

AQUA PENNSYLVANIA WASTEWATER, INC.
BRYN MAWR, PENNSYLVANIA

REBUTTAL TESTIMONY
OF
HAROLD WALKER, III

FAIR MARKET VALUE APPRAISAL

EAST WHITELAND TOWNSHIP
WASTEWATER SYSTEM ASSETS

March 18, 2022

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Valley Forge, Pennsylvania

TABLE OF CONTENTS

I.	INTRODUCTION	1
II.	SCOPE OF TESTIMONY	1
III.	RESPONSE TO OCA WITNESS GARRETT	1
IV.	COST APPROACH	3
V.	INCOME APPROACH	10
VI.	SELECTED TRANSACTION METHOD	17
VII.	RECOMMENDED WEIGHTING	24
VIII.	CONCLUSION.....	24

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

I. INTRODUCTION

1
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3
4
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Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Harold Walker, III my business address is 1010 Adams Avenue, Audubon, Pennsylvania.

Q. ARE YOU THE SAME HAROLD WALKER WHO PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?

A. Yes.

II. SCOPE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. Gannett Fleming Valuation and Rate Consultants, LLC (“Gannett Fleming”) was engaged by Aqua Pennsylvania Wastewater, Inc. (“Aqua”) to perform a fair market value appraisal of the East Whiteland Township (“Township”) wastewater system assets (“Wastewater System”). The purpose of my rebuttal testimony is to respond to and comment on the direct testimony submitted by the Office of Consumer Advocate’s (“OCA”) witness David J. Garrett.

III. RESPONSE TO OCA WITNESS GARRETT

Q. DID MR. GARRETT PERFORM AN APPRAISAL OF THE TOWNSHIP WASTEWATER SYSTEM ASSETS?

A. No.

Q. WOULD YOU PLEASE SUMMARIZE MR. GARRETT’S ADJUSTMENTS OF THE GANNETT FLEMING FAIR MARKET VALUE APPRAISAL AND IDENTIFY THE TOPICS THAT YOU WILL ADDRESS IN YOUR REBUTTAL TESTIMONY?

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 A. Yes. In his direct testimony, Mr. Garrett proposed adjustments to the Gannett Fleming
2 service lives used in the Cost Approach to valuation. Mr. Garrett also proposed a new
3 Income Approach to valuation. Mr. Garrett proposed adjustments to the Gannett Fleming
4 Selected Transaction Method, which is included in the Market Approach to valuation. All
5 of Mr. Garrett's proposed adjustments/changes are downward, or negative, adjustments to
6 Gannett Fleming's appraisal report. My rebuttal testimony addresses Mr. Garrett's
7 changes and recommended adjustments to Gannett Fleming's appraisal report.

8 **Q. DO MR. GARRETT'S RECOMMENDATIONS MEET A STANDARD OF VALUE**
9 **OF FAIR MARKET VALUE?**

10 A. No. Mr. Garrett's recommendations do not meet a standard of value of fair market value
11 and are in direct violation of Section 1329 of the Public Utility Code.

12 **Q. DID MR. GARRETT PERFORM AN APPRAISAL OF EAST WHITELAND**
13 **TOWNSHIP'S WASTEWATER SYSTEM ASSETS?**

14 A. No, for the reasons discussed in detail later in my testimony.

15 **Q. HAS MR. GARRETT EVER PERFORMED A FAIR MARKET VALUE**
16 **APPRAISAL OF OTHER WASTEWATER SYSTEM ASSETS?**

17 A. No. (See Exhibit HW-1, page 1 for Mr. Garrett's response to Aqua's Interrogatories, Set I,
18 question 3d.)

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 **Q. HAS MR. GARRETT EVER VALUED UTILITY PROPERTY?**

2 A. No. (See Exhibit HW-1, page 1 for Mr. Garrett’s response to Aqua’s Interrogatories, Set I,
3 question 3c.)

4 **Q. DID MR. GARRETT INSPECT OR REVIEW THE WASTEWATER SYSTEM?**

5 A. No. (See Exhibit HW-1, page 2 for Mr. Garrett’s response to Aqua’s Interrogatories, Set I,
6 question 1.)

7 **Q. DID YOU INSPECT OR REVIEW EAST WHITELAND TOWNSHIP’S**
8 **WASTEWATER SYSTEM?**

9 A. Yes, I viewed or observed the Wastewater System’s facilities on June 15, 2021. We also
10 relied on the engineering assessment of the Wastewater System’s facilities report, “East
11 Whiteland Township Sewerage Facilities Engineering Assessment and Original Cost”
12 prepared by Pennoni Associates Inc., the Wastewater System’s Chapter 94 Reports, the
13 Wastewater System’s 537 Plan, the Wastewater System’s Municipal Wasteload
14 Management Program Reduction Plan, and the Asset Purchase Agreement, to confirm the
15 condition of the Wastewater System’s property and equipment.

16 **IV. COST APPROACH**

17 **Q. ON PAGES 19 TO 22 OF MR. GARRETT’S DIRECT TESTIMONY, HE**
18 **EXPLAINS HIS ADJUSTMENTS TO THE COST APPROACH. PLEASE**
19 **SUMMARIZE MR. GARRETT’S ADJUSTMENTS TO THE GANNETT**
20 **FLEMING COST APPROACH.**

21 A. Mr. Garrett proposed the use of shorter service lives for five separate plant accounts.

22 **Q. HOW ARE ASSET SERVICE LIVES RELEVANT TO THE COST APPROACH?**

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 A. The estimation of the service lives of the Wastewater System’s assets are part of the
2 valuation of depreciable plant assets under the Cost Approach. Shorter service lives result
3 in lower values under the Cost Approach.

