajoyce@aquaamerica.com
Counsel for Aqua PA Wastewater, Inc.

Thomas Wyatt, Esquire
Matthew S. Olesh, Esquire
Sydney N. Melillo, Esquire
Obermayer Rebmann Maxwell & Hippel, LLP
Centre Square West
1500 Market Street, Suite 3400
Philadelphia, PA 19102-2101
Thomas.Wyatt@obermayer.com
Matthew.Olesh@obermayer.com
Sydney.Melillo@obermayer.com
Counsel for East Whiteland Township

Richard J. Gage
120 Treaty Drive
Wayne, PA 19087
brittagage@aol.com

/s/ Harrison W. Breitman
Harrison W. Breitman
Assistant Consumer Advocate
PA Attorney I.D. # 320580
E-Mail: HBreitman@paoca.org

Christine Maloni Hoover
Senior Assistant Consumer Advocate
PA Attorney I.D. # 50026
E-Mail: CHoover@paoca.org

Erin L. Gannon
Senior Assistant Consumer Advocate
PA Attorney I.D. # 83487
E-Mail: EGannon@paoca.org

Laura J. Antinucci
Assistant Consumer Advocate
PA Attorney I.D. # 327217
E-Mail: LAntinucci@paoca.org

Counsel for:
Office of Consumer Advocate
555 Walnut Street
5th Floor, Forum Place
Harrisburg, PA 17101-1923
Phone: (717) 783-5048
Fax: (717) 783-7152
Dated: April 15, 2022
*326996

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of Aqua Pennsylvania Wastewater, :
Inc. pursuant to Sections 507, 1102, 1329 and :
2102 of the Public Utility Code for Approval of its : Docket No. A-2021-3026132
Acquisition of the Wastewater System Assets :
of East Whiteland Township :

REPLY BRIEF
OF THE
OFFICE OF CONSUMER ADVOCATE

Laura J. Antinucci
Assistant Consumer Advocate
PA Attorney I.D. # 327217
E-Mail: LAntinucci@paoca.org

Harrison W. Breitman
Assistant Consumer Advocate
PA Attorney I.D. # 320580
E-Mail: HBreitman@paoca.org

Erin L. Gannon
Senior Assistant Consumer Advocate
PA Attorney I.D. # 83487
E-Mail: EGannon@paoca.org

Christine Maloni Hoover
Deputy Consumer Advocate
PA Attorney I.D. # 50026
E-Mail: CHoover@paoca.org

Counsel for:
Patrick M. Cicero
Acting Consumer Advocate

Office of Consumer Advocate
555 Walnut Street
5th Floor, Forum Place
Harrisburg, PA 17101-1923
Phone: (717) 783-5048
Fax: (717) 783-7152
Dated: April 15, 2022

TABLE OF CONTENTS

I. STATEMENT OF THE CASE..... 1

 A. Procedural History 1

 B. Overview of the Proposed Transaction..... 2

II. BURDEN OF PROOF 3

III. STATEMENT OF QUESTIONS INVOLVED..... 4

IV. SUMMARY OF REPLY ARGUMENT 5

V. REPLY ARGUMENT 6

 A. Section 1102/1103 6

 1. Introduction..... 6

 2. Fitness 6

 3. Substantial Affirmative Public Benefits 6

 a. The Commission Cannot Approve an Acquisition That Is Not in the Public Interest..... 6

 b. Economies of Scale..... 8

 c. Aqua’s Ownership and Service as a Claimed Benefit 11

 d. Consolidation 14

 4. Conclusion 15

 B. Section 1329..... 16

 1. Introduction..... 16

 2. Legal Principles 16

 3. Aqua’s Application 16

 4. Challenges to the UVE Appraisals 17

a.	Cost Approach	17
i.	Gannett Cost Approach.....	17
ii.	AUS Cost Approach	19
b.	Market Approach	20
i.	Gannett Market Approach.....	20
a)	<i>Ex-Ante</i> Data and Commission-Determined Rate Base.....	20
b)	Selected Transactions.....	21
ii.	AUS Market Approach	22
a)	Using Rate Base to Perform a Market Approach Valuation...	22
b)	Weighting.....	24
c.	Income Approach.....	24
5.	Conclusion	29
C.	Stipulation.....	29
1.	Cost of Service Study.....	30
2.	East Whiteland Township Rates, Rate Freeze and Rate Stabilization.....	30
3.	Long Term Infrastructure Improvement Plan	32
4.	Allowance for Funds Used During Construction, Deferral of Depreciation and Transaction Costs.....	33
5.	Conclusion	33
D.	Recommended Conditions	34
E.	Section 507 Approvals	35
F.	Section 2102 Approval	35
G.	Other Approvals, Certificates, Registrations and Relief, If Any, Under the Code.....	35
VI.	CONCLUSION WITH REQUESTED RELIEF	36

TABLE OF AUTHORITIES

	Page(s)
Cases	
<i>Berner v. Pa. PUC</i> , 116 A.2d 738 (Pa. 1955).....	3
<i>City of York v. Pa. PUC</i> , 295 A.2d 825 (Pa. 1972).....	<i>passim</i>
<i>McCloskey v. Pa. PUC</i> , 195 A.3d 1055 (Pa. Cmwlth. Ct. 2018)	8, 10
<i>Middletown Twp. v. Pa. PUC</i> , 482 A.2d 674 (1984).....	6
<i>University of Pennsylvania v. Pa. PUC</i> , 485 A.2d 1217 (1984).....	3
Administrative Decisions	
<i>Application of Aqua Pennsylvania Wastewater, Inc.</i> , Docket No. A-2016-2580061, Order (June 29, 2017)	31, 35
<i>Application of Aqua Pennsylvania Wastewater, Inc.</i> , Docket No. A-2017-2605434, Order (Nov. 29, 2017).....	31, 35
<i>Application of Aqua Pennsylvania Wastewater, Inc.</i> Docket No. A-2019-3008491, Order (Oct. 24, 2019).....	20-21, 24
<i>Application of Aqua Pennsylvania Wastewater, Inc.</i> , Docket No. A-2021-3024267, Order (Jan. 13, 2022)	27
<i>Application of CMV Sewage Co., Inc.</i> , 2008 Pa. PUC LEXIS 950 (Dec. 23, 2008)	6
<i>Implementation of Act 11 of 2012</i> , Docket No. M-2012-2293611, Final Implementation Order (Aug. 2, 2012)	33
<i>Implementation of Section 1329 of the Public Utility Code</i> , Docket No. M-2016-2543193, Final Implementation Order (Oct. 27, 2016).....	32, 33
<i>Pa. PUC v. Equitable Gas Co.</i> , 57 Pa. PUC 423 (1983).....	3

Statutes

66 Pa. C.S. § 1102..... *passim*
66 Pa. C.S. § 1103.....6
66 Pa. C.S. § 1329..... *passim*
66 Pa. C.S. § 1329(c)(2).....34
66 Pa. C.S. § 1329(d)(4)32
66 Pa. C.S. Ch. 14.....13

I. STATEMENT OF THE CASE

A. Procedural History

The Office of Consumer Advocate (OCA) submits this Reply Brief in response to the Briefs of Aqua Pennsylvania Wastewater Inc. (Aqua or Company) and East Whiteland Township (East Whiteland or Township). On April 8, 2022, the OCA, the Bureau of Investigation and Enforcement (I&E), the Office of Small Business Advocate (OSBA), East Whiteland Township (East Whiteland or the Township), and Aqua filed Main Briefs. The OCA's Main Brief contained a comprehensive discussion of the evidence and its position on all issues. Thus, in this Reply Brief, the OCA will respond to only those matters raised by Aqua and East Whiteland that were not previously addressed or that require clarification.

