

COMMONWEALTH OF PENNSYLVANIA



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August 18, 2017

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

Re: Application of Aqua Pennsylvania  
Wastewater, Inc. pursuant to Sections 1102  
and 1329 of the Public Utility Code for  
Approval of its Acquisition of the  
Wastewater System Assets of Limerick  
Township  
Docket No. A-2017-2605434

Dear Secretary Chiavetta:

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

Copies have been served per the attached Certificate of Service.

Very truly yours,

A handwritten signature in cursive script that reads "Christine Maloni Hoover".

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

Attachment

cc: Honorable Steven K. Haas  
Certificate of Service  
\*238596

CERTIFICATE OF SERVICE

Re: Application of Aqua Pennsylvania :  
Wastewater, Inc. pursuant to Sections :  
1102 and 1329 of the Public Utility Code : Docket No. A-2017-2605434  
for Approval of the Acquisition by Aqua of :  
the Wastewater System Assets of Limerick :  
Township :

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

Dated this 18<sup>th</sup> day of August, 2017.

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Dated: August 18, 2017

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Application of Aqua Pennsylvania :  
Wastewater, Inc. Pursuant to Sections 1102 :  
and 1329 of the Public Utility Code for : Docket No. A-2017-2605434  
Approval of its Acquisition of the :  
Wastewater System Assets of Limerick :  
Township :

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REPLY BRIEF OF  
THE OFFICE OF CONSUMER ADVOCATE

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## I. INTRODUCTION

The Office of Consumer Advocate (OCA) submits this Reply Brief in response to the Brief of Aqua Pennsylvania Wastewater, Inc. (Aqua or Company). The OCA's Main Brief contained a comprehensive discussion of the evidence and its position on all issues. Thus, the OCA will respond to only those matters raised by Aqua that were not previously addressed or that require clarification.

In its Brief, Aqua argued that Section 1329 eliminates the Commission's authority to determine ratemaking rate base and assigns that role to the Utility Valuation Experts (UVE). In addition, Aqua contends that the Commission has no statutory authority to consider ratemaking rate base testimony by the statutory advocates. To the extent the OCA's testimony is considered, Aqua asks the Commission to assign it no weight. Aqua's arguments are inconsistent with the plain language of Section 1329 and should be rejected. Divesting the Commission of its ability to investigate the reasonableness of the appraisals and make adjustments necessary to determine fair market value would prevent the Commission from carrying out its obligation to ensure that rates are just and reasonable and would deny due process to the statutory advocates. In addition, the OCA presents credible and persuasive testimony that identifies several adjustments to the appraisals that are required to correct errors and remove unsupported adjustments. The OCA's testimony should be given full weight and its calculation of a rate base of \$60,976,180 pursuant to the statutory fair market value process should be adopted.

Further, Aqua has not shown that the proposed acquisition of the Limerick wastewater system will provide substantial affirmative public benefits. While the acquisition of the Limerick customers would increase the number of Aqua's wastewater customers by approximately 27%, the average rate base cost for Aqua's existing wastewater customers would



increase by 60% per customer.<sup>1</sup> OCA M.B. at 57. Aqua’s existing customers are also at risk to support any subsidies for keeping Limerick rates lower than cost for the first three years post-acquisition and to support the costs of acquiring the Limerick customers. Aqua St. 1, Exhs. C,D; OCA M.B. at 57. Aqua will freeze rates for Limerick customers for three years post-acquisition. Asset Purchase Agreement (APA), ¶7.05(b); Aqua St. 1 at 14-15; OCA St. 1 at 1-2; OCA M.B. at 57. In the fourth year of ownership, however, Aqua projects increasing those rates by nearly 100% and, in order to shift less costs to Aqua’s existing customers, the Limerick rates could be increased at an even greater amount. Aqua St. 1 at 14-15; OCA St. 1 at 11-12; Tr. at 22; OCA M.B. at 58. The harms of this transaction outweigh any alleged benefit provided by the agreement between Aqua and the Limerick Township.

The OCA submits that the Commission should deny the Joint Application because it is not in the public interest. If the Commission disagrees and determines that the proposed transaction provides substantial affirmative benefits, the OCA submits that it must condition its approval to prevent harm to Aqua’s customers.

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<sup>1</sup> Ms. Everette explained:

“Adding the \$75,100,000 ratemaking rate base of Limerick to Aqua’s current net utility plant of 73,477,924 produces total plant in service of \$148,577,924. With the acquisition of the Limerick system, the number of Aqua wastewater customers would increase from 20,440 to 25,874 (20,440 + 5,434). Therefore, the new average rate base cost per customer will be \$5,742 ( $\$148,577,924 / 25,874$ ), or an increase of more than \$2,100 (60%) per customer.”