4 **Q. DID MR. GARRETT CONDUCT A STATISTICAL ANALYSIS TO SUPPORT HIS**
5 **RECOMMENDATION TO SHORTEN THE SERVICE LIVES FOR THE FIVE**
6 **PLANT ACCOUNTS?**

7 A. No. On page 20 of his direct testimony, Mr. Garrett explains that two of his five
8 recommended changes, those for the Structures and Improvements - Pumping (account
9 354.30), and Structures and Improvements - Treatment (account 354.40), are based on the
10 AUS Consultant’s appraisal for those two accounts and are consistent with his “proposed
11 Iowa curves for these accounts in prior Section 1329 proceedings.”¹

12 His recommended changes for two other accounts, Force Mains (account 360.10)
13 and Gravity Mains (account 361.10), are based on a 2016 depreciation study in the State
14 of Indiana (“Indiana Study”). Lastly, according to Mr. Garrett, his recommended change
15 for Services (account 363.20) is consistent with his proposal for this account in prior
16 Section 1329 proceedings.

17 Although I was not involved in the Indiana Study, my research indicates that the
18 Indiana Study included information for Citizens Energy Group – Citizens Wastewater
19 (“CWW”), Citizens Energy Group – Westfield Wastewater (“WWW”) and numerous other
20 larger Citizens Energy Group entities.² The data for CWW’s Force Mains account
21 included only seven years of accounting data, with no retirements, and the data for WWW’s

1 OCA Statement 1 at 20.

2 Cause No. 45039 before the Indiana Utility Regulation Commission.

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 Force Mains account included only three years of accounting data, with a total of \$15,000
2 of retirements. Similarly, the data for CWW's Gravity Mains account included only seven
3 years of accounting data, with a total of \$30,000 of retirements, and the data for WWW's
4 Gravity Mains account included only four years of accounting data, with no retirements.
5 Therefore, Mr. Garrett's recommendation for these accounts is based solely on minute
6 statistical samples from a foreign jurisdiction.³ Further, Mr. Garrett provides no evidence
7 to support his conclusion that the CWW and WWW assets are comparable to the
8 Township's. Instead, there are reasons to doubt that they are comparable. For example,
9 CWW's system is a combined sewer system, whereas the Township's is not.

10 **Q. HAS THE COMMISSION ACCEPTED MR. GARRETT'S PROPOSED SERVICE**
11 **LIVES IN PRIOR SECTION 1329 PROCEEDINGS?**

12 A. No.

13 **Q. ON PAGE 15 OF HIS DIRECT TESTIMONY, MR. GARRETT STATES THE**
14 **TOWNSHIP DOES NOT MAINTAIN RETIREMENT DATA. IS THIS UNIQUE**
15 **TO THE TOWNSHIP?**

16 A. No. Most, if not all, Pennsylvania municipal utilities which are not regulated by the
17 Commission do not maintain retirement data. As Mr. Garrett testified on pages 15 and 16
18 of his direct testimony, Gannett Fleming relied on our professional judgment to determine
19 the depreciation parameters of survival/retirement characteristics and service lives for the

³ "Many utilities keep **historical records of asset placements and retirements by vintage year**. When such data is available, depreciation experts can use **actuarial techniques to analyze the historical retirement patterns** in each account. The most common of these techniques is called the retirement rate method. Under this method, **historical retirement patterns can be displayed graphically** in the form of original survivor curves. Depreciation experts then **use visual and mathematical curve fitting techniques**, along with professional judgement, **to select empirically derived Iowa curves that best fit** the original survivor curve. The Iowa curve is ultimately used to calculate the average remaining life and depreciation rate for each account." (Emphasis added, OCA Statement 1, pages 14 and 15.)

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 utility property under the Cost Approach based on the materials used for construction and
2 how long the depreciable assets are likely to meet service demands. We believe our
3 determined average service lives of depreciable assets are appropriate based on our
4 experience of having determined average service lives for numerous other Commission-
5 regulated Pennsylvania wastewater utilities and given the fact these assets resemble those
6 used by other Commission-regulated Pennsylvania wastewater companies. Therefore,
7 the service lives of the Township's depreciable assets encompass statistical data related to
8 Commission-regulated Pennsylvania wastewater assets.

9 **Q. HAS THE COMMISSION ADJUSTED GANNETT FLEMING'S**
10 **RECOMMENDED SERVICE LIVES IN PRIOR 1329 PROCEEDINGS?**

11 A. No. Further, the service lives used by Gannett Fleming for the Township's assets are
12 similar to the service lives approved by the Commission in prior fully litigated 1329
13 proceedings. Table 1 shows a comparison between the survivor curve estimates
14 recommended by Gannett Fleming's appraisal (Aqua Exhibit Q) and Mr. Garrett for the
15 Township's assets, and the approved recommendations from other Gannett Fleming
16 appraisals in fully litigated section 1329 proceedings. The comparison shown in Table 1

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 below demonstrates Mr. Garrett’s recommended average service lives are not reasonable
2 and are not suitable for the Wastewater System’s assets.

<u>Accounts</u>	<u>East Whiteland Township</u>		<u>Other 1329 Proceedings</u>		
	<u>Gannett Fleming Appraisal</u>	<u>Mr. Garrett (OCA)</u>	<u>Limerick</u>	<u>Cheltenham</u>	<u>Lower Makefield</u>
354.30 Structures and Improvements - Pumping	60-R3	45-R3	60-R3	NA	65-R3
354.40 Structures and Improvements - Treatment	65-R2.5	55-R2.5	75-R3	NA	70-R2.5
360.10 Force Mains	70-R2.5	60-R2.5	70-R2.5	NA	70-R2.5
361.10 Gravity Mains	65-R2.5	60-R2.5	65-R2.5	75-R2.5	65-R2.5
363.20 Services To Customers	55-R2.5	45-R2.5	NA	60-R2.5	55-R2.5

Table 1

3 **Q. IS THERE ADDITIONAL INFORMATION WHICH INDICATES MR.**
4 **GARRETT’S RECOMMENDED AVERAGE SERVICE LIVES ARE NOT**
5 **SUITABLE FOR THE WASTEWATER SYSTEM’S MAINS AND SERVICES?**

6 A. Yes. In his most recent depreciation testimony concerning wastewater assets in the Blue
7 Granite Water Company rate case before the South Carolina Public Service Commission
8 in docket no. 2019-290-WS (“Blue Granite”), Mr. Garrett determined and recommended
9 average service lives of 65 years for force mains, 95 years for gravity mains, and 53 years
10 for customer services for wastewater assets. Although I was not involved in Blue Granite,
11 my research indicates Mr. Garrett’s recommended services lives for force mains, gravity
12 mains, and customer services in Blue Granite are between 8% to 58% longer than what he
13 recommends for the Wastewater System for the same accounts.