The OCA continues to recommend the Commission deny the Application because Aqua failed to meet its burden of proving that the transaction would provide the required substantial affirmative benefits under Section 1102. Should the Commission determine to approve the proposed transaction, however, the OCA identified several conditions that are necessary to protect the public interest and should be adopted as part of such determination. Since filing Main Briefs, the parties entered a Stipulation which addresses, *inter alia*, the proposed rate freeze, cost of service studies, Aqua's Long Term Infrastructure Improvement Plan, and the Company's treatment of Allowance for Funds Used During Construction. See Stipulation of the Bureau of Investigation and Enforcement, the Office of Consumer Advocate, the Office of Small Business Advocate, Protestant Gage, East Whiteland Township and Aqua Pennsylvania Wastewater, Inc. filed April 14, 2022 (Stipulation). As a result, while affirmative public benefits and the ratemaking rate base remain issues for litigation, if the Stipulation is adopted, the matters addressed by the Stipulation will be resolved.

B. Overview of the Proposed Transaction

The OCA's overview of the proposed transaction is contained in the OCA's Main Brief.

OCA M.B. at 3.

II. BURDEN OF PROOF

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

The Pennsylvania Supreme Court has stated:

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

Berner v. Pa. PUC, 116 A.2d 738, 44 (1955). The Commission has also addressed this standard in its rate determinations:

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

Pa. PUC v. Equitable Gas Co., 57 Pa. PUC 423, 71 (1983); *accord University of Pennsylvania v. Pa. PUC*, 485 A.2d 1217 (1984). As discussed below and in the OCA's Main Brief, the OCA's comprehensive analysis demonstrates, and the record supports the conclusion that customers will experience substantial harm that outweighs any purported benefits. As such, Aqua has not met its burden of proof under Section 1102. Further, Aqua has not met its burden of showing that its valuations pursuant to Section 1329 are reasonable under Chapter 13 of the Public Utility Code and accepted financial and ratemaking principles.

III. STATEMENT OF QUESTIONS INVOLVED

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

IV. SUMMARY OF REPLY ARGUMENT

The proposed transaction should not be approved under Section 1102 because Aqua has not established that there are affirmative public benefits. The OCA presented credible and persuasive testimony that details why the harms that would result from the transaction outweigh the speculative claims regarding long-term benefits. The same concerns were raised in the testimony of the formal complainants and the customers who testified against the sale to Aqua.

Review of the appraisals provided by Aqua and East Whiteland Township show that there are judgments made in each type of analysis and in how much weight is given to each approach. The OCA identified several flaws in the exercise of that judgment. When errors are corrected and unsupported adjustments removed, the average of the two appraisals is less than the purchase price of \$54,930,000. If approved, the appropriate ratemaking rate base for ratemaking purposes should be \$46.5 million. However, even at this lower purchase price the OCA emphasizes that this transaction will not result in substantial affirmative public benefits. Aqua's arguments to the contrary are without merit.

V. REPLY ARGUMENT

A. Section 1102/1103

1. Introduction

As discussed in Section V.B.3 below and on pages 11 to 22 of the OCA's Main Brief, based on a weighing of the known harms and claimed future benefits, Aqua has failed to establish that the proposed transaction is in the public interest.

2. Fitness

The OCA did not present any evidence regarding Aqua's fitness.

3. Substantial Affirmative Public Benefits

a. The Commission Cannot Approve an Acquisition That Is Not in the Public Interest.

Under Sections 1102 and 1103 of the Public Utility Code, the standard for reviewing the benefits of an application is whether the transaction will provide substantial, affirmative benefits to the public. *See City of York v. Pa. PUC*, 295 A.2d 825, 828 (Pa. 1972) (*City of York*); 66 Pa. C.S. §§ 1102, 1103. The transaction must affirmatively promote the service, accommodation, convenience or safety of the public in some substantial way; mere absence of any adverse effect is not sufficient. *City of York* at 828. An acquisition provides an affirmative benefit if the benefits of the transaction outweigh the adverse impacts of that transaction. *Application of CMV Sewage Co., Inc.*, 2008 Pa. PUC LEXIS 950, *30 (Dec. 23, 2008) (*CMV*). Further, when the "public interest" is considered, the benefits and detriments to all affected parties must be considered. *See Middletown Twp. v. Pa. PUC*, 482 A.2d 674, 682 (1984).

Aqua argues that only two Commission findings are sufficient to support a conclusion that there is a public benefit to "an Aqua Section 1329 transaction":

i) that Aqua, as the owner of numerous water and wastewater systems has sufficient operational expertise and ability to raise capital to support system operations; and

ii) that the Commission has a policy of consolidation/regionalization of wastewater system assets that allows for increased maintenance, upgrade and expansion of public sewer and water facilities.

Aqua M.B. at 10. According to Aqua, “[n]o more needs to be determined to support Commission approval of the transaction.” *Id.* Aqua then provides the following list of claimed benefits: Aqua’s record of acquiring and improving wastewater systems, consolidation/regionalization, benefits to East Whiteland customers, enhanced customer service for East Whiteland Township customers, enhanced customer billing and payment protections, benefits to existing Aqua customers, no adverse effect, and East Whiteland Township wants to sell its sewer system. Aqua M.B. at 10-13.

Aqua’s position is essentially that, whenever Aqua seeks to acquire a system, it is de facto in the public interest and satisfies any challenge to the claim of affirmative public benefits. Aqua acknowledges that “there is an expectation of increased rates going forward” but calls that increase “hypothetical” and emphasizes that rates for East Whiteland or existing Aqua customers will not change in this proceeding. Aqua M.B. at 14. Aqua also notes that it is not proposing any change in rates to East Whiteland customers as a part of this transaction. *Id.* In the *New Garden* case, however, the Commonwealth Court reversed the Commission for failing to consider rate impact in its determination. It stated:

Simply, by approving the sale and then putting off the consideration of the impact on rates to a later rate base proceeding, the Commission cannot do 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. It is in this proceeding that the Commission is charged with deciding whether the impact on rates based on the OCA's undisputed evidence was outweighed by the other positive factors that the acquisition served a substantial public benefit. Because it did not do so, this matter is remanded to the Commission to make that determination, including the propriety of the rate restriction on New Garden ratepayers set forth in the APA.

McCloskey v. Pa. PUC, 195 A.3d 1055, 1067 (Pa. Cmwlth. Ct. 2018) (*New Garden Appeal*). Aqua’s position that only two Commission findings are needed to support a conclusion that there is a public benefit to “an Aqua Section 1329 transaction” conflicts with the Court’s ruling in the *New Garden Appeal*. Aqua, however, claims that while the *New Garden* case “concludes that rate impact should be addressed, it recognizes that it is not dispositive in the Commission’s determination of substantial affirmative benefits.” Aqua M.B. at 15. However, the Court required the Commission to *include rate impact in the weighing* of benefits and harms. Where, as here, the claimed benefits do not outweigh the harms, including rate impact, the acquisition would not serve a substantial public benefit. Aqua has failed to demonstrate the necessary public benefits required for approval of this Application.

b. Economies of Scale

Aqua takes issue with OCA witness Eastman’s “[r]eferencing of a textbook definition of Economies of Scale” and claims that OCA witness Eastman has failed to recognize the overall benefits of consolidation. Aqua M.B. at 20. In his Direct Testimony, OCA witness Eastman quoted the definition of Economies of Scale utilized in Charles F. Phillips, Jr.’s *The Regulation of Public Utilities: Theory and Practice*, which states as follows: “Economies of scale exist when a firm’s average cost curve decreases as output increases.” OCA St. 2 at 7. As Mr. Eastman explained, Aqua is misusing the term “economies of scale” because adding customers does not create economies of scale unless it also decreases the utility’s overall costs for providing service. OCA St. 2 at 7-9; OCA St. 2SR at 3-4. The Company has not shown that acquisition of the East Whiteland customers will produce net cost reductions or efficiencies. *Id.*

Economies of scale are achieved through a reduction in total cost per service delivered, i.e., when the average cost of providing a service to a customer is reduced over time because of

increasing size. OCA St. 2SR at 3. Aqua calculates that, over the past five years, *incremental* capital investment costs have been reduced for Aqua customers in its FMV and non-FMV systems. *See* Aqua M.B. at 21. However, this does not show that acquiring the East Whiteland system produces economies of scale because it is undisputed that the average total cost of providing service to its customers will increase from the East Whiteland acquisition, causing an annual revenue deficiency of \$5.011 million and rate increases for both Aqua’s existing customers and, to a larger degree, the East Whiteland customers.