OCA St. at 16

## II. ARGUMENT

### A. Section 1329 Establishes a Voluntary Process for Determining Fair Market Value; It Does Not Change the Role of the Commission or Statutory Advocates.

#### 1. Section 1329 Does Not Eliminate the Commission's Authority to Determine Rate Base or Prohibit Consideration of the OCA's Testimony on Fair Market Value.

Aqua claims that, under Section 1329, there is “no legislated authorization . . . for involvement by the OCA in the determination of the fair market value of the selling utility or in a determination of whether the valuation arrived at pursuant to the clear statutory language is appropriate.”<sup>2</sup> Aqua M.B. at 39. The Company contends that the Commission does not have statutory authority to consider the OCA’s ratemaking rate base testimony and that no challenge can be brought against the appraisals of the UVEs. Aqua M.B. at 40. Aqua further argues that Section 1329 “approved UVEs to fully represent the public interest” and eliminated the Commission’s authority to determine what is in the public interest. Aqua M.B. at 38. Following Aqua’s logic, even when there are errors and bias in the UVE’s calculation, as the OCA has demonstrated, no review is permitted. OCA M.B. at 8-9.

Aqua’s position must be rejected. Section 1329 creates a valuation process, which begins with two UVEs providing individual appraisals of “fair market value.” 66 Pa. C.S. § 1329(a)(3). There is no expectation or presumption that these appraisals will be the same. Rather, the statute anticipates they will differ and provides for the appraisals to be averaged. 66 Pa. C.S. § 1329(g). The fact that two UVEs, who both must comply with the Uniform Standards of Professional Appraisal Practice (USPAP) and employ the cost, market, and income approaches, may recommend different fair market values establishes that the appraisal process is not simply a

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<sup>2</sup> The OCA may intervene in all matters properly before the Commission. 71 P.S. § 309-4. Under Section 5.72 of the Commission’s regulations, “[t]he Commonwealth or an officer or agency thereof may intervene as of right” in a proceeding involving an “interest which may be directly affected and which is not adequately represented” or “another interest of such nature that participation of the petition may be in the public interest.” 52 Pa. Code § 5.72. The Commission has stated that “[t]he OCA. . . of course, may intervene as of right.” See Petition of Pennsylvania Electric Company Requesting Approval of Rate Recovery, 1997 Pa. PUC LEXIS 145 at 6\* (April 21, 1997).

“formulaic” mathematical exercise. The UVEs are required to make judgments in each type of analysis and in how much weight is given to each approach. OCA M.B. at 14. Thus, the consumer interest can only be protected if the Commission may consider evidence regarding errors and unsupported adjustments in the UVE appraisals.

The OCA’s position is consistent with the plain language of Section 1329 and the rules of statutory construction, which dictate that all provisions of a statute should be given effect. 1 Pa. C.S. § 1921(a). Section 1329 was established within Chapter 13 of the Public Utility Code and must be implemented consistent with its mandate that all rates be just and reasonable. 66 Pa. C.S. § 1301; 1 Pa. C.S. § 1932 (“The rules of statutory construction provide that statutes are to be construed in harmony with existing law and as part of a general and uniform system of jurisprudence”). Divesting the Commission of its ability to investigate the reasonableness of the appraisals and make adjustments necessary to determine fair market value would prevent the Commission from carrying out its obligation to ensure that rates are just and reasonable.

The importance of Commission review is underscored where, as here, the impact of approving the proposed \$75.1 million ratemaking rate base may constitute a general rate increase of up to 52% for all Aqua wastewater customers if the Company is permitted to recover from existing customers the difference between the Limerick cost of service and the Limerick revenues during the rate freeze period.<sup>3</sup> 66 Pa. C.S. § 1308(d); OCA M.B. at 11. The premise that any review or challenge to the Company’s UVE appraisals is not permitted, would be inconsistent with the just and reasonable rate requirement and the Commission’s authority thereunder. 66 Pa. C.S. §§ 501(a), 1301.

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<sup>3</sup> Total operating revenues for Aqua Wastewater on its 12/31/16 income statement were \$12,114,548. Assuming the annual costs of Aqua’s ownership of the Limerick system are applied only to Aqua’s wastewater customers, the estimated increase is 52% ( $\$6,311,000 \div \$12,114,548$ ). Aqua Exh. C, D. Adding the Limerick revenues of \$4,771,000 (Aqua’s estimated revenues for Limerick in Year 2 after the acquisition) would mean total revenues of \$16,885,548. Aqua Exh. D. Accordingly, the estimated increase if applied to Limerick and existing Aqua wastewater customers is at least 37% ( $\$6,311,000 \div \$16,885,548$ ).