14 **Q. DID I&E PROPOSE ANY CHANGES TO THE SERVICE LIVES IN GANNETT**
15 **FLEMING’S APPRAISAL?**

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 A. No. I&E does not recommend any changes to the service lives used in Gannett Fleming's
2 appraisal.

3 **Q. ON PAGE 20 OF HIS DIRECT TESTIMONY, MR. GARRETT EXPLAINS THAT**
4 **TWO OF HIS FIVE RECOMMENDED CHANGES TO SERVICE LIVES ARE**
5 **BASED ON THE AUS CONSULTANTS' APPRAISAL FOR THOSE TWO**
6 **ACCOUNTS. WERE THOSE TWO ACCOUNTS ALSO INCLUDED IN THE**
7 **INDIANA STUDY DISCUSSED PREVIOUSLY?**

8 A. Yes. In the Indiana Study, Mr. Garrett recommended using longer service lives for each
9 of the two accounts where he is currently recommending use of the AUS Consultants'
10 appraisal's service lives. For example, Mr. Garrett recommends an average service life of
11 45 years for account Structures and Improvements – Pumping (account 354.30) for the
12 Township's assets, but he recommended 55 years for this same account in his Indiana
13 Study. Similarly, Mr. Garrett recommends an average service life of 55 years for account
14 Structures and Improvements – Treatment (account 354.40) for the Township's assets, but
15 he recommended 65 years in his Indiana Study. Additionally, it should be noted that Mr.
16 Garrett recommends an average service life of 45 years for account Services (363.20) for
17 the Township's assets, but he recommended 55 years in his Indiana Study. Therefore,
18 without explanation or justification, Mr. Garrett is recommending services lives that are
19 between 18% to 22% shorter for these three accounts for the Township's assets than he
20 recommended for the same accounts in his Indiana Study.

21 Based upon this comparison, it is apparent that Mr. Garrett only recommends using
22 the results from the Indiana Study when those services lives are shorter than those used in
23 the AUS Consultants' Appraisal and Gannett Fleming's Appraisal. That is, for each

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 account he recommends using the shortest service lives found in the Indiana Study, the
2 AUS Consultants' appraisal or Gannett Fleming's appraisal. For example, the shortest
3 service lives for both force and gravity mains (accounts 360.10 and 361.10) are found in
4 the Indiana Study and that is his recommendation for the Township for those accounts.
5 Similarly, the shortest service lives for Structures and Improvements – Pumping (account
6 354.30), and Structures and Improvements – Treatment (account 354.40) are found in the
7 AUS Consultants' appraisal and that is his recommendation for the Township for those two
8 accounts. Likewise, Mr. Garrett's service life recommendation for Services (account
9 363.20) is shorter than AUS's recommendation and shorter than Mr. Garrett's
10 recommendation in his Indiana Study.

11 Clearly, such an approach described above is unreasonable, not appropriate and
12 does not meet a standard of value of fair market value and is in direct violation of Section
13 1329 of the Code. Furthermore, the fact that the AUS Consultants' appraisal and Gannett
14 Fleming's appraisal may use different service lives for different accounts is not surprising
15 since rarely do experts agree on every aspect of an appraisal. However, the fact that the
16 AUS Consultants' appraisal and Gannett Fleming's appraisal produced independent
17 appraised values using the Cost Approach that are within 1% of each other proves their
18 conclusions are reasonable and should not be adjusted.⁴

4 See page 3 of OCA Statement 1, AUS Consultants' appraisal Cost Approach of \$59,847,171 and Gannett Fleming's appraisal Cost Approach of \$59,118,924.

V. INCOME APPROACH

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Q. ON PAGES 24 TO 45 OF MR. GARRETT’S DIRECT TESTIMONY, HE EXPLAINS HIS INCOME APPROACH. WOULD YOU PLEASE SUMMARIZE MR. GARRETT’S ADJUSTMENTS TO THE GANNETT FLEMING INCOME APPROACH AND IDENTIFY THE TOPICS THAT YOU WILL ADDRESS IN YOUR REBUTTAL TESTIMONY?

A. Yes. Mr. Garrett’s adjustments to the Gannett Fleming Income Approach to valuation include using a different model and different cash flows to value. He also disagrees with the discount rates used in the model and presents what he believes is a more appropriate discount rate.

Q. DO MR. GARRETT’S RECOMMENDED ADJUSTMENTS TO THE INCOME APPROACH MEET A STANDARD OF VALUE OF FAIR MARKET VALUE?

A. No. For the reasons discussed later in my rebuttal testimony, Mr. Garrett’s recommendations do not meet a standard of value of fair market value and are in direct violation of Section 1329 of the Code.

Q. WHAT MODEL OR METHOD IS MR. GARRETT’S INCOME APPROACH TO VALUATION RECOMMENDATION BASED ON?

A. Mr. Garrett explained, on page 26 of his direct testimony, that he applied a capitalization of earning or cash flow method model. The capitalization of earning method converts a single base economic income number to a value by dividing it by a capitalization rate. As explained on page 27 of Gannett Fleming’s appraisal, “[t]he capitalization of earnings is best suited when the future earnings, or cash flow, can be predicted. The implicit assumption in the capitalization of earning method is that the cash flow is a perpetuity, and

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 the capitalization rate is a constant.” Mr. Garrett’s recommended model is shown on OCA
2 Exhibit DJG-14.