Aqua also points to operating expenses, claiming that operating expenses for the East Whiteland system might be \$800,000 per year lower for Aqua than for the Township. *See* Aqua M.B. at 19. Identifying a potential reduction in one, isolated cost does not show there will be a reduction in Aqua’s average cost for serving each customer over time. Even if there is an \$800,000 savings in operating expenses, that savings is eradicated by the \$5.011 million revenue deficiency produced by the change to Aqua ownership.¹ OCA St. 2SR at 7. That deficiency would increase rates for acquired East Whiteland customers by 132.93% or be subsidized by increasing rates for other Aqua customers. OCA St. 2SR at 4. Thus, a small relative reduction in costs considered in the context of the much greater increase in total costs does not show that acquisition of East Whiteland will produce economies of scale or substantial affirmative public benefit.

Aqua also claims that OCA witness Eastman “single[s] out the East Whiteland system for individualized economic analysis” and argues that this is “inconsistent with the public interest and adverse to the basic public utility model.” Aqua M.B. at 20. Individualized analysis of every system proposed to be acquired under Section 1329 is not only in the public interest, but also

¹ For the first year of Aqua ownership, Aqua’s additional required income (\$5.011 million) exceeds the budgeted Operations and Management for the East Whiteland system (\$1.965 million) meaning that even if Aqua could operate the system at zero cost, it still would not offset the increased rates needed to pay a return on the fair market value ratemaking rate base. Aqua St. 1, App. A at 1.

necessary to ensure that each acquisition complies with the Public Utility Code, particularly Section 1102.² Again, just because Aqua *can* acquire systems – it has technical, managerial and financial ability – does not mean that every acquisition will further the public interest. For each transaction, Aqua must show that benefits will substantially outweigh the harms. *See City of York*; 66 Pa. C.S. § 1102. It has not done so regarding East Whiteland.

Importantly, Aqua’s argument that “[o]nce Aqua is managing the East Whiteland system, specific quantifiable public benefits will be more readily available” (Aqua M.B. at 21) does not support the proposition that economies of scale will be produced because of the proposed transaction. Aqua is essentially arguing that, although the record evidence does not exist in the present proceeding, it may exist in the future after the record has closed. The Court in *New Garden*, however, stated as follows:

Because *City of York* requires the impact on rates to be considered, the Commission must address that impact when deciding whether there is substantial public benefit. Contrary to its contention that impact on rates can only be addressed in a rate base case, the impact on rates can be addressed without all the cost-of-service studies, rate base valuations or rate-of-return calculations.

New Garden Appeal at 1066-67.

In this proceeding there has been no showing of how acquired and existing customers will benefit more than they will be harmed by the transaction in the short or long term. Claiming that quantifiable benefits may be available at some unknown date after Aqua already owns the system, rate base is already established, and after the transaction is already closed, in no way supports Aqua’s claim that affirmative public benefits arise because of this transaction due to economies of scale.

² *New Garden* at 1067.

c. Aqua's Ownership and Service as a Claimed Benefit

The OCA does not dispute that Aqua has expertise in providing wastewater service and its service and rates are subject to Commission regulation and oversight. *See, e.g.*, Aqua M.B. at 23-24. The proposed transaction, however, must affirmatively promote the service, accommodation, convenience or safety of the public in some substantial way. It must reflect benefits that are substantial, and the various risks and harms that could result from the acquisition must be mitigated so that, all factors considered, there is an affirmative public benefit. The Commonwealth Court stated as follows:

Despite the unequivocal command of the Public Utility Law that a utility merger is not to be approved unless the Commission is able to find that the merger will affirmatively benefit the public, this Court's decision in *Northern Pennsylvania Power Co.*, supra, adopted a different standard. There we held that a utility subject to the jurisdiction of the P.U.C. has the right to sell its property and thereby effect a merger with another utility "unless it is established, by competent evidence, that the sale will adversely affect the public in some substantial way." 333 Pa. at 267, 5 A. 2d at 134.

We now believe that our holding in *Northern Pennsylvania Power Co.*, supra, must be abandoned, for it is not in accord with the intent of the Legislature. Section 203 of the Public Utility Law 5 requires that those seeking approval of a utility merger demonstrate more than the mere absence of any adverse effect upon the public. Section 203 requires that the proponents of a merger demonstrate that the merger will affirmatively promote the "service, accommodation, convenience, or safety of the public" in some substantial way.

City of York at 828.

As discussed in the OCA's Main Brief, there is no evidence that the sale would provide an affirmative public benefit by ensuring that East Whiteland customers have safe and reliable service any more so than they have under the current East Whiteland Township ownership. OCA M.B. at 15-20. East Whiteland is not a troubled or non-viable system. While Aqua emphasizes the importance of its emergency preparedness plan, field staff personnel and in-house laboratory (Aqua M.B. at 19), there is no evidence that the Township's service is less safe or adequate than

Aqua's service. The Township acknowledges that it is providing safe and reliable service and that it is in an overall healthy financial position. Aqua Statement 3R at 2-3.

Aqua claims that having "dedicated staff and an established process to address sewer emergencies" will be a benefit of the acquisition. Aqua M.B. at 22. As OCA witness Eastman stated, freeing up police officer time may be a benefit to the Township. However, the substantive nature of the benefit is the important factor, as discussed in the *City of York* proceeding. In response to the OCA's discovery, the Township clarified that over the past five years, the police have been called regarding sewer emergencies only five times. OCA St. 2SR at 6. Out of these five sewer emergencies over five years, the police responded to zero. *Id.* Instead, the police directed the callers to on-call sewer staff. *Id.* This indicates a de minimis impact on the police department.

From the customer's perspective, the Township responds to sewer emergencies outside of its normal business hours and the fact that Aqua will also respond outside of normal business hours in no way produces a substantive affirmative benefit in relation to the rate increase the East Whiteland customers will experience as a result of the proposed transaction. No East Whiteland customer raised any issues with East Whiteland's response to emergency situations or with the service provided by its contracted operators. To the contrary, at the Public Input Hearing, customers were supportive of the service provided by East Whiteland Township. Tr. 50-52, 74. Aqua's position that in-house operators will provide a detectible difference in the level of service provided to customers (Aqua M.B. at 19) is not supported by record evidence and does not outweigh the harms of the proposed transactions.

Aqua makes a related claim that the financial fitness of the seller is not a factor to consider in approval of the acquisition, which should also be rejected. *See* Aqua M.B. at 16; OCA St. 2 at

6. In responding to Aqua's claim that the Township's customers would receive benefits from the Company's technical experience and fitness in deploying resources towards capital improvements, OCA witness Eastman noted that given the evidence of record, "it seems likely that the Township would be able to make necessary improvements over the coming decade equal to what Aqua proposed." OCA St. 2 at 6. Moreover, the total cost to customers will be considerably less under the continued ownership of East Whiteland Township.³ OCA St. 2SR at 9.

Also, although Aqua claims that the ability to pay Aqua bills online is a benefit (Aqua M.B. at 22), East Whiteland stated that it may deploy its own online bill system in the future. OCA St. 2SR at 6. Nevertheless, there is no evidence of any complaints regarding the Township's current billing system. The option of an immediate implementation of online bill payments does not outweigh the harms caused by a rate increase of over 132%.

Regarding Aqua's low-income programs (Aqua M.B. at 23), while some East Whiteland customers may be eligible for assistance, if East Whiteland bills are increased under Aqua ownership and then decreased through assistance programs to be the same as or higher than current, that is not an affirmative public benefit. OCA St. 2 at 10.

