

COMMONWEALTH OF PENNSYLVANIA



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May 27, 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 Exceptions in the above-referenced proceeding.

Copies have been served per the attached Certificate of Service.

Respectfully submitted,

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Certificate of Service

*329577

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 Exceptions, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 27th day of May 2022.

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Dated: May 27, 2022
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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 EXCEPTIONS
OF THE
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I. INTRODUCTION

The Office of Consumer Advocate (OCA) submits this Reply to the Exceptions of Aqua Pennsylvania, Inc. (Aqua or Company) and East Whiteland Township (Township). The Public Utility Commission (Commission) should adopt Administrative Law Judge (ALJ) Marta Guhl's recommendation that Aqua's acquisition of the East Whiteland Township wastewater system does not provide substantial, affirmative public benefits and deny Aqua's Application. If the Commission, despite the substantial evidence demonstrating that there is no affirmative public benefit, approves Aqua's Application, it should adopt the OCA's adjustments to the appraisal values and decrease the ratemaking rate base to \$46.5 million, and should also approve the Stipulation filed April 14, 2022 addressing conditions that need to be imposed on the transaction.

II. REPLY EXCEPTIONS

A. Substantial Affirmative Public Benefits

Reply to Aqua Exception 1: The ALJ Properly Concluded that the Transaction Fails to Meet the Statutory Requirement to Provide Substantial, Affirmative Public Benefits, Consistent with Ratemaking Principles and Commission Precedent. R.D. at 27-59; OCA M.B. at 10-20; OCA R.B. at 6-16.

ALJ Guhl properly determined that Aqua has failed to demonstrate the necessary public benefits required for approval of this Application. *See* R.D. at 53-59. Aqua contests that ruling, arguing that only two findings are necessary to support Commission approval of 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 Exc. at 4-5. According to Aqua, based on those findings alone, the ALJ should have approved the transaction. *Id.* at 5. Aqua is essentially claiming that, whenever it seeks to acquire a system, it is de facto in the public interest and any challenge to the claim of affirmative public benefits has been satisfied. 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 v. Pa. PUC*, 295 A.2d 825, 828 (Pa. 1972) (*City of York*); 66 Pa. C.S. §§ 1102, 1103. It has not done so here.

Aqua characterizes the rate impact that would occur as a result of this transaction as “hypothetical.” Aqua Exc. at 23. In the *New Garden* case, 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*). Aqua's position that only two Commission findings are needed in order to support a conclusion that there is a public benefit to “an Aqua Section 1329 transaction” is in conflict with the Court's ruling in *New Garden*.

Consistent with *New Garden* and *City of York*, ALJ Guhl properly considered rate impacts in weighing the benefits claimed by Aqua and the Township with the evidence provided by other parties. R.D. at 27-59. In the context of that review, the ALJ recognized that Aqua has expertise

in providing wastewater service and that its service and rates are subject to Commission regulation and oversight. *Id.* at 33. ALJ Guhl also recognized that the proposed acquisition could increase rates as much as 133% for East Whiteland customers, 5% for existing Aqua wastewater customers, and 0.4% for existing Aqua wastewater customers depending on how the \$5.011 million revenue shortfall is apportioned between customers. R.D. at 36-37, 39. The ALJ also considered the evidence regarding the ways that Aqua ownership would eliminate some of the benefits and conveniences that East Whiteland customers currently receive from the Township. *Id.* at 40-47.

ALJ Guhl's analysis is consistent with the requirements of the Public Utility Code. The proposed transaction 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 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. ALJ Guhl correctly determined that the evidence did not establish that any benefit to be realized from the proposed transaction would outweigh the harms to current Aqua water and wastewater customers or existing East Whiteland wastewater customers. R.D. at 59.