3 Conversely, the Income Approach to valuation used in Gannett Fleming’s appraisal
4 is based on the discounted cash flow method (“DCF method”) which values the potential
5 for profit in an investment and reflects future events. Gannett Fleming used the DCF
6 method to be consistent with the required standard of value of fair market value.⁵ Fair
7 market value is defined as “the price, expressed in terms of cash equivalents, at which
8 property would change hands between a **hypothetical** willing and able **buyer** and a
9 **hypothetical** willing and able **seller**, acting at arm’s length in an open and unrestricted
10 market, when neither is under compulsion to buy or sell and when both have reasonable
11 knowledge of the relevant facts.”⁶ The DCF method “is based on the principle of
12 anticipation – i.e., value is created by the anticipation of future benefits. DCF analysis
13 reflects investment criteria and requires the appraiser to make rational and supportable
14 assumptions.”⁷

15 The capitalization of earnings method used by Mr. Garrett uses the income or cash
16 flow producing capabilities for a **single year, reflecting current ownership and**
17 **operations**, as shown on OCA Exhibits DJG-14 and DJG-15.⁸ Although Mr. Garrett
18 states, on page 26 of his direct testimony via footnote 37, that the single cash flow that he
19 utilized is from the Gannett Fleming appraisal, he fails to disclose that the single cash flow

5 Pratt, Shannon P. “Defining Standards of Value.” *Valuation* 34, no. 2, June 1989.
<http://www.appraisers.org/docs/default-source/college-of-fellows-articles/defining-standards-of-value.pdf>.

6 Emphasis to the text has been added. The original text is from *The International Glossary of Business Valuation Standards*.

7 Appraisal Standards Board, “First Exposure Draft of proposed new Advisory Opinions and Advisory Opinion Revisions in conjunction with the 2016-17 edition of the Uniform Standards of Professional Appraisal Practice” pg. 6.

8 On OCA Exhibit DJG-15, Mr. Garrett developed his single cash flow by averaging the Township’s 2018 to 2020 results.

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 was not used in the Income Approach to valuation used in Gannett Fleming’s appraisal.
2 Specifically, the Income Approach to valuation used in Gannett Fleming’s appraisal is
3 based on **projected** cash flows beginning in 2022 and thereafter. Therefore, the Income
4 Approach to valuation used in Gannett Fleming’s appraisal did not use a single year’s cash
5 flow utilized by Mr. Garrett.

6 Pages 30 and 31 of Gannett Fleming’s appraisal states, “[a]s noted previously, the
7 Wastewater System’s financial statements and their rates did not include taxes nor a fair
8 rate of return. Accordingly, on Exhibits 13 through 16, we adjusted the Wastewater
9 System’s **post-2020** financial information for pro forma expenses and returns to be
10 reflective of a MUNI or IOU ownership.” (Emphasis added). I do not believe it is
11 appropriate, nor reasonable to use a single year cash flow as recommended by Mr. Garrett
12 in his Income Approach to valuation.

13 **Q. YOU PREVIOUSLY STATED THAT THE INCOME APPROACH TO**
14 **VALUATION USED IN THE GANNETT FLEMING APPRAISAL IS BASED ON**
15 **THE DCF METHOD. HAS THE COMMISSION EXPRESSED MISGIVINGS OR**
16 **CONCERNS REGARDING THE USEFULNESS OF APPLYING GANNETT**
17 **FLEMING’S INCOME APPROACH TO VALUATION BASED UTILIZING THE**
18 **DCF METHOD IN A 1329 PROCEEDING IN WHICH GANNETT FLEMING HAS**
19 **BEEN INVOLVED?**

20 **A.** No. Gannett Fleming has applied the DCF method as its Income Approach to valuation
21 as part of its fair market value appraisal in 14 Section 1329 fair market value proceedings
22 that have been reviewed by the Commission. In fact, the Commission has not adjusted
23 Gannett Fleming’s DCF method recommendation in any prior proceeding. Conversely,

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 the Commission has never accepted the recommended use of the capitalization of earnings
2 method recommended by Mr. Garrett in a Section 1329 fair market value proceeding.

3 **Q. ON OCA EXHIBIT DJG-15 OF MR. GARRETT'S DIRECT TESTIMONY, HE**
4 **SHOWS THE DEVELOPMENT OF HIS SINGLE YEAR'S "FREE CASH FLOW**
5 **FROM OPERATIONS" USED IN HIS RECOMMENDED CAPITALIZATION OF**
6 **EARNINGS METHOD MODEL. WHAT CONCERNS DO YOU HAVE WITH**
7 **MR. GARRETT'S DETERMINATION OF "FREE CASH FLOW FROM**
8 **OPERATIONS" FOR VALUING THE WASTEWATER SYSTEM?**

9 A. I have several concerns and my observations or concerns discussed below reference the
10 information shown on OCA Exhibit DJG-15. First, the revenues (\$4,734,652) and the
11 EBIT (\$1,116,178) amounts reflect current ownership, current rates, and current
12 operations, none of which reflect the anticipation of future benefits of a hypothetical
13 buyer's ownership. Second, the revenues and EBIT used do not include income taxes nor
14 a fair rate of return. Third, the depreciation expense (\$756,089) is based on the original
15 cost of the assets, not a current value of the assets.⁹ Fourth, the subtraction of income
16 taxes (\$322,464) is not consistent with Mr. Garrett's current ownership approach, as the
17 Township is a non-income tax paying entity (*i.e.*, municipality). Finally, the EBIT
18 (\$1,116,178) amount used by Mr. Garrett is equivalent to a before income tax overall rate
19 of return of only 1.9% to 2.0% on the value of net plant, based on Gannett Fleming's Cost
20 Approach (\$59,118,924) or Mr. Garrett's Cost Approach (\$56,338,551), and is clearly
21 below the zone of reasonable returns for public utility assets.

9 For example, Exhibit 1 from Aqua Exhibit Q, shows the net original cost of the Township's property, plant equipment was recorded as being \$34,143,673 on their financial statements for 2019 while their value is shown to be \$59,118,924 in Gannett Fleming's Cost Approach and \$56,338,551 in Mr. Garrett's Cost Approach.

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 Therefore, I believe Mr. Garrett’s “Annual Cash Flow” of \$259,361, shown on
2 OCA Exhibit DJG-14 and developed on OCA Exhibit DJG-15, is unreasonable, is not
3 appropriate to use to determine the value of the Wastewater System and should not be
4 adopted by the Commission.