Aqua also argues that Chapter 14 of the Public Utility Code is an affirmative public benefit of the transaction. Aqua M.B. at 23 (citing 66 Pa. C.S. Ch. 14). While the OCA acknowledges that protections provided by the Public Utility Code are a benefit, they are statutory requirements that Aqua must meet for all of its customers. OCA St. 2SR at 16-17. While these may be a part

³ As discussed in the OCA's Main Brief, the cost of ownership is significantly higher if the East Whiteland Township system is acquired by Aqua because those costs include nearly \$4 million for return to Aqua shareholders. OCA M.B. at 17. There is no cost of equity for East Whiteland Township as its cost of capital is limited to repaying debts at a much lower interest rate (about 3.7%). OCA St. 2 at 9. Aqua is required to pay taxes, whereas East Whiteland Township is not. *Id.* Additionally, the acquisition of East Whiteland is a Section 1329 acquisition, and as such, the entirety of the purchase price can be incorporated into Aqua's rate base without recognizing offsets for contributed plant or capital, as is done in traditional ratemaking. There is no evidence of substantial cost savings or quantified efficiencies for this proposed acquisition that would offset Aqua's higher cost of ownership.

of the overall benefit associated with a public utility purchasing a municipal system, even in combination with the benefits to low income customers noted above, they are not sufficient to meet the affirmative public benefits standard. *Id.*

East Whiteland Township points to its ability to reallocate its employees' time from sewer operations to other public works functions as a benefit. EWT M.B. at 10. The OCA agrees that this may produce some benefit. In addition, as proposed, the Township will receive \$54.93 million or 64% more than the net book value of the system and Aqua will spend \$16.92 million for capital improvements during the next 10 years. OCA St. 2 at 6, 9. Thus, it is not disputed that the Township would benefit from the proposed transaction. There is, however, no support for concluding that existing and acquired Aqua wastewater and water customers will see a net benefit because the rate impact of the revenue deficiency will cause such substantial harm. *See* OCA M.B. at 11-20.

In summary, there may be some level of benefit related to these claims or they may be imperceptible to most customers. As noted above, the scale of the benefit is important. Considered together, the claimed benefits from Aqua's ownership and customer service do not outweigh the significant and known harms to customers.

d. Consolidation

Aqua acknowledges that investor-owned utilities can create a higher cost of capital and income taxes compared to a municipally-owned system but notes that the difference in cost of capital and income taxes is known by the Commission and the General Assembly. Aqua M.B. at 21. Aqua further argues that Section 1329 is meant to encourage consolidation. *Id.*

Regarding consolidation as an affirmative public benefit, the OCA agrees that as a matter of policy, the Commission supports consolidation because the acquisition of smaller systems by

larger systems may improve the long-term viability of the water and wastewater industry, or otherwise enhance ratepayers' daily lives and communities. *See* Aqua M.B. at 9, 14. However, that has not been shown for the East Whiteland transaction. Aqua calculates that the acquisition of East Whiteland, would be at a higher rate base per customer than for its existing customers. Aqua St. 1 at 17. As such, acquisition of East Whiteland would only serve to transfer a viable system to a different provider at higher cost and would not meaningfully enhance the service provided.

While Aqua characterizes the rate impact as “hypothetical” (Aqua M.B. at 14), the proposed ratemaking rate base and planned system investment in conjunction with the level of East Whiteland rates means the system will not generate revenue sufficient to cover its cost of service under Aqua ownership and that *annual* revenue deficiency of \$5.011 million will be subsidized by Aqua's other customers. OCA St. 2SR at 3. Until that subsidy is eliminated, existing customers will experience no benefit from the larger customer base. Any benefit gained from consolidation regarding this specific transaction is diminished.

4. Conclusion

Many of the benefits claimed by Aqua will not be realized in the short term, but instead are speculative, at best in the long term, and are being claimed without any supporting evidence. In contrast, what is certain is the detrimental rate impacts resulting from the ratemaking rate base approved in this case will be realized in the short term, in the next rate case when the East Whiteland system is included in Aqua's rate base. The Company estimates that the rates of a typical residential ratepayer in the Township could increase nearly 133% because of Aqua ownership including the revenue requirement for the proposed ratemaking rate base. OCA St. 2SR at 4. If East Whiteland customers pay less than the revenue requirement for the proposed

ratemaking rate base, other Aqua customers will subsidize this transaction. This is not occurring in a vacuum. Aqua has other Section 1329 acquisitions pending or approved since its last base rate case, like Willistown Township, Lower Makefield Township and DELCORA, for which it also projects revenue requirement deficiencies that would put upward pressure on rates for acquired or existing customers in the short term and push the timing for customers to realize possible benefits from cost sharing further into the future. Consolidation alone is not enough to meet the *City of York* standard. If it were, every acquisition by an investor-owned utility would satisfy the standard.

B. Section 1329

1. Introduction

As discussed in the OCA's Main Brief, the process for determining the fair market value is based on two separate appraisals that reflect the judgments and choices made by each utility valuation expert. OCA M.B. at 21. Aqua's proposed rate base is overstated due to errors, flaws, and unreasonable subjectivity by the UVEs making the appraisals. If the Commission approves the proposed acquisition, the correct ratemaking rate base amount is \$46.5 million for the Township's system. OCA St. 1 at 6 and 44; OCA Exh. DJG-2.

2. Legal Principles

The legal standard for Section 1329 approvals is addressed in detail in the OCA's Main Brief. OCA M.B. at 22.

3. Aqua's Application

Both Gannett Fleming and the Township provided FMV appraisals for Aqua and the Township, respectively, using different weightings for each of their approaches and relying on

their own judgment and experiences. Aqua M.B. at 24-27; OCA M.B. at 23-24. As discussed in the OCA’s Main Brief, with proper adjustments the average of these two appraisals would be \$46.5 million, and that is the amount that should be used by the Commission to establish the ratemaking rate base under Section 1329. OCA M.B. at 6 and 44; OCA St. 1 at 5-6.

4. Challenges to the UVE Appraisals

Aqua argues that OCA witness Garrett’s recommended ratemaking rate base of \$46.5 million should be denied because it does not meet a standard of FMV and “is in direct violation of Section 1329.” Aqua M.B. at 27-28. As discussed in the OCA’s Main Brief and below, Mr. Garrett’s recommendations are consistent with the OCA’s recommendations in prior Section 1329 proceedings and they properly reflect reasonable adjustments to the UVE appraisals under Section 1329. OCA M.B. at 23-24; OCA St. 1 at 6; OCA Exh. DJG-2; 66 Pa. C.S. § 1329.

a. Cost Approach

i. Gannett Cost Approach

Aqua argues that Mr. Garrett’s service life recommendations under the cost approach are not supported by statistical evidence and are inconsistent with the service lives approved by the Commission in prior 1329 proceedings, and thus they should not be adopted. Aqua M.B. at 29. Specifically, Aqua takes issue with the fact that Mr. Garrett’s recommended service lives are based on a depreciation study that took place in Indiana, and that Mr. Garrett has provided no evidence that the assets that were the subjects of the Indiana study are comparable to the East Whiteland assets. *Id.* at 29-30. Aqua argues that it was neither reasonable nor appropriate for Mr. Garrett to choose service lives that are shorter than the service lives that Aqua proposes, which impact accumulated depreciation and result in lower values under the cost approach. *Id.* at 30.

It was entirely reasonable for Mr. Garrett to use the Indiana study to inform his service life recommendations in the present case. As discussed in the OCA’s Main Brief and in testimony, the Township did not maintain the requisite records about asset placements and retirements, so the UVEs used their subjective judgment to calculate service lives. OCA M.B. at 29-30; OCA St. 1SR at 10-11. To be clear, neither of the UVEs conducted the type of “statistical analysis” that Aqua claims Mr. Garrett should have conducted because the type of data required was not available from East Whiteland Township. OCA St. 1SR at 9. Like Mr. Garrett, both UVEs support their subjectively selected service lives by comparing them to other utilities – Limerick, Cheltenham and Lower Makefield for Mr. Walker and Pennsylvania-American and Aqua for Mr. Weinert. Aqua St. 4 at 18; Aqua St. 5 at 9.