Aqua also argues that the ALJ failed to properly apply the *Popowsky* standard and instead “demands a quantification of benefits.” Aqua Exc. at 3. The *Popowsky* Court stated as follows:

In summary, as indicated in *City of York*, the appropriate legal framework requires a reviewing court to determine whether substantial evidence supports the Commission’s finding that a merger will affirmatively promote the service, accommodation, convenience, or safety of the public in some substantial way. In 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, 937 A.2d 1040, 1057 (Pa. 2007) (*Popowsky*) (emphasis added). The *Popowsky* Court further noted that “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.” *Popowsky* at 1061, n.21. The Recommended Decision discusses *Popowsky* throughout the decision and in no way demands or implicitly requires a quantification of benefits where it is impractical, burdensome, or impossible. See R.D. at 22, 48-49. Rather, consistent with *Popowsky*, the ALJ considered and reached a determination based on the record evidence about the benefits claimed by Aqua in the short and long term. R.D. at 52-59. As discussed *infra* in the OCA’s Reply to Aqua Exception 2, there is substantial evidence countering Aqua’s claims for short- and long-term benefits. In contrast, the projected annual revenue deficiency that would be generated by the acquisition and the resulting rate increase for East Whiteland and/or existing Aqua customers, in the next rate case when the East Whiteland system is included in Aqua’s rate base, is not disputed. If the East Whiteland revenue requirement is born by East Whiteland customers, their rates would increase 133% because of Aqua ownership. OCA St. 2SR at 4.

Aqua also criticizes the ALJ for characterizing the potential rate increases to Aqua’s existing customers as a “risk” rather than a “benefit.” Aqua Exc. at 14-15 (citing *Pittsburgh v. Pa*

PUC, 560 A.2d 889, 893 (Pa. Cmwlth. Ct. 1989)). There is no question that the short-term rate impacts are accurately considered a “risk.” Aqua focuses on the “long-term” when, it claims, the East Whiteland customers will contribute to the revenue requirement of Aqua’s larger customer base. As discussed below, East Whiteland customers will not cover the revenue requirement for their own system until their rates have increased 133%.¹ The ALJ properly characterized and weighed the evidence regarding the distant and theoretic benefits of cost sharing against the certain rate increases to customers if the East Whiteland acquisition were approved.

For Aqua water customers, Aqua also argues that if any subsidy is permitted it must necessarily be a “benefit” rather than a “risk” to those customers because Section 1311(c) of the Public Utility Code requires a showing that the subsidy is “in the public interest.” Aqua Exc. at 14-15; 66 Pa. C.S. § 1311(c). While it may be established, in the context of Aqua’s base rate proceeding, that some level of subsidy of wastewater revenue requirement by Aqua’s water operations is in the public interest, a different section of the statute is at issue here. The review of Aqua’s proposed transaction under Sections 1102 and 1103 requires a showing that the benefits substantially and affirmatively outweigh the harms. Here, the ALJ properly recognized that subsidizing the East Whiteland revenue deficiency is a risk rather than a benefit. R.D. at 53-54 (finding that all Aqua water customers “already must pay for wastewater disposal either to another provider, to Aqua, or with their individual wastewater system”).

In its Exceptions, Aqua also suggests that the ALJ erred in finding the short term rate impact to be a harm because Aqua is not proposing to increase the rates of its existing wastewater

¹ Aqua’s claim that rate impacts are “hypothetical” was disproven by its recent rate filing, which resulted in average rate increases of 57 to 107% for customers in systems acquired under Section 1329. *Pa. PUC v. Aqua Pennsylvania Wastewater, Inc.*, R-2021-3027385, Order at 245, 267 (May 16, 2022). Moreover, the proposed East Whiteland transaction is not occurring in a vacuum. Aqua has other Section 1329 acquisitions pending or approved since its last base rate case, such as Willistown, Lower Makefield 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 benefits from cost sharing further into the future. *See* R.D. at 37.

or water customers in this proceeding. Aqua Exc. at 22. The Commonwealth Court held in *New Garden*, the Commission is required to decide in the Application proceeding whether the impact on rates – that will not occur until the next base rate case – is outweighed by other positive factors. *New Garden* at 1067. Aqua’s argument is misleading and contrary to controlling precedent.