5 **Q. IS MR. GARRETT’S RECOMMENDED USE OF THE ORIGINAL COST PLANT**
6 **VALUE AS THE BASIS FOR HIS INCOME APPROACH A REASONABLE**
7 **APPROACH?**

8 A. No. The circularity of this recommendation defeats or eliminates the need to appraise
9 plant assets since the indicated value of net cost of the plant assets is simply the net original
10 cost of the plant assets under Mr. Garrett’s recommendation. If this was the appropriate
11 or correct method to value assets, then an original cost less depreciation analysis would be
12 the only method needed to value assets. However, the value of the investment in plant
13 and equipment for the Township’s wastewater system assets is being determined in these
14 proceedings based upon a standard of value of fair market value, not a standard of value of
15 original cost.¹⁰

16 The Commission has previously rejected the use of original cost as the basis of fair
17 market value in prior decisions,

18 We note that the original cost study, which is reviewed to determine
19 the reasonableness of a utility’s acquisition adjustment claim in a future
20 base rate proceeding, consistent with Section 1327(a) of the Code, 66 Pa.
21 C.S. § 1327(a), and the Commission’s policy statement at 52 Pa. Code §
22 69.721, regarding acquisitions of viable water and wastewater systems, is
23 not applicable in a Section 1329 proceeding.¹¹

10 Pratt, Shannon P. “Defining Standards of Value.” Valuation 34, no. 2, June 1989.
<http://www.appraisers.org/docs/default-source/college-of-fellows-articles/defining-standards-of-value.pdf> .

11 *Application of Aqua Pennsylvania Wastewater, Inc. – Limerick Township*, Docket No. A-2017-2605434,
Opinion and Order entered November 8, 2017, p 30.

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 Historically, regulated utilities under the Commission’s
2 jurisdiction have predominantly followed a standard and practice of using
3 depreciated original cost value (with various adjustments) as the rate base
4 in which they may recover their capital investment and earn a rate of return
5 on the unrecouped asset value or rate base. However, Section 1329
6 establishes fair market value, not original cost, as the ratemaking rate base
7 for municipal transactions. Under Section 1329, it is fair value, ratemaking
8 rate base that, ultimately, will be used for ratemaking purposes, rather than
9 being constrained by depreciated original cost value. As indicated by
10 Aqua, “[t]he OCA’s proposed adjustments to the Income Approach are also
11 contrary to the language in McCloskey where the Commonwealth Court
12 clearly stated that ‘Section 1329 allows a private utility to acquire a
13 government utility’s assets at its fair market value rather than at the original
14 cost of assets minus the accumulated depreciation and then add that amount
15 to rate base.’” Aqua R.B. at 6 (citing McCloskey, 195 A.3d at 1055).¹²

16 **Q. IS MR. GARRETT’S DISCOUNT RATE SHOWN ON OCA EXHIBIT DJG-14 OF**
17 **HIS DIRECT TESTIMONY AN APPROPRIATE DISCOUNT RATE TO USE FOR**
18 **FAIR MARKET VALUATION PURPOSES?**

19 A. No. Mr. Garrett’s 4.5% discount rate (cost of capital) shown on OCA Exhibit DJG-14 and
20 developed on OCA Exhibit DJG-16 is not appropriate and is not determined in accordance
21 with accepted valuation practice for five reasons. First, Mr. Garrett developed his 4.5%
22 discount rate based on methods used by witnesses who provide testimony before the
23 Commission concerning fair rate of return on original cost rate base; whereas discount rates
24 used in the Income Approach to valuation under a standard of value of fair market value
25 are not calculated in this manner (as discussed above). Second, Mr. Garrett’s
26 capitalization of earnings method (OCA Exhibit DJG-14) incorporates actual revenues and
27 EBIT reflecting current ownership, current rates, and current operations as a municipality.
28 Accordingly, Mr. Garrett’s discount rate should similarly be based on a municipality’s

¹² *Application of Aqua Pennsylvania Wastewater, Inc. – Lower Makefield Township*, Docket No. A-2021-3024267, Opinion and Order entered January 13, 2022, p 69.

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 discount rate, not an investor-owned discount rate, so that the cash flows and discount rates
2 are coordinated. This mixing and matching by Mr. Garrett are inappropriate and
3 inconsistent.

4 Third, Mr. Garrett used book capitalization ratios (*i.e.*, 50% debt and 50% equity
5 ratios) calculated from a balance sheet. Book capitalization ratios are only used in rate
6 proceedings, whereas the use of market value capitalization ratios at the valuation date (*i.e.*,
7 May 20, 2021) are in accordance with accepted valuation practice and used for fair market
8 valuation purposes.¹³ For a municipality, the appropriate capitalization ratio is always
9 100% debt because debt is the only major source of capital available to finance an
10 acquisition. Although a municipality likely carries equity on its books (balance sheet), all
11 existing equity is already invested in other assets and therefore, cannot be used to finance
12 an acquisition.¹⁴

13 Fourth, Mr. Garrett used an embedded cost of debt of 3.9% or the historical cost of
14 all debt issuances outstanding (OCA Exhibit DJG-17) of his comparison companies. An
15 embedded cost of debt is only used in rate proceedings, whereas the use of the marginal
16 cost of debt at the valuation date (*i.e.*, May 20, 2021) is in accordance with accepted
17 valuation practice and used for fair market valuation purposes.¹⁵ For a municipality, the
18 appropriate debt cost rate is the current municipal revenue bond rate at the valuation date.

13 Both the American Society of Appraisers, ASA Business Valuation Standards, 2009, and the National Association of Certified Valuation Analysts, Professional Standards, 2007, use the same definition: “Weighted Average Cost of Capital (WACC). The cost of capital (discount rate) determined by the weighted average, at market values, of the cost of all financing sources in the business enterprise’s capital structure.”

14 For example, when a municipal or government entity, such as the Commonwealth of Pennsylvania, finances construction of a road or bridge, it only considers the marginal debt cost despite having “equity” reflected on its books (balance sheet).

¹⁵ For example, see <http://www.investinganswers.com/financial-dictionary/financial-statement-analysis/weighted-average-cost-capital-wacc-2905>. Also see <http://www.wallstreetmojo.com/weighted-average-cost-capital-wacc/>, or <http://accountingexplained.com/misc/corporate-finance/wacc>.