Aqua criticizes Mr. Garrett for proposing service lives in this case that differ from those he proposed in other cases where he addressed service lives for grouped depreciable assets. Aqua M.B. at 30-31. While he was informed by his prior service life recommendations, Mr. Garrett recognized that in those cases the utilities produced significant historical retirement data to support their proposed service lives that was not available for East Whiteland. OCA St. 1SR at 9. Given this distinction, Mr. Garrett applied his experience and judgment in determining what service lives are appropriate for the East Whiteland system. Thus, for the Township’s pumping account and treatment account, Mr. Garrett accepted the Iowa curves that Mr. Weinert used in this case and prior Section 1329 proceedings.⁴ OCA St. 1 at 20. Mr. Garrett’s proposed service lives for the force and gravity mains accounts are the same as what Gannett Fleming proposed for a wastewater utility in Indiana. *Id.* Finally, Mr. Garrett’s proposed service life for the services account is

⁴ A more detailed discussion of Iowa curves may be found in the OCA’s Main Brief at pages 28-32, and in OCA Statement 1, App. A.

consistent with his proposal for this account in prior Section 1329 proceedings (which were settled), and it is within a reasonable range for this account. OCA St. 1 at 20. Mr. Garrett's service life recommendations are appropriately conservative, given the need to rely on comparative analyses in lieu of utility-specific data. In contrast, Aqua has failed to justify using longer proposed service lives in this proceeding, which would only serve to increase the values under the cost approach. OCA St. 1 at 20; OCA M.B. at 28-30. Thus, the OCA's shorter proposed service lives are most appropriate and result in adjusted cost valuation of \$56.3 million, which is \$2.8 million less than Mr. Walker's proposed cost approach valuation of \$59.1 million and should be adopted by the Commission. OCA St. 1 at 22; OCA M.B. at 30.

ii. AUS Cost Approach

Aqua critiques Mr. Garrett's proposed adjustments to the AUS cost approach because Aqua claims that Mr. Garrett provided no basis for his recommended service lives and used the same lives to adjust the Gannett Fleming cost approach. Aqua M.B. at 31-32. As is explained in the OCA's Main Brief, both Mr. Garrett and Mr. Weinert from AUS Consultants selected their service lives based on data from other cases. OCA M.B. at 31; OCA St. 1SR at 10-11. Aqua's "specific reference to depreciation studies presented by [PAWC]" does not make its service life estimates inherently more reliable than Mr. Garrett's own reference to other Section 1329 proceedings to calculate his proposed service lives. Aqua M.B. at 32; OCA M.B. at 31-32; OCA St. 1SR at 10-11. There is no utility-specific actuarial data available for the East Whiteland Township system assets, so it is more reasonable to be conservative when calculating the appropriate service lives for various accounts. OCA M.B. at 32; OCA St. 1SR at 10-11.

Without more information, Mr. Garrett's proposed shorter service lives are most reasonable and result in a Renewed Cost New Less Depreciation (RCNLD) value of approximately \$53.1

million, which is \$6.7 million less than AUS Consultant's calculation of \$59.8 million. OCA St. 1 at 24; OCA Exh. DJG-12.

b. Market Approach

i. Gannett Market Approach

a) Ex-Ante Data and Commission-Determined Rate Base

Aqua argues that OCA witness Garrett's adjustments to the Gannett Fleming market approach do not meet the standard of value of fair market value and are in direct violation of Section 1329. Aqua M.B. at 34-35; Aqua St. 4R at 17-18. Specifically, Aqua argues that Mr. Garrett wrongfully substituted purchase price paid with the fair market value rate base approved by the Commission in his analysis, that Mr. Garrett wrongfully excluded *ex-ante* data from his analysis, and that Mr. Garrett removed selected transactions utilized by Gannett. *Id.* Aqua relies on the *Cheltenham* case to support each of these assertions. *Id.*; *Application of Aqua Pennsylvania Wastewater, Inc.*, Docket No. A-2019-3008491 (Oct. 24, 2019) (*Cheltenham*).

Mr. Garrett's reliance on *ex-post* data in this proceeding is consistent with the OCA's recommendations in prior Section 1329 proceedings. OCA St. 1SR at 4; OCA M.B. at 34-35. Relying on OCNLD, or *ex-post* data, should not be disregarded as irrelevant simply because it was obtained after the transaction purchase price was determined. OCA St. 1SR at 4. Moreover, Aqua witness Walker acknowledges that using only OCNLD (without *ex-ante* data) would not have significantly changed his valuation (less than \$1 million). *Id.*; Aqua St. 4R at 18.

Mr. Garrett's use of Commission-approved rate base to make a valuation under the market approach is also acceptable since Commission-approved rate base represents a market transaction. OCA St. 1 at 3-4; OCA M.B. at 34. Further, using Commission-approved rate base here helps address the concerns that the Commission expressed in *Cheltenham* about allowing UVEs to use

purchase prices that are higher than the Commission-determined ratemaking value when assessing an asset's FMV. *Cheltenham* at 57. The Commission expressed concern that using purchase price to determine FMV has the potential to create a circular pattern that rewards utilities for paying excessive purchase prices. *Id.* The Commission acknowledged that this outcome would be contrary to the public interest and would "likely result in unjust and unreasonable rates." *Id.* Using Commission-approved rate base to determine FMV under the market approach helps to avoid this concern. The only reason that the Commission ultimately accepted the UVE's use of purchase price instead of Commission-determined rate base in the *Cheltenham* case was because the Commission was concerned that Commission-determined rate base represented a hypothetical assumption of market value rather than an actual indication of market value. *Id.* at 58. However, as Mr. Garrett explained in his testimony, once the Commission determines a rate base both parties still have the freedom to choose not to move forward with the proposed transaction. OCA St 1SR at 6. Thus, the Commission-determined rate base does represent a market sale that must be agreed to by both buyer and seller. It is not a hypothetical value, and its use is acceptable to determine a valuation of East Whiteland Township's assets under the market approach. *Id.*

b) Selected Transactions

Aqua also argues that Mr. Garrett's selected transactions under the market approach are an unreliably small sample size, and that Mr. Garrett did not explain his choices to include or exclude certain transactions. Aqua M.B. at 35-37. Specifically, Aqua argues that, by eliminating wastewater transactions that included treatment facilities, OCA witness Mr. Garrett should have eliminated three water distribution properties in his analysis of the market approach also for lack of comparability, and that he failed to include the value of purchased treatment capacity outside of East Whiteland and at the Valley Forge Treatment Plant, thus undervaluing the system. Aqua

M.B. at 38. Mr. Garrett explained his decision to include only transactions involving collection/distribution systems in his market approach analysis in his testimony. OCA St. 1 at 9-10; OCA St. 1SR at 5. That is, East Whiteland Township owns only one small wastewater treatment plant which is why it may be properly characterized as a collection-only system. OCA St. 1 at 9; OCA M.B. at 35. It is not reasonable to include integrated systems in the market approach analysis, as Mr. Walker does, when those systems are incomparable to the East Whiteland system. OCA St. 1 at 10; OCA M.B. at 35.