Aqua’s position that every Aqua Section 1329 Application produces affirmative public benefits merely due to Aqua being Aqua and the Commission’s promotion of regionalization/consolidation circumvents the Commission’s review and is contrary to ratemaking principles and controlling precedent. As discussed above and in response to Aqua’s second Exception, ALJ Guhl conducted a fact-based weighing of the evidence regarding the harms and benefits specific to the East Whiteland acquisition, consistent with *City of York* and *New Garden* and correctly concluded that the proposed transaction would not serve the public interest.

Reply to Aqua Exception 2 and East Whiteland Exception 1: The ALJ Properly Weighed All Factors, Including the Impact on Rates, In Concluding that the Transaction Fails to Meet the Statutory Standard. R.D. at 27-59; OCA M.B. at 10-21; OCA R.B. at 6-16.

Aqua argues that the Recommended Decision departs from *Cheltenham* and that instead of weighing all factors for and against the transaction, the Recommended Decision “gives dispositive effect to potential *short-term* rate impact.” Aqua Exc. at 3 (emphasis in original) (citing *Application of Aqua Pennsylvania Wastewater, Inc.*, A-2019-3008491 (Oct. 24, 2019) (*Cheltenham*)). The Recommended Decision, however, contains an extensive discussion of public benefits and in no way gives “dispositive effect” to potential short term rate impact. *See* R.D. at 47-59. The ALJ considered rate impact – as required by the appellate decision in *New Garden* – along with all of the record evidence provided by Aqua regarding claimed benefits of the transaction, including economies of scale, volume discounts, quality of service, billing and payment options and East Whiteland’s interest in selling its system for \$54.93 million. R.D. at 50-

59; see *New Garden* at 1066-67 (the Commission is required to consider the impact on rates as part of its balancing test under Section 1102). In each case, the OCA and customer participants provided credible and persuasive evidence countering Aqua's claims. *Id.*; OCA St. 2 at 2-16; OCA St. 2SR at 2-10, Tr. 45-78. This counter-evidence is discussed at length in the R.D. and the OCA's briefs. R.D. at 27-59; OCA M.B. at 10-20; OCA R.B. at 6-16.

Further, the OCA notes that in *Cheltenham*, the Commission considered short term rate impact and found it necessary to adjust Aqua's proposed ratemaking rate base and impose conditions in order for that transaction to satisfy the affirmative benefits standard. *Cheltenham* at 84-87. *Cheltenham* is also instructive because the Commission recognized that the standard for approval requires more than a showing that Aqua is fit to acquire another system and that the Commission has a policy of encouraging regionalization/consolidation. *Id.* at 86-87. Additionally, in *Cheltenham*, there was no record evidence countering the transaction's other claimed public benefits. *Id.* at 81. As discussed in the Recommended Decision and below, here, the benefits are disputed and there is evidence that existing service quality would decline in specific ways under Aqua ownership.

1. Economies of Scale

Aqua excepts to the ALJ's conclusion that individualized analysis of each system that Aqua seeks to acquire is in the public interest and required by Section 1102. Aqua Exc. at 18. Aqua claims that simply by increasing its customer base, Aqua provides more service to more customers for less overall incremental cost, which shows a public benefit. *Id.* The ALJ considered and properly rejected Aqua's position. R.D. at 55-56. Mr. Eastman explained that 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* (not incremental) costs for providing service. OCA St. 2 at

7-9; OCA St. 2SR at 3-5. As discussed further below, despite its repeated references to “economies of scale,” Aqua has not shown that acquisition of the East Whiteland customers will produce net cost reductions or efficiencies. R.D. at 55-56.

Further, individualized analysis of every system proposed to be acquired is not only in the public interest, but also necessary to ensure that each acquisition complies with the Public Utility Code, particularly Section 1102. R.D. at 57-58; OCA M.B. at 10 (citing *New Garden*). Just because Aqua can acquire systems does not mean that every acquisition will further the public interest. *Id.* For each transaction, Aqua must show that benefits will substantially outweigh the harms. *City of York*; 66 Pa. C.S. § 1102. 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. As in *Application of CMV Sewage Co., Inc.*, 2008 Pa. PUC LEXIS 950 (Dec. 23, 2008), the alleged benefits of acquiring the East Whiteland system are disputed and the adverse impacts of the proposed acquisition outweigh any claimed benefits.²