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 Fifth, Mr. Garrett's equity cost rate was not determined at the valuation date (*i.e.*,
2 May 20, 2021) in accordance with accepted valuation practice and used for fair market
3 valuation purposes. Rather, Mr. Garrett's equity cost rate was calculated over a period
4 from January 18, 2022, to March 1, 2022 (OCA Exhibits DJG-18 and DJG-20), which does
5 not comport with the requirements of 66 Pa. C.S. § 1329 nor comply with the Uniform
6 Standards of Professional Appraisal Practice. A fair market value appraisal is determined
7 on a stated valuation date, not for a period of time. Gannett Fleming's stated valuation
8 date was May 20, 2021.

9 Therefore, based on the aforesaid, I believe Mr. Garrett's 4.5% discount rate (cost
10 of capital) shown on OCA Exhibit DJG-14 and developed on OCA Exhibit DJG-16 is
11 unreasonable, not appropriate to use to determine the value of the Wastewater System and
12 should not be adopted by the Commission.

13
14 **VI. SELECTED TRANSACTION METHOD**

15 **Q. ON PAGES 8 TO 10 OF MR. GARRETT'S DIRECT TESTIMONY, HE EXPLAINS**
16 **HIS ADJUSTMENTS TO THE SELECTED TRANSACTION METHOD.**
17 **PLEASE SUMMARIZE MR. GARRETT'S ADJUSTMENTS TO THE GANNETT**
18 **FLEMING SELECTED TRANSACTION METHOD.**

19 **A.** Yes. Mr. Garrett's adjustments to the Gannett Fleming Selected Transaction Method to
20 valuation include using rate base value in lieu of purchase price, excluding some financial
21 statement metrics, other un-documented, or unexplained, changes to metrics and the
22 removal of selected transactions utilized by Gannett Fleming.

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 **Q. DO MR. GARRETT’S RECOMMENDED ADJUSTMENTS TO THE SELECTED**
2 **TRANSACTION METHOD MEET A STANDARD OF VALUE OF FAIR**
3 **MARKET VALUE?**

4 A. No. For the reasons discussed later in my rebuttal testimony, Mr. Garrett’s
5 recommendations are unreasonable, do not meet a standard of value of fair market value
6 and are in direct violation of Section 1329 of the Public Utility Code.

7 **Q. DID MR. GARRETT USE THE SAME DATA OR METRICS THAT WERE USED**
8 **IN THE SELECTED TRANSACTIONS METHOD UTILIZED BY GANNETT**
9 **FLEMING?**

10 A. No. The Gannett Fleming appraisal’s Selected Transaction Method uses both data from
11 financial statements, or *ex-ante* data, and Original Cost New Less Depreciation
12 (“OCNLD”) data used in the respective 1329 proceedings, or *ex-post* data. I believe *ex-*
13 *ante* data is the proper data to use but recognize limited *ex-ante* data exists.¹⁶ Accordingly,
14 the Gannett Fleming appraisal **used both** *ex-ante* and *ex-post* data.

15 The Selected Transaction Method contained in Gannett Fleming’s appraisal
16 determines a value of \$44,142,464 for the Wastewater System’s assets using both *ex-ante*
17 and *ex-post* data. If the *ex-ante* data were excluded (financial statements), the Selected
18 Transaction Method contained in Gannett Fleming’s appraisal would have produced a
19 value of \$43,350,133 for the Wastewater System, whereas using only *ex-post* data

¹⁶ See pages 40 and 41 of the Gannett Fleming appraisal, “[c]omplete information only exists for a few of the transactions, with only Customers and Population having ample data for all transactions as is evident from the information shown (Exhibit 18, page 2). Therefore, we supplemented the *ex-ante* data with *ex-post* information of GPPE and NPPE (collectivity called “Asset Items”) as shown on page 3 of Exhibit 18.” (Aqua Exhibit Q – Gannett Fleming Fair Market Value Appraisal).

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 (OCNLD), produces a difference of \$792,331, or about 2% less than Gannett Fleming's
2 appraisal determined value of \$44,142,464.

3 I should note that an identical approach of excluding *ex-ante* data (financial
4 statements) was recommended by OCA in Cheltenham¹⁷ and it was rejected by the
5 Commission. The Selected Transaction Method relies on and reflects information that
6 was known, *ex-ante*, at the time the winning purchase bid (price) was given. After all, the
7 winning purchase bid (price) could not have reflected *ex-post* information that was not
8 available when it was made. The metrics (property, plant and equipment, Customers, etc.)
9 used in the Selected Transaction Method are relative to the time period the bid (price) was
10 made. That is, the metrics are time period sensitive. For example, a 2016 bid would
11 likely reflect metrics from 2015 since the results of 2016 would not be known at the time.
12 It is unrealistic and unreasonable for Mr. Garrett to suggest, by omission, that only *ex-post*
13 data that **becomes available only after a bid is made** is more appropriate than *ex-ante*
14 financial information in the Market Approach.

15 Additionally, Mr. Garrett substituted the purchase price paid with the fair market
16 value rate base approved by the Commission. An identical approach was recommended
17 by OCA in Cheltenham, and it was rejected by the Commission. As recognized by the
18 Commission in Cheltenham, the correct purchase price for Limerick of \$75 million should
19 be used in the Selected Transaction Method in lieu of the Commission-determined
20 ratemaking rate base value, because \$75 million was the amount bid and paid by the buyer.

17 *Application of Aqua Pennsylvania Wastewater, Inc. – Cheltenham Township*, Docket No. A-2019-3008491, Opinion and Order entered November 5, 2019, p 60-61.

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 A Commission-determined ratemaking rate base value for an entity does not change the
2 price bid and paid by a buyer.

3 The purchase prices used by Mr. Garrett in his Selected Transaction Method are
4 based on the Commission-determined ratemaking rate base value not the purchase price
5 determined by buyer and seller. The valuation approach is the Market Approach based on
6 market values, not the “PUC ratemaking rate base value approach.” There is no
7 authoritative source, nor Commission precedent, which supports use of Commission-
8 determined ratemaking rate base value in the Market Approach.