As provided in the OCA's Main Brief, OCA witness Garrett's adjustments to Gannett Fleming's market approach result in a market approach valuation estimate of \$39.5 million, which is about \$7.1 million less than Gannett Fleming's market approach valuation of \$46.7 million. OCA St. 1 at 11; OCA M.B. at 35. This number is far more reasonable than Gannett Fleming's result because Mr. Garrett excluded integrated systems because the Township is not an integrated system and Mr. Garrett found that the analysis including integrated systems produced several results that are unreasonably high. *Id.*

ii. AUS Market Approach

a) Using Rate Base to Perform a Market Approach Valuation

Aqua argues that Mr. Garrett wrongfully substituted Commission-determined rate base for purchase price in his adjustments to the AUS market approach. Aqua M.B. at 36-37. Aqua provides a definition of market value taken from "The Appraisal of Real Estate 14th Edition" and uses it to argue that Commission-determined rate base in Section 1329 proceedings cannot represent market value because the Commission-determined rate base is derived from the input of parties other than just the buyer and seller. *Id.* at 37. Aqua also argues that buyer and seller are under "duress" when they agree to Commission-approved rate base. *Id.*

This argument is flawed because Section 1329 transactions are not comparable to purely market-driven transactions. OCA St. 1SR at 7; OCA M.B. at 37. The incentives that are present in competitive marketplace transactions between buyers and sellers are not present in Section 1329 transactions, which is in part why the Section 1329 regulations exist at all. *Id.*; 66 Pa. C.S. § 1329. As Mr. Garrett explained in testimony, when the Commission establishes a ratemaking rate base that is lower than the purchase price of any given transaction, the Commission is finding that the purchase price does not comport with the fair market value for that transaction. OCA St. 1SR at

3. Mr. Garrett explained:

For example, the purchase price in the Limerick transaction was \$75.1 million; however, the ratemaking rate base based on fair market value, as determined by the Commission, was \$64.4 million. Suppose the winning bid had been even higher at \$90 million – even further divergent from the fair market value. Yet this is still the figure Mr. Walker [and Mr. Weinert] would have presumably relied on in his selected transaction analysis, despite the fact that it would be grossly excessive relative to the Commission’s ultimate determination. We are using the selected transactions method (and all other models in the case) for the sole purpose of helping the Commission determine the fair market value in this proceeding.

Id. at 3-4. Further, once the Commission establishes the appropriate FMV both parties have the freedom to not go forward with the transaction, or to still go forward with a higher agreed-upon purchase price if they wish do so. Commission determined rate-base only establishes the amount of the transaction that is fair to recover from ratepayers. Parties do not agree to Commission determined FMV under “duress.” Aqua M.B. at 37. However, most frequently both buyer and seller do agree to move forward with the Commission-determined rate base in a transaction, and thus that is the best indication of FMV for the purpose of performing a valuation under the market approach.

b) Weighting

Aqua also argues that Mr. Garrett’s use of a simple average in his market analysis is a “less reliable market comparable indicator” than Mr. Weinert of AUS Consultant’s use of a weighted average. Aqua M.B. at 38-39. However, it is Mr. Weinert’s weightings that produce an unreasonable result in this case. Mr. Weinert’s weightings allow transactions with higher purchase prices to have more influence than lower-priced transactions. OCA St. 1 at 12; OCA M.B. at 38. For Mr. Weinert’s weightings to be acceptable he would have to demonstrate that it is appropriate in this case for larger transactions to influence his market approach under Section 1329 more than smaller transactions. *Cheltenham* at 69. Mr. Weinert has not put forth any evidence in this proceeding to support his use of the weighted average other than his own unexplained assertion that it is more “reliable.” Aqua M.B. at 39; Aqua St. 5R at 7-8. The OCA has put forth evidence demonstrating that the use of the weighted average would cause large transactions such as the \$159 million McKeesport transaction to have the greatest statistical weighting in this proceeding, when the McKeesport transaction cannot reasonably be compared to the East Whiteland assets. OCA St. 1 at 7-8; OCA M.B. at 38.

After using the Commission’s approved ratemaking rate bases instead of purchase price to determine fair market value, and giving equal weight to the transactions that Mr. Garrett appropriately selected to adjust the AUS market approach FMV of the East Whiteland system, the OCA’s adjusted value is approximately \$40.9 million. OCA St. 1 at 14; OCA M.B. at 38.

c. Income Approach

Aqua argues that Mr. Garrett’s recommended adjustments to the income approach should be rejected because, *inter alia*, the Commission has not adjusted Gannett Fleming’s DCF recommendation in any of the prior Section 1329 proceedings where Gannett applied the DCF

method as its income approach to valuation. Aqua M.B. at 39. This is misleading because most of those proceedings were settled and, due to that, the Commission has not yet reviewed the adjustments recommended by OCA witness Garrett. Further, Mr. Garrett does not challenge the DCF method as a basis for the income approach, he challenges the inputs used in the model. OCA St. 1 at 25. Specifically, and as discussed further below, Mr. Garrett recommends using more reasonable estimates for a growth rate and discount rate (cost of capital). OCA St. 1 at 25-29; OCA M.B. at 40-44.

Moreover, Aqua claims that the Commission “has *never* accepted the capitalization of earnings method recommended by Mr. Garrett in a Section 1329 fair market value proceeding.” Aqua M.B. at 40. To arrive at their respective income approach valuations, however, Mr. Walker, Mr. Weinert, and OCA witness Garrett all utilize a process which involves discounting projected cash flows (in other words, a capitalization of earnings method). OCA St. 1SR at 14. Again, Mr. Garrett’s adjustment to the income approach has not yet been reviewed in a litigated Section 1329 proceeding.

Aqua broadly critiques the “free cash flow from operations” that OCA witness Garrett utilized in his comparable earnings analysis and concludes that a 4.5% discount rate “was not determined in accordance with accepted valuation practice.” Aqua M.B. at 41. Each witness, including the UVEs, arrived at different valuations as a result of the inputs that were utilized. The difference between OCA witness Garrett’s and the UVEs’ income approaches is that OCA witness Garrett based his FMV analysis on current ownership and cash flow metrics, rather than future ownership. OCA St. 1SR at 14. Mr. Walker uses a multi-stage DCF approach, which requires separate inputs, estimates and assumptions for each year into the future for the duration of the model. OCA St. 1SR at 14. In contrast, OCA witness Garrett used known data regarding cash

flow and applied a reasonable, constant growth rate to those cash flows. *Id.* Using actual data is a reasonable approach to valuation, whether or not Mr. Walker has proposed it in a Section 1329 proceeding. *Id.* Indeed, Aqua is essentially arguing that any adjustment to the DCF of any UVE, even when the DCFs utilized by the UVEs are not the same, is not in accordance with accepted valuation practices. That argument is without merit and should be rejected. Mr. Garrett's adjustments are consistent with accepted ratemaking approaches and should be adopted.

Aqua critiques OCA witness Garrett's reliance on 2018-2020 cash flow data and alleges that OCA witness Garrett "failed to disclose" that the 2018-2020 cash flow data was not utilized in Gannett Fleming's appraisal. Aqua M.B. at 40-41. To be clear, OCA witness Garrett never stated that Gannett Fleming utilized the 2018-2020 cash flow data, but instead testified to the fact that he based his DCF analysis on the cash flow data presented as an exhibit to Mr. Walker's appraisal, but not used by Mr. Walker. *See* OCA St. 1 at 27; Aqua Exh. Q at Exh. 13, 1 of 7. In

OCA witness Garrett used the cash flow data as the basis of his cash flow analysis because, unlike Mr. Walker's approach that is based on estimates and assumptions for each year into the future for the duration of the model, the data are known. OCA St. 1SR at 14-15. OCA witness Garrett testified as follows:

In my view, the value of an asset is primarily based on its present value. I am not suggesting that projecting future cash flows should entirely ignore future ownership, however, the various and numerous assumptions Mr. Walker has made in his discounted cash flow model indicate a much different (and higher) value than if the analysis is based on a reasonable projected growth (and discount) of known cash flow metrics under current ownership.

OCA St. 1SR at 14. OCA witness Garrett's use of the actual 2018-2020 cash flow data in this proceeding is reasonable and appropriate.

Aqua argues that projected data should be utilized in the income approach instead of known actual data. Aqua M.B. at 40-41. The fair market value of the Township's assets is what the value

is today, however, not what the value could speculatively be someday, if and when a buyer adds value to the system. As discussed by OCA witness Garrett, it is more appropriate to base an income approach FMV analysis under Section 1329 on current ownership and cash flow metrics, rather than future ownership. OCA St. 1SR at 14. The importance of basing the income approach on present ownership under Section 1329 has been recently discussed by the Commission in the Aqua/Lower Makefield Section 1329 proceeding as follows:

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.