2. Volume Discounts and Sharing Costs

Aqua excepts to the ALJ’s conclusion that Aqua failed to establish that Aqua’s higher cost of capital would not offset any potential savings from volume discounts and cost sharing. Aqua Exc. at 19; R.D. at 58-59. Because investor-owned utilities are likely to have higher cost of capital and income taxes compared to a municipally-owned system, the specific transaction must provide benefits that outweigh those additional costs. The ALJ found that Aqua did not provide any

² In *CMV*, the Commission was not persuaded that potential economies of scale provided a benefit that outweighed the known adverse impacts of the transaction. As the OCA pointed out in *CMV*, there is no guarantee that savings resulting from any economies of scale will be reflected in the rates charged to customers. *Id.* at *15-16. In this case, the operation and maintenance expense savings of \$800,000 calculated by Aqua is dwarfed by the annual revenue requirement shortfall of \$5,011,000. R.D. at 58.

specific evidence to support a fact-based determination that the East Whiteland transaction would provide the general benefits that Aqua claimed. R.D. at 58-59; *Popowsky* at 1057.

Aqua claims that consolidation in and of itself is a benefit but says that it cannot presently quantify how this acquisition will be a benefit in the long-term. Aqua Exc. at 9. As discussed in the prior Reply Exception, however, because East Whiteland customers will not even be covering their full cost of ownership at the proposed \$54.93 million rate base, they will not share the costs of infrastructure improvements for other parts of Aqua's service territory until their rates increase by 132.93%. Aqua St. 1, App. A. Other pending acquisitions with projected revenue requirement deficiencies will push the timing for customers to realize benefits from cost sharing further into the future. R.D. at 54.

In the short term, Aqua argues that there is a benefit in acquiring East Whiteland because its expense projections for Aqua to operate the system are less than the Township's operating expenses were in 2020. Aqua Exc. at 19. Mr. Packer estimated that operating expenses for the System might be \$800,000 (29%) per year lower for Aqua than for the Township. R.D. at 119; Aqua Exc. at 19. Again, even if there is an \$800,000 savings in operating expenses, that savings is eliminated by the \$5.011 million revenue deficiency produced by the change to Aqua ownership. R.D. at 58. 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 a substantial affirmative public benefit.

3. Weighing of All Factors, Including the Impact on Rates

Aqua argues that the Recommended Decision, by focusing on rate impact, fails to account for the aspirational and "other public benefits" such as the policy objective of regionalization and consolidation. Aqua Exc. at 19-22. The OCA has already addressed economies of scale and

regionalization/consolidation and the countering evidence supporting the ALJ's conclusions and will not repeat that discussion here. The additional failing in Aqua's and East Whiteland's arguments about weighing all factors is that they ignore the ALJ's thorough discussion of the record evidence regarding Aqua's "other" claimed benefits and additional harms unrelated to rate impact. R.D. at 52-59. That evidence shows that East Whiteland customers would receive no detectable improvement in their service and, in many cases, lose existing benefits if Aqua took ownership. ALJ Guhl stated:

Aqua has not established that it can improve on the Township's quality of service, operations, convenience or safety. Aqua can also terminate water service for customers that are not able to stay current with wastewater service payment terms, subject to Commission regulations and protections, a result that cannot occur under Township ownership of the wastewater system. The evidence also failed to establish that Aqua's operation of the sewer system will be safer than the Township's operations as no real difference was demonstrated regarding Aqua or the Township's ability to bring skilled experienced resources to the operation of the Township's sewer system.

R.D. at 59; *see also* R.D. at 13, 56-57 (current service is safe and reliable and the Township's system has the capacity to meet the demands of current and future customers). The ALJ also addressed Aqua and East Whiteland's claims about bill payment options (Aqua Exc. at 7) and Chapter 14 protections (Aqua Exc. at 12). ALJ Guhl summarized the evidence as follows:

In addition, although Aqua's provides 24/7/365 customer service, emergency contact number, and bill payment options, the Township already has the ability to address emergencies. In addition, no evidence was presented to establish that Township customers have any issues with their current billing and payments to the Township. Here, any advantages realized by Aqua's billing system and Chapter 14 services and protections are outweighed by the costs that ratepayers will bear based on the proposed ratemaking rate base.