9 **Q. DID MR. GARRETT MAKE ADDITIONAL ADJUSTMENTS TO THE**
10 **SELECTED TRANSACTION METHOD IN ADDITION TO THE ITEMS HE**
11 **DISCUSSED IN HIS DIRECT TESTIMONY?**

12 A. Yes. While Mr. Garrett includes only six selected transactions as shown on OCA Exhibit
13 DJG-4, the Selected Transaction Method included in Gannett Fleming’s appraisal includes
14 information for 13 selected transactions. Mr. Garrett did not explain why he excluded
15 seven selected transactions. The selected transactions missing from OCA Exhibit DJG-4
16 include: Municipal Authority of the City of Mckeesport, Steelton Borough (Water)
17 Authority, Exeter Township Wastewater System Assets, Borough of Royersford
18 Wastewater System Assets, Sadsbury Township Wastewater Utility, Cheltenham
19 Township Wastewater System Assets, and East Norriton Township Wastewater System
20 Assets. Additionally, the Selected Transaction Method included in Gannett Fleming’s
21 appraisal includes separate transactions for the Township of Mahoning Water System
22 Assets and the Township of Mahoning Sewer System Assets while OCA Exhibit DJG-4
23 shows these as a single transaction. I should also note that Mr. Garrett **includes** all the

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 selected transactions that he **excluded** from OCA Exhibit DJG-4 in his adjustments to the
2 AUS Consultants' appraisal's Selected Transaction Method shown on OCA Exhibit DJG-
3 5.

4 Furthermore, the Selected Transaction Method included in Mr. Garrett's direct
5 testimony on OCA Exhibit DJG-4 includes Upper Pottsgrove, which was not included in
6 the Gannett Fleming appraisal. The Gannett Fleming appraisal included all Section 1329
7 acquisitions that had been settled and/or fully litigated as of the valuation date of May 20,
8 2021. The OCA has previously argued in support of this practice in prior Section 1329
9 proceedings. The Upper Pottsgrove settlement was filed with the Commission on June
10 25, 2021, or 36 days **after** the May 20, 2021 valuation date, and therefore, should be
11 appropriately excluded.

12 **Q. DID MR. GARRETT MAKE ANY OTHER ADJUSTMENTS TO THE SELECTED**
13 **TRANSACTION METHOD IN ADDITION TO THE ITEMS YOU PREVIOUSLY**
14 **DISCUSSED?**

15 A. Yes. On page 9 of his direct testimony, Mr. Garrett states “[i]n this case, my market
16 analysis included transactions involving only collection/distribution systems, and did not
17 include transactions involving integrated treatment and collection systems (“integrated
18 systems”). In contrast, Mr. Walker’s market analysis included the Section 1329
19 transactions involving integrated systems.”¹⁸ Despite taking this position in this case,
20 Mr. Garrett **included both** collection/distribution systems and integrated systems selected

18 Mr. Garrett acknowledged later in his testimony, on page 9, that Gannett Fleming appraisal gave greater weight to the collection/distribution assets selected transactions multiples than the integrated systems transactions multiples. In fact, the Gannett Fleming appraisal gave 75% weight to the collection/distribution assets selected transactions multiples and only 25% weight to the integrated systems transactions multiples. Due to the small sample size of collection/distribution transactions and the fact that similar multiples occurred in both the collection/distribution systems and integrated systems selected transactions, consideration was given to both.

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 transactions in prior testimonies for other Section 1329 proceedings before the
2 Commission.¹⁹ Therefore, Mr. Garrett's rationale for disregarding integrated systems'
3 selected transactions included in Gannett Fleming's appraisal is unfounded and has not
4 been consistently applied.

5 Further, Mr. Garrett's recommendation regarding Gannett Fleming's Selected
6 Transaction Method is **based on only three selected transactions** due to his excluding
7 numerous selected transactions and relying solely on collection/distribution systems, which
8 resulted in an unreliable small sample size of transactions. Additionally, he compounded
9 his small sample size problem by excluding what he subjectively determined to be too high
10 or too low of a result from his recommendation. Had he not subjectively removed the
11 indicated values which he determined were too high or too low from his analysis his result
12 would be \$38,072,212, or \$8,315,259 more than his \$29,756,954 recommendation, for the
13 selected transactions, a **28% difference**.

14 **Q. YOU PREVIOUSLY STATED MR. GARRETT EXCLUDED NUMEROUS**
15 **SELECTED TRANSACTIONS FROM HIS ANALYSIS. DO YOU KNOW WHAT**
16 **MR. GARRETT'S RESULTS WOULD BE IF HE DID NOT EXCLUDE ANY**
17 **COLLECTION/DISTRIBUTION SYSTEMS?**

18 A. Yes. Using only the *ex-post* data (the only data used by Mr. Garrett) for all the
19 collection/distribution systems selected transactions, Mr. Garrett's methodology would
20 indicate a value of \$47,693,222, or \$17,936,268 more than his \$29,756,954

19 See Mr. Garrett's testimonies in other 1329 proceedings involving the purchase of wastewater assets of East Norriton Township (Docket No. A-2019-3009052) and Borough of Royersford (Docket No. A-2020-3019634).

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 recommendation, for the selected transactions, **a 60% difference.**

2 Therefore, based on the aforesaid, I believe Mr. Garrett's recommendation for the
3 Selected Transactions Method is not appropriate to use to determine the value of the
4 Wastewater System, is unreasonable and should not be adopted by the Commission.