Application of Aqua Pennsylvania Wastewater, Inc., Docket No. A-2021-3024267, Order at 69 (Jan. 13, 2022) (*Lower Makefield Township*) (emphasis added).

Aqua further claims that the discount rate should have been based on a municipality's discount rate, not an investor-owned discount rate. Aqua M.B. at 41. OCA witness Garrett's discount rate, however, acknowledges that when a buyer attempts to value an asset, the buyer would conduct a cash flow analysis based upon the buyer's after-tax cash-flow and cost of equity, not the seller's. OCA St. 1SR at 15. Here, the buyer is an investor-owned utility and the seller is a municipality. Utilizing an investor-owned discount rate instead of a municipality's discount rate is reasonable given that it is an investor-owned utility that is the buyer in this proceeding.

Next, Aqua argues that Mr. Garrett's "[discount] rate is not reflective of market capitalization ratios at the valuation date in accordance with accepted valuation practice." Aqua M.B. at 41. It would be unreasonable for a buyer, however, to conduct a discounted cash flow analysis using the discount rate of a different entity. OCA St. 1SR at 15. Since both Mr. Walker and Mr. Garrett used a proxy group to assess the market-based cost of equity of a non-municipal

buyer, it is reasonable to use the capital structures of the same proxy group as the indicated cost of equity derived from a DCF and CAPM analysis of the proxy group's metrics cannot be disassociated with the proxy group's capital structures; they are interrelated. OCA St. 2SR at 15-16.

Aqua also argues that the appropriate debt cost rate that OCA witness Garrett should have used is the current municipal revenue bond rate at the valuation date, not the embedded cost of debt. Aqua M.B. at 41. As discussed *supra* in relation to the cash flow, cost of equity, and capital structure issues, however, it is not appropriate to use the seller's metrics when conducting a valuation model, especially when the seller is a municipality. OCA St. 1SR at 16.

Lastly, Aqua argues that “[t]he equity cost rate was not determined at the valuation date in accordance with accepted valuation practice and used for market valuation purposes.” Aqua M.B. at 41-42. The Commission has never determined that the equity cost rate must be determined at the valuation date. To be clear, most analysts use various periods of time to develop averages for certain metrics of a cost of equity model. OCA St. 1SR at 16. For example, a company will have a daily closing stock price, but most analysts take an average of closing stock prices (typically ranging from 30-90 days) to arrive at a single price to represent the “current” price, rather than relying on the input of a single day, which might be abnormally high or low depending on the circumstances. OCA St. 1 SR at 16.

In relation to Mr. Weinert's appraisal, Aqua further states that OCA witness Garrett's estimated cost of equity of 6.0% is “far below what the Commission regularly assumes is the cost of equity, which was 9.85% based on the Bureau of Technical Utility Services Report on Quarterly Earnings of Jurisdictional Utilities for the Year Ending December 31, 2020.” Aqua M.B. at 42. An increase to the cost of equity, however, results in a decrease in valuation under both OCA

witness Garrett's model and the UVEs' models (as they are the same formulas with different inputs). *See* OCA St. 1 at Exh. 14. In other words, the higher the cost of equity percentage utilized, the lower the resulting valuation. Indeed, the UVEs did not utilize a cost of equity as high as 9.85%. Mr. Walker estimates a range for the cost of capital of 6.36%-7.59%. OCA St. 1 at 29. Mr. Weinert estimates a cost of capital of 7.57%. *Id.* The differences in the cost of capital estimates stem from the differences between the various components of the cost of capital – primarily the cost of equity and capital structure. OCA witness Garrett's adjustments to the UVEs' income approach are reasonable and appropriate.

5. Conclusion

Aqua's criticisms of Mr. Garrett identified above are without merit.⁵ OCA witness Garrett corrected errors and removed unsupported adjustments in the UVE appraisals. As Section 1329 does not delegate or otherwise eliminate the Commission's authority to determine rate base for ratemaking purposes and to consider testimony by statutory advocates regarding fair market valuation, the OCA respectfully submits that, if the transaction is approved, the Commission should establish a rate base under the Section 1329 methodology of \$46,500,000 for the East Whiteland system, rather than a rate base of \$54,930,000 as proposed by Aqua. OCA M.B. at 44.

C. Stipulation

Aqua's proposed acquisition of East Whiteland should be denied because the Company has failed to meet its burden of proving that the transaction would provide the required substantial affirmative benefits under Section 1102. While the OCA continues to recommend that the

⁵ East Whiteland does not make any specific arguments regarding the valuations but states its support for the reasons set forth in Aqua's Main Brief. EWT M.B. at 14. The OCA's response to Aqua should be considered the basis for rejecting the Township's position also.

Commission deny the Application, the OCA entered into a Stipulation to resolve certain contested issues that would need to be addressed in the event the Commission determines to approve the transaction. The Stipulation does not resolve contested issues regarding ratemaking rate base.

1. Cost of Service Study (COSS)

The OCA identified the need for a separate cost of service study for the East Whiteland system in the first base rate case in which Aqua includes the Township assets in rate base. OCA St. 1 at 46; OCA M.B. at 45-46. A separate cost of service study would provide information to establish rates that reflect the costs for that system. *Id.*

The Stipulation addresses this issue. The Stipulation provides that, in its first rate case following closing, in which Aqua includes the Township assets in rate base, Aqua will submit a wastewater cost of service study that removes all costs and revenues associated with the East Whiteland system. Stipulation at 3-4. The Company will also provide a separate cost of service study for the East Whiteland system. *Id.* These provisions provide the opportunity for the parties in the next Aqua base rate case to use the cost of service data to propose that the rates for the East Whiteland customers should differ, as appropriate, from rates proposed by Aqua.

2. East Whiteland Township Rates, Rate Freeze and Rate Stabilization

The OCA challenged the three-year rate freeze in the APA. OCA St. 2 at 15-16. The OCA contended that the rate freeze fell under the definition of a Rate Stabilization Plan under Section 1329 because the proposed three-year rate freeze could hold East Whiteland rates constant after Aqua's next base rate case. Existing Aqua customers should not be at risk to cover the revenue requirement required to keep East Whiteland rates lower than rates set for those customers in a base rate case. *Id.*; OCA M.B. at 12-13 (citing *Application of Aqua Pennsylvania Wastewater, Inc.*, Docket No. A-2016-2580061, Order at 42 (June 29, 2017) (internal citations omitted) (*New*

Garden); *Application of Aqua Pennsylvania Wastewater, Inc.*, Docket No. A-2017-2605434, Order at 31 (Nov. 29, 2017) (*Limerick*).

The Stipulation provides that in the first rate case in which Aqua includes the Township's assets in rate base, Aqua will propose to move the Township's system to its cost of service based on a separate cost of service study for East Whiteland's system; provided, however, that Aqua will not be obligated to propose East Whiteland wastewater rates in excess of Aqua's proposed Rate Zone 1 system-average rates. Stipulation at 5. If Aqua proposes an effective date for these new rates that is different from the effective date of new rates for other customers, i.e. freeze rates as provided in the Asset Purchase Agreement, all parties reserve their rights to address that proposal. Stipulation at 4. Further, if Aqua is permitted to freeze East Whiteland rates, it will calculate its compliance proof of revenue using the new rate otherwise applicable to East Whiteland customers, not the frozen rate. Stipulation at 4.

At existing rates, revenues generated by the East Whiteland system are not sufficient to offset the cost of Aqua ownership. Aqua St. 1, App. A at 1. Thus, the subsidization of the revenue deficiency by existing Aqua wastewater and water customers is a concern. The Stipulation terms addresses the potential subsidy by, first, permitting the parties to address a reasonable increase for East Whiteland customers in the next Aqua base rate case. Stipulation at 5. Moving East Whiteland to or toward its cost of service should serve to reduce the amount and length of time that existing Aqua wastewater and water customers will subsidize the shortfall in revenues generated by the East Whiteland system. The provisions also apply the ratemaking principle of gradualism to rates set for customers in East Whiteland's service area.