R.D. at 56. Further, the ALJ also considered Aqua's claim that its future plans to make capital improvements in the East Whiteland system are an affirmative benefit (Aqua Exc. at 10-11). ALJ Guhl found it was not, stating:

The evidence establishes that the Township is financially fit to complete any necessary improvements and upgrades given that it has cash and cash equivalents exceeding \$29 million. In the year 2020 alone, the Sewer Fund had an increase to cash and cash equivalents of more than \$500,000. While Aqua currently estimates that it will invest approximately \$16.92 million in capital improvements over the next 10 years, the evidence regarding East Whitefield's financial position indicates the Township could make necessary improvements and upgrades to the system, equal to what Aqua has proposed, and it would not present an unreasonable financial burden for the Township.

R.D. at 57; OCA St. 2 at 6. The record evidence does not establish 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 Township ownership. R.D. at 54-59. East Whiteland is providing safe and reliable service (both from the perspective of DEP and its customers), and is financially sound. OCA St. 2 at 6; OCA St. 2SR at 9-10; Tr. 55, 60-61, 65. 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. Again, any benefit gained from regionalization and consolidation in regard to this specific transaction is diminished.

4. Benefits to the Township

East Whiteland argues that the Township exiting the sewer business and receiving \$54.93 million in proceeds from the transaction constitute affirmative benefits. East Whiteland Exc. at 3-5. The OCA has not disputed that the Township itself would receive some benefit from the proposed transaction. It would receive \$54.93 million or 64% more than the net book value of the system.³ The benefits that Aqua and the Township ascribe to the proposed transaction, however, do not outweigh the harms to Aqua's existing customers and the East Whiteland customers. As discussed in the Recommended Decision and above, the proposed ratemaking rate base and

³ The original cost of the assets, as determined by the engineer's report, is \$44,447,309, and the original cost less depreciation is \$33,955,596. Application at ¶ 19. That does not reflect any reduction for contributions or grants. 66 Pa. C.S. § 1329(d)(5).

planned system investment in conjunction with the level of East Whiteland rates will generate an annual revenue deficiency of \$5.011 million. R.D. at 57. As a result, the East Whiteland customers may see large rate increases after future Aqua base rate cases. *Id.* at 57-59. To the extent that East Whiteland rates are not increased to recover the system's cost of service, Aqua's existing wastewater and water customers will bear the difference. *Id.* Also, the service received by East Whiteland customers would not be enhanced if Aqua took ownership and would decline in some respects. *Id.* at 59.

Reply to East Whiteland Exception 2: The Recommended Decision Does Not Create a Precedent that Municipalities Cannot Sell Assets Under the Public Utility Code Unless or Until Dire Circumstances Warrant the Sale.

East Whiteland claims that the Recommended Decision creates a precedent that municipalities cannot sell assets under the Public Utility Code unless or until dire circumstances warrant the sale. East Whiteland Exc. at 6-8. The Township further argues that the Recommended Decision "seemingly requires" Aqua to satisfy a higher burden of proof under Section 1103 of the Public Utility Code due to East Whiteland's "admitted healthy financial position and reliable customer service." East Whiteland Exc. at 6. Aqua makes a similar argument that the ALJ recommended denying the acquisition because East Whiteland is a viable system. Aqua Exc. at 22. This is a strawman argument. At no point does the Recommended Decision mention "dire circumstances" or come close to establishing a precedent that only acquisitions of troubled municipal systems will meet the substantial affirmative benefits test. East Whiteland's exception unreasonably misinterprets both the Recommended Decision and the OCA's arguments. This alleged standard was not applied by the ALJ, argued or implied by the OCA, nor is it contained in

Sections 1102 and 1329.⁴ 66 Pa. C.S. §§ 1102, 1329. Instead, ALJ Guhl notes that East Whiteland is not a troubled system and that the current service by the Township is safe and reliable, in the context of the ALJ considering the evidence regarding the impact of Aqua ownership on quality of service. R.D. at 56-57; *see, e.g.*, Aqua M.B. at 19 (claiming that its in-house operators, engineers and laboratory are “further benefits” of the transaction).