The OCA submits that adhering to Aqua's position would also violate due process. In Milesburg, the Court determined that customers are entitled to notice and opportunity to be heard before the Commission is permitted to make binding decisions likely to increase customers' rates in a subsequent rate proceeding. See Barasch v. Pa. P.U.C., 546 A.2d 1296, 1306 (1988) (Milesburg). The Court stated:

In our view, due process requires that, before the PUC may issue a declaration approving the legality of the terms and conditions of a contract for a utility's purchase of power from a QF that includes payments for capacity, the utility's customers must be provided with notice of the proceedings and an opportunity to be heard to challenge the proposed action.

Id. As the determination of ratemaking rate base will impact the calculation of revenue requirement, that determination can only be made by giving due notice<sup>4</sup> and a meaningful opportunity to challenge the UVE appraisals.

With regard to an opportunity to be heard, in Milesburg, the Commonwealth Court found that the Commission's order was an adjudication because:

[F]inal affirmative approval is precisely what West Penn sought, and received, from the PUC. If the commission's order is affirmed by the courts, then the propriety of the contract's capacity cost credit rate will not be subject to later challenge in a complaint proceeding before the commission under section 701; that issue will have been fully adjudicated already in these proceedings.

See Milesburg, 546 A.2d at 1306. An adjudication is defined as:

Any final order, decree, decision, determination or ruling by an agency affecting personal or property rights, privileges, immunities, duties, liabilities or obligations of any or all of the parties to the proceeding in which the adjudication is made.

2 Pa. C.S. § 101. In this case, the Commission's order regarding the valuation is a final order, which affects the property interests and rights of the ratepayers. Specifically, the rates of the Aqua customers will be based, in part, on this final order for decades throughout the future.

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<sup>4</sup> The OCA notes that direct notice was not provided to Aqua's existing customers.

As the Commonwealth Court stated, the question is what process is due. See Milesburg, 546 A.2d at 1307. In this case, the Commission’s use of a hearing is appropriate. See Id. A hearing must be a **meaningful** opportunity to be heard, not just an opportunity for Aqua to submit its appraisals. See Barasch v. Pa. P.U.C., 568 A.2d 276, 279 (1989) (Rivercrest) (there can be no doubt that an opportunity to be heard after due notice must be given to the affected parties before the PUC may enter an order fixing general rates.) The determination of rate base under Section 1329 may, as in the present case, increase future rates of Aqua’s wastewater customers up to 52%. OCA M.B. at 11. Therefore, the opportunity to “challenge” and “be heard” in a Section 1329 proceeding logically includes the submission of testimony relating to the valuation.

Further, the law is clear that the Commission has the authority to make corrections to the appraisal results of the UVEs in order to establish the fair market value. Aqua’s arguments to the contrary are untenable. If Section 1329 serves to remove all authority from the Commission to determine rate base and delegate that authority to the UVEs, it would render the statute unconstitutional. Article II, Section 1 of the Pennsylvania Constitution vests legislative power in a General Assembly.<sup>5</sup> Pa. Const. Art. II, §1. The General Assembly may delegate authority and discretion in connection with the execution and administration of a law to an independent agency. See Blackwell v. Commonwealth, State Ethics Comm’n, 523 Pa. 347, 567 A.2d 630 (1989). The legislative power over prices, rates or wages, or that authority as vested within a particular commission, may not be delegated to a private party. See Carter v. Carter Coal Co., 298 U.S. 238, 310-11 (1936); A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495, 537,

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<sup>5</sup> “The legislative power of this Commonwealth shall be vested in a General Assembly, which shall consist of a Senate and a House of Representatives.” Pa. Const. Art. II, §1.

541-42 (1935). Accordingly, the Commission cannot delegate its authority to determine ratemaking rate base to the UVEs.<sup>6</sup>

Aqua's restrictive interpretation of Section 1329 is not supported by the plain language of Section 1329 or the rules of statutory interpretation. The Commission has authority to review the UVE appraisals under Section 1329 and to ensure that the ratemaking rate base of the acquired utility will result in just and reasonable rates. The Commission must give affected parties a meaningful opportunity to be heard, which includes the consideration of testimony regarding errors and bias in appraisals.