Second, the Stipulation ensures that existing customers will not subsidize any revenue deficiency related to rates for East Whiteland customers being frozen beyond the effective date of

new rates in Aqua's first base rate case that includes the Township assets, by providing that Aqua and its shareholders – rather than existing customers – will subsidize the difference in revenues provided by frozen rates and the new rates otherwise applicable to East Whiteland customers at the conclusion of Aqua's base rate case. Stipulation at 4.

3. Long Term Infrastructure Improvement Plan (LTIIP)

Pursuant to statute and Commission Orders and regulations, Aqua is permitted to charge a Distribution System Improvement Charge (DSIC) to customers in systems acquired under Section 1329, before the system is included in a base rate case, if Aqua revises its Long Term Infrastructure Improvement Plan to include the acquired system. 66 Pa. C.S. § 1329(d)(4); *Implementation of Section 1329 of the Public Utility Code*, Docket No. M-2016-2543193, Final Implementation Order at 27-28 (Oct. 27, 2016) (*2016 FIO*); OCA St. 2 at 14-15. The OCA recommended that it should be a condition of approval of the proposed Application that the proposed projects reflected in the revised LTIIP should be in addition to, and should not reprioritize, any capital improvements that Aqua has already committed to undertake for existing customers. OCA St. 2 at 15. Reprioritization of capital improvements would disadvantage existing Aqua customers. *Id.* The Stipulation adopts the OCA's recommended condition (Stipulation at 5), which will 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 East Whiteland acquisition. *See* OCA St. 2 at 15; OCA M.B. at 46.

The Stipulation also reflects that Aqua is required to have approval of a revised LTIIP to begin applying the DSIC prior to the acquired system being included in a base rate case, however, there is no requirement to revise the LTIIP to begin applying the DSIC after the acquired system

has gone through a rate case.⁶ Stipulation at 5-6. Accordingly, the Stipulation clarifies that Aqua will begin applying the DSIC to the East Whiteland customers no later than when the systems rates are established in the first Aqua base rate proceeding that includes the Township assets. *Id.* at 6. The sooner the DSIC is applied to East Whiteland customers, the sooner those customers will begin contributing, up to 5% of their total wastewater bill, toward DSIC-eligible capital projects.

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

The Stipulation adopted the OCA's recommended condition that rates claims related to the accrual of AFUDC for non-DSIC eligible, post-acquisition improvements should be made in the next Aqua base rate case following the plant additions. Stipulation at 6; OCA St. 2 at 15; OCA M.B. at 46. This condition ensures that the AFUDC would be claimed at the same time as the improvements are included in rates. OCA St. 2 at 15. Additionally, the Stipulation preserves all parties' positions in future rate cases, including the ability to challenge the reasonableness and prudence of the Company's claims and specifies that the parties' assent to this agreement should not be construed to operate as its preapproval of Aqua's requests. Stipulation at 6. This provision reserves the parties' rights to litigate any issues that may arise related to the AFUDC, deferral of depreciation, and transaction costs related to this acquisition.

5. Conclusion

For the foregoing reasons, the OCA requests that the Presiding Officer and the Commission accept and approve the Stipulation.

⁶ After the system acquired under Section 1329 has been rolled into the acquiring utility's rate base and its rates have been established through a base rate case, the projects affecting service to such customers are eligible for DSIC treatment and the DSIC should be applied to their bills. *See Implementation of Act 11 of 2012*, Docket No. M-2012-2293611, Final Implementation Order at 53-54 (Aug. 2, 2012); *2016 FIO* at 27-28.

D. Recommended Conditions

As set forth above and in the OCA's Main Brief, the OCA recommends that the Commission deny the relief requested in the Application. If, however, the Commission approves the proposed acquisition, the OCA recommends that certain conditions should be applied. OCA M.B. at 45-46. As identified in the Section above, in the interval since the OCA filed its Main Brief, the parties reached a Stipulation on terms addressing, *inter alia*, the proposed rate freeze, COSS, LTIP, and AFUDC. Stipulation at 2-6. The Stipulation does not address affirmative public benefits or the ratemaking rate base, which remain issues for litigation. With regard to the ratemaking rate base, the OCA continues to recommend that if the Commission approves the proposed acquisition, it should condition its approval on the following:

1. *The Commission should adopt the OCA's proposed adjustments to the appraisals, resulting in an overall ratemaking rate base of \$46,500,000 (prior to closing and transaction costs).*

The average of the adjusted appraisal results is less than the purchase price and thus, pursuant to 66 Pa. C.S. § 1329(c)(2), should be adopted as the ratemaking rate base. *See discussion supra* at pages 18-31; OCA M.B. at 23-44. Also, the lower ratemaking rate base will reduce the revenue deficiency created by the acquisition and the resulting rate increases for customers.

In the event the Stipulation is not adopted, the OCA recommends these additional conditions if the acquisition is approved:

2. *The rate freeze provision should be rejected. OCA St. 2 at 4. If the Commission does not reject the rate freeze provision, the Commission should condition its approval on the recognition that the Commission retains the ultimate authority to set rates, including but not limited to, the authority to allocate revenues, if appropriate, to the East Whiteland Township customers that are different from the restrictions contained in Section 7.03 of the Asset Purchase Agreement.*
3. *Aqua should be required to provide a separate Cost of Service Study for the East Whiteland system, in the first base rate case which includes the Township's assets.*

4. *The proposed projects reflected in the revised LTIP should be in addition to, and not reprioritize, any capital improvements that Aqua was already committed to undertake for existing customers.*
5. *Rates claims related to the accrual of AFUDC for non-DSIC eligible, post-acquisition improvements should be made in the next Aqua base rate case following the plant additions.*

OCA St. 2 at 15-16; *New Garden* at 42; *Limerick* at 31; OCA St. 1 at 46; OCA M.B. at 12-14, 45-46.

E. Section 507 Approvals

The OCA did not present any evidence regarding the Section 507 Approval aspects of the proposed transaction.

F. Section 2102 Approval

The OCA did not present any evidence regarding the Section 2102 Approval aspects of the proposed transaction.

G. Other Approvals, Certificates, Registrations and Relief, If Any, Under the Code

The OCA did not present any evidence regarding other approvals, certificates, registrations, and relief under the Pennsylvania Public Utility Code concerning the proposed transaction.

VI. CONCLUSION WITH REQUESTED RELIEF

For the reasons stated above and in its Main Brief, the Office of Consumer Advocate requests that the Public Utility Commission deny the Application. If the Commission determines to approve the Application under Sections 507, 1102, 1329 and 2102 of the Public Utility Code, the Office of Consumer Advocate requests that the Commission approve a fair market value of \$46,500,000 for ratemaking rate base and further requests that the Commission adopt the proposed Stipulation submitted by the parties or, if the Stipulation is not accepted, adopt the Office of Consumer Advocate's proposed conditions.

Respectfully Submitted,

Erin L. Gannon
Senior Assistant Consumer Advocate
PA Attorney I.D. # 83487
E-Mail: EGannon@paoca.org

Christine Maloni Hoover
Deputy Consumer Advocate
PA Attorney I.D. # 50026
E-Mail: CHoover@paoca.org

Office of Consumer Advocate
555 Walnut Street
5th Floor, Forum Place
Harrisburg, PA 17101-1923
Phone: (717) 783-5048
Fax: (717) 783-7152

Dated: April 15, 2022
327203

/s/Harrison W. Breitman
Harrison W. Breitman
Assistant Consumer Advocate
PA Attorney I.D. # 320580
E-Mail: HBreitman@paoca.org

Laura J. Antinucci
Assistant Consumer Advocate
PA Attorney I.D. # 327217
E-Mail: LAntinucci@paoca.org

Counsel for:
Patrick M. Cicero
Acting Consumer Advocate