Where, as here, the acquiring utility makes claims that it will improve on the service received by the seller’s customers, the condition of the acquired system should be considered when determining whether substantive affirmative benefits are produced as a result of the transaction. Based on the evidence presented by Aqua, the Township, the OCA and the customers, the ALJ properly determined that East Whiteland is technically, managerially and financially fit and there would be no change or a reduction in the quality and convenience of the service provided. R.D. at 54-59; *see* discussion *supra* at Reply to Aqua Exception 2. As such, to meet the *City of York* standard, Aqua needed to establish that other types of benefits would result from the transaction and that those benefits are substantial enough to outweigh the harms. The ALJ properly determined that Aqua did not do so here. R.D. at 47-59.

The Recommended Decision and the OCA do not discourage elected officials from selling their municipality’s sewer assets and do not require imminent financial distress or a failure to adequately serve customers, as claimed by East Whiteland Township and Aqua. East Whiteland Exc. at 7-8; Aqua Exc. at 24. A selling municipality can sell its sewer system to whatever entity it chooses subject to the applicable legal requirements. When the buyer will be regulated by the Public Utility Commission, however, the buyer must meet the Commission’s requirements, and

⁴ Contrast the language of Sections 1102 and 1329 with Section 1327 which specifically requires the acquiring utility to provide evidence to meet the statutory criteria to show that the acquired system is non-viable before an acquisition premium can be approved. *See* 66 Pa. C.S. § 1327.

the statutory requirement, including Section 1102 of the Public Utility Code. 66 Pa. C.S. §§ 1102, 1103. As discussed above, that is not a “no harm” standard. Where, as here, the seller’s system is not troubled, the buyer will need to establish other benefits that are substantial and affirmative. *City of York* at 828.

Moreover, to meet that threshold in cases where the evidence shows that the proposed ratemaking rate base would increase rates for acquired or existing customers, it may be necessary to reduce the ratemaking rate base to mitigate the harm caused by that rate impact. In prior Section 1329 proceedings, this has been accomplished where adjustments to the UVE appraisals were required by the Commission (*see, e.g., Cheltenham; Application of Aqua Pennsylvania Wastewater, Inc., A-2017-2605434* (Nov. 19, 2017)) (*Limerick*) or agreed to by the parties (*see, e.g., Application of Pennsylvania American Water Co., A-2019-3006880, Settlement at 4-5* (July 2, 2019) (*Steelton*); *Application of Pennsylvania American Water Co., A-2018-3004933, Settlement at 6-7* (June 11, 2019) (*Exeter*); *Application of Aqua Pennsylvania Wastewater, Inc., A-2018-3002437, Settlement at 4-5* (Sept. 18, 2018) (*Sadsbury*); *Application of Pennsylvania American Water Co., A-2017-2606103, Settlement at 5-6* (Sept. 20, 2017) (*McKeesport*)).

As discussed above, Aqua’s proposal to acquire East Whiteland’s system should not be approved under Section 1102 because Aqua has not established that there are affirmative public benefits for this particular transaction. The OCA and customers presented credible and persuasive testimony that details why the harms that would result from the transaction outweigh the claims regarding long-term benefits. The Recommended Decision properly evaluated the record evidence in this proceeding, which showed that any purported benefits of the acquisition were outweighed by the harm to East Whiteland or existing Aqua customers. No new standard requiring a showing

of dire circumstances to satisfy Section 1102 will be established by rejecting the Application, as recommended by the ALJ.

B. Ratemaking Rate Base

Reply to Aqua Exception 3: Aqua's Proposed Rate Base Is Overstated Due to Errors, Flaws, and Unreasonable Subjectivity; the Correct Ratemaking Rate Base Is \$54.93 million. Aqua Exc. 23-35; Aqua M.B. at 8-13; OCA M.B. at 23-24; OCA R.B. at 17-29; OCA St. 1 at 6; OCA Exh. DJG-2.