2. The OCA's Corrections to the UVE Appraisals Are Supported by the Record.

The OCA's testimony demonstrates that Aqua's proposed rate base is overstated due to errors in the appraisals and that the correct rate base number is \$60,976,180 under the Section 1329 methodology. Ms. Everette's and Mr. Watkins' corrections to the UVE appraisals are addressed in detail in the OCA's Main Brief. OCA M.B. at 13-45.

Aqua initially argues that the appraisal criticisms of Ms. Everette and Mr. Watkins should not be considered because they "are not based on USPAP but rather are based on the 'just and reasonable' ratemaking standard found in Section 1301 of the Public Utility Code." Aqua M.B. at 40. The Commission has stated that "Section 1329 contains no prohibitions on the ability of the Parties to review the UVE appraisals as to their reasonableness." See Application of Aqua Pennsylvania Wastewater, Docket No. A-2016-2580061 at 53 (June 29, 2017) *reconsideration pending* (July 20, 2017) (New Garden). The ratemaking approvals of Section 1329 must be reconciled with the requirement that each rate be just and reasonable under Section 1301. 66 Pa.

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<sup>6</sup> Arguably, under MCI Telecomm. Corp. v. American Telephone and Telegraph Co., the Commission has no authority to adopt such interpretation. 512 U.S. 218 (1994) (After finding that rate filings are an essential characteristic of rate-regulated industry, the Supreme Court held that the FCC's detariffing policy which exempted certain telephone carriers from tariff filing requirements, exceeded that Commission's authority).

C.S. § 1301. As such, in evaluating UVE appraisals, application of the just and reasonable standard is appropriate. Here, Ms. Everette and Mr. Watkins employed standard financial and business models to make recommendations as to how to correct assumptions within the UVE appraisals that are unreasonable or inconsistent with utility practice.

Aqua argues that Ms. Everette's recommendations should be given no weight because she is not a registered UVE and has not previously performed a fair market value appraisal. Aqua M.B. at 42. The Company also takes issue with Mr. Wakins not being a registered UVE. Aqua M.B. at 45. In fact, neither of Aqua nor Limerick's utility valuation experts has previously conducted a fair market value appraisal that has been used for ratemaking purposes in a proceeding other than New Garden. Further, Aqua witness Packer has not presented testimony in any other jurisdiction regarding fair market valuation. The appraisals of two UVEs are required for purposes of determining fair market value under Section 1329, but nowhere is it provided that only UVEs may criticize already calculated fair market value for purposes of litigation before the Commission. The analyses of the UVE appraisals conducted by Ms. Everette and Mr. Watkins are derived from standard financial and business concepts and properly based on their ratemaking expertise.

For the foregoing reasons, the OCA submits that the Commission should reject Aqua's argument that the OCA's valuation testimony should be given no weight. The OCA's testimony regarding errors and unsupported adjustments in the UVE appraisals are fully supported by the record, warrant consideration by the Commission, and should be adopted.

3. The Commission Should Not Approve Aqua's Proposed Use of Regulatory Assets as Part of its Rate Stabilization Plan In This Proceeding.

Aqua asserts that its rate stabilization plan "results in a delayed recovery of the portion of the ratemaking rate base attributed to the regulatory asset," which it claims benefits customers.

Aqua M.B. at 51. Aqua seeks to split the \$75.1 million ratemaking rate base into an initial rate base of \$60 million and a regulatory asset of \$15.1 million, which would be amortized at a rate of \$2.1 million per year, moved into the rate base when Aqua files a base rate case, and depreciated at that time. OCA St. 1 at 5; OCA M.B. at 49; Aqua M.B. at 50-51. The proposed regulatory asset treatment is not consistent with the typical use of a regulatory asset as a ratemaking tool. OCA St. 1 at 6; OCA M.B. at 49. Ms. Everette clarified that “amortiz[ing] the asset in increments as Aqua decides to file base rate cases means that it is not possible to know when the asset will be fully amortized and included in rate base.” OCA St. 1 at 5-6; OCA M.B. at 49-50. As such, Aqua’s proposal “potentially creates unnecessary risk for customers.” Id.