5 **Q. ARE THERE OTHER COMPARISONS WHICH PROVE MR. GARRETT'S**
6 **RECOMMENDED SELECTED TRANSACTIONS METHOD IS**
7 **UNREASONABLE?**

8 A. Yes. The results of any method used to provide an indication of value must be viewed or
9 weighed against known facts. For example, Mr. Garrett's recommended Selected
10 Transactions Method result of \$29,756,954 can be compared to known facts. We know
11 the Wastewater System has \$32,955,596 of OCNLD of property plant and equipment.
12 Therefore, Mr. Garrett's Selected Transaction Method suggests a multiple of East
13 Whiteland's OCNLD of 0.90-times ($\$29,756,954 \div \$32,955,596$). The fair market value
14 for \$32,955,596 OCNLD cannot be as low as 0.90-times. The Market Multiples Method
15 shows (Aqua Exhibit Q on Exhibit 17, page 2) the value of a OCNLD to range from 0.97-
16 times to 2.26-times even when "cost free" capital is included. In fact, Mr. Garrett adopted
17 a 1.64-times multiple for the OCNLD multiple under the Market Multiples Method (Aqua
18 Exhibit Q on Exhibit 17, page 1) for East Whiteland. Under the Selected Transaction
19 Method (Aqua Exhibit Q on Exhibit 18, page 3), the value of OCNLD ranges from a
20 multiple of 0.91-times to 3.26-times and averages 1.80-times when only
21 collection/distribution systems transactions are considered. In fact, only one of the 13
22 selected transactions shown on page 3 of Exhibit 18 (Aqua Exhibit Q) had a multiple of
23 OCNLD below 1.0-times. Since there has been no evidence presented which suggests a

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 multiple of OCNLD of 0.90-times is reasonable, the result of Mr. Garrett’s Selected
2 Transactions Method should be given no weight.

3
4 **VII. RECOMMENDED WEIGHTING**

5 **Q. WOULD YOU RECOMMEND USING THE WEIGHTINGS MR. GARRETT**
6 **APPLIED TO HIS RESULT OF THE VALUATION APPROACHES SHOWN?**

7 A. No. Mr. Garrett did not conduct an appraisal. Mr. Garrett recommended substantial
8 changes to each valuation approach. Mr. Garrett does not justify the weightings he applied
9 to the valuation approaches shown. Mr. Garrett assumes weightings remain the same
10 regardless of the results of the valuation approaches which is “putting the wagon ahead of
11 the horse.” An appraisal is an opinion of fair market value and is not a “mechanical”
12 process. When information changes, opinions, weightings, methodologies, and
13 techniques change as well.

14 By attempting to analyze and adjust Gannett Fleming’s appraisal, Mr. Garrett is
15 doing no more than selectively choosing the parts of the appraisal that are to his liking
16 while jettisoning those parts that are not. Depending on the quantity and quality of the
17 results, weights applied under fair market value differ, but Mr. Garrett did not do this.

18
19 **VIII. CONCLUSION**

20 **Q. IS THERE ANYTHING PRESENTED IN MR. GARRETT’S DIRECT**
21 **TESTIMONY THAT WOULD RESULT IN YOU ALTERING YOUR FAIR**
22 **MARKET VALUE APPRAISAL OF THE WASTEWATER SYSTEM’S ASSETS?**

AQUA PENNSYLVANIA WASTEWATER, INC.
REBUTTAL TESTIMONY OF HAROLD WALKER, III

1 A. No, there was nothing presented in Mr. Garrett's direct testimony which would result in
2 our changing our fair market value appraisal of the Wastewater System.

3 **Q. YOUR RESPONSE TO I&E'S INTERROGATORIES, SET I, QUESTION 7**
4 **STATED IN PART, "GANNETT FLEMING BECAME AWARE THAT APA**
5 **SCHEDULE 4.10 AND THE ENGINEERING ASSESSMENT WERE UPDATED IN**
6 **THE PUC REVIEW PROCESS FOR CERTAIN VEHICLES." DOES THIS**
7 **UPDATE TO SCHEDULE 4.10 AND THE ENGINEERING ASSESSMENT HAVE**
8 **A MATERIAL IMPACT TO THE GANNETT FLEMING FAIR MARKET VALUE**
9 **APPRAISAL?**

10 A. No. I estimate our appraisal of the Wastewater System would have been \$55,598,000
11 based on the update to Schedule 4.10 and the Engineering Assessment, a reduction of
12 \$70,000. This small 0.13% reduction is not a material change.

13 **Q. DOES THAT CONCLUDE YOUR REBUTTAL TESTIMONY?**

14 A. Yes, it does. However, I reserve the right to supplement my testimony as additional issues
15 arise during this proceeding.

**APPLICATION OF AQUA PENNSYLVANIA WASTEWATER, INC.
DOCKET NO. A-2021-3026132**

**OCA RESPONSES TO INTERROGATORIES OF
AQUA PENNSYLVANIA WASTEWATER, INC. - SET I**

- Aqua-I-3. Please provide the following, if not already provided:
- a. A list of valuations of utility property performed by Mr. Garrett;
 - b. A list of fair market value appraisals of utility property performed by Mr. Garrett
 - c. A list of valuations of wastewater utility property performed by Mr. Garrett;
 - d. A list of fair market value appraisals of wastewater utility property performed by Mr. Garrett

Response: **None to (a) through (d).**

Witness: David Garrett
Dated: March 17, 2022

**APPLICATION OF AQUA PENNSYLVANIA WASTEWATER, INC.
DOCKET NO. A-2021-3026132**

**OCA RESPONSES TO INTERROGATORIES OF
AQUA PENNSYLVANIA WASTEWATER, INC. - SET I**

Aqua-I-1. Please provide the date of Mr. Garrett's inspection or review of the Wastewater System Assets of East Whiteland.

Response: **Mr. Garrett did not physically inspect the Wastewater System Assets of East Whiteland.**

Witness: David Garrett
Dated: March 17, 2022

VERIFICATION

I, Harold Walker, III, Manager, Financial Studies, Gannett Fleming Valuation and Rate Consultants, LLC, hereby state that the facts set forth in my Rebuttal Testimony, Aqua Statement No. 4-R, at PaPUC Docket No. A-2021-3026132, are true and correct to the best of my knowledge, information and belief and that I expect to be able to prove the same at a hearing held in this matter. I understand that the statements herein are made subject to the penalties of 18 Pa. C.S. § 4904 (relating to unsworn falsification to authorities).

Date: March 30, 2022



Harold Walker, III
Manager, Financial Studies
Gannett Fleming Valuation and Rate Consultants, LLC