Aqua excepts that the ALJ erred in failing to address the fair market value of the wastewater system in the Recommended Decision and that the Commission should approve the acquisition and adopt a fair market value ratemaking rate base amount of \$54.93 million. Aqua Exc. at 23-35. As discussed above and in the OCA's briefs, the ALJ properly determined that the proposed transaction would not provide affirmative public benefits. Further, 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 and resulting ratemaking rate base is \$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 argues in Exceptions that OCA witness Garrett's recommended ratemaking rate base of \$46.5 million should be denied. Aqua Exc. at 25. As discussed in the OCA's briefs 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 R.B. at 17; OCA St. 1 at 6; OCA Exh. DJG-2.

1. Cost Approach

a. Gannett Cost Approach

Specifically, Aqua argues that OCA witness 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 Exc. at 25-27. 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 26-27. 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.*

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. 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 Exc. at 26-27. 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. 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. 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 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. *Id.* 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, 22; OCA M.B. at 28-30. Thus, if the acquisition were to be approved by the Commission, 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.

b. 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 Exc. at 27-28. Both Mr. Garrett and Mr. Weinert from AUS Consultants selected their service lives based on data from other cases. 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. *Id.* Without more information, Mr. Garrett's proposed shorter service lives are most reasonable and result in a Renewed Cost New Less Depreciation (RCNLD) came to 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.

2. Market Approach

a. Gannett Market Approach

i. 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 Exc. at 29-32. 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.

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.*

ii. Selected Transactions

Aqua also excepts 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 Exc. at 30. 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 9-10. It is not reasonable to include integrated systems in the market approach analysis, as Mr. Walker does, when those systems are incomparable. *Id.*

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.*

b. AUS Market Approach

i. 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 Exc. at 31-32. Aqua argues that the use of Commission determined rate base, as opposed to the agreed upon purchase price, is not an appraisal market comparable approach as it does not represent a market transaction.

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, 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. He stated:

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.

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 Exc. at 31. However, most frequently both buyer and seller do agree to move forward with the PUC-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.

ii. Selected Transactions

For the same reasons provided above in Section B.2.a.ii of the OCA’s Reply to Aqua Exception 3, Mr. Garrett’s exclusion of integrated systems produces a far more reasonable result under the market approach as well.

iii. 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 Exc. at 32. However, 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 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.

3. Income Approach

As discussed above, the ALJ did not make a determination regarding the Income Approach. Nevertheless, Aqua restates the arguments made in its briefs. Aqua Exc. at 32-35. Aqua excepts 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 Exc. at 32-33. 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 R.B. at 24-25; OCA M.B. at 40-44; OCA St. 1 at 25-29. Specifically, and as discussed further below, Mr. Garrett recommends using more reasonable estimates for a growth rate and discount rate (cost of capital). *Id.*

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 Exc. at 33. 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. Further, Mr. Garrett's adjustment 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 Exc. at 34. 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 R.B. at 25-26; 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. 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.* 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 Exc. at 33-34. 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. 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. Mr. 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 Exc. at 33-34. 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., A-2021-3024267, Order at 69 (Jan. 13, 2022) (Lower Makefield Township) (emphasis added).

In relation to Mr. Weinert's appraisal, Aqua further excepts 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 Exc. at 35. An increase to the cost of equity, however, results in a decrease in valuation under both Mr. Garrett's model and the UVEs' models (as they are the same formulas with different inputs). OCA 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.

4. Conclusion

Aqua's criticisms of Mr. Garrett are without merit. OCA witness Garrett corrected errors and removed unsupported adjustments in the UVE appraisals. If the transaction is approved, the Commission should establish a ratemaking rate base of \$46.5 million for the system.

III. CONCLUSION WITH REQUESTED RELIEF

For the reasons set forth above and in the OCA's Briefs, the Office of Consumer Advocate submits that the proposed transaction should not be approved and the Exceptions to that recommendation by ALJ Guhl should be denied. If the Commission determines to approve the Application, however, the Commission should adopt the OCA's proposed adjustments to the appraisals and approve the Stipulation filed April 14, 2022 addressing conditions that need to be imposed on the transaction.

Respectfully Submitted,

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