In support of the rate stabilization plan, Aqua witness Packer avers that Aqua currently has regulatory assets in its rate base. OCA-V-1; OCA St. 1S at 2; OCA M.B. at 50. The Company’s purported present use of regulatory assets is not relevant because, as Aqua witness Packer acknowledged, these regulatory assets were not specifically approved by the Commission. Id. The Commission has stated that “creation of a regulatory asset through the deferral of specific costs is a traditional ratemaking tool that is available to the Commission under [its] general powers and ratemaking authority.” See Joint Application for Approval of the Merger of GPU, Inc. with First Energy Corp., 2001 Pa. PUC LEXIS 16 at 24-25 (June 20, 2001). Commission approval of treatment of an item as a regulatory asset is necessary for deferral accounting in Pennsylvania. See Petition of West Penn Power Company for Authority to Defer for Regulatory Accounting and Reporting Purposes Certain Losses from Extraordinary Storm Damage, 2011 Pa. PUC LEXIS 1270 at 7 (April 1, 2011).

The Commission should not approve the regulatory asset in this proceeding. OCA M.B. at 50. The OCA recommends that, if Aqua pursues regulatory asset treatment in its next rate base case, it should make available an analysis comparing the impact on ratepayers of



depreciating only a portion of the ratemaking rate base rather than the total \$75.1 million rate base. Id. The entire amount of ratemaking rate base approved by the Commission should be depreciated immediately upon closing and, as necessary, modified in future base rate cases. Id.

4. The Fair Market Value of the Limerick System Pursuant to Section 1329 Is \$60,976,180.

Ms. Everette provided testimony supporting four adjustments to HRG's cost approach results and recommended that HRG's market approach analysis be calculated using the actual number of customers without future capital improvements. OCA St. 1 at 20-23, 24-28; OCA M.B. at 14. Mr. Watkins corrected the calculation of income tax expense and the discount rate in the HRG discounted cash flow analysis under the income approach. OCA St. 2 at 11-18; OCA M.B. at 14. He recommended that adders for "going value" and "erosion of cash flow" be denied for all of the appraisal methodologies. OCA St. 2 at 11-18. Mr. Watkins also recommended that no consideration be given to HRG's rate base/ rate of return analysis in its income approach. OCA St. 2 at 18-22; OCA M.B. at 14. Further, he suggested adjustments to the termination value and discount rates used in Gannett Fleming's DCF model in the income approach analysis. OCA St. 2 at 22-29; OCA M.B. at 14.

After incorporating these adjustments, Ms. Everette calculated that the Gannett Fleming appraisal result would be \$73,275,485, while the HRG appraisal result would be \$48,676,875. OCA St. 1S at 22; OCA Exh. AEE-1S; OCA M.B. at 45. The recalculated average of the two appraisal results under Section 1329 is \$60,976,180. Id.

With regard to the market approach, Aqua claims that Ms. Everette selectively relied on parts of the appraisals that would produce a lower ratemaking rate base and that Mr. Watkins should not have evaluated only one aspect of fair market valuation. Aqua M.B. at 42, 45. As an

initial matter, the OCA made no substantial changes to any methodology. Ms. Everette offered adjustments as to how to correct portions of the UVE appraisals.<sup>7</sup>

Based on Aqua witness Vicari's testimony, the Company disagrees with Ms. Everette's criticism that the inclusion of capital improvements in the selling price of systems in the sample transaction was not warranted. Aqua M.B. at 43. For comparative acquisitions, Aqua witness Vicari considered the purchase price plus the value of capital improvements required by the agreement of sale. OCA St. 1 at 24; OCA M.B. at 43-44. For Limerick, Aqua witness Vicari considered only the purchase price and did not add the \$8.3 million of capital investments. Id. As Ms. Everette identified, "the market value [for Limerick] is artificially inflated because the prices of other acquisitions . . . include capital improvements, but the resulting market value of Limerick is not adjusted to reflect Aqua's planned capital improvements." OCA St. 1 at 24. Without adding in capital improvements for each acquisition, the estimated market value is \$39,775,212. OCA St. 1 at 24; OCA M.B. at 43-44.

Also in terms of the inclusion of capital improvements, Aqua witness Vicari claimed that the capital improvements were "inducements to enter into the agreement and should be viewed as part of the compensation." Aqua M.B. at 43. However, after Aqua completes capital improvements, it will be compensated through traditional ratemaking methodology. OCA St. 1S at 14-15; OCA M.B. at 44. Therefore, including these projects in the appraisal value at this time will result in Aqua "double recover[ing] for the same costs" to the detriment of ratepayers. Id.

As it pertains to the cost approach, Aqua witness Vicari asserted that Ms. Everette's criticism of HRG's use of the ENR Index to calculate reproduction cost was inappropriate. Aqua M.B. at 44. For the non-interceptor Collection System Mains, Aqua witness Vicari disregarded

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<sup>7</sup> Ms. Everette stated, "My testimony addresses some of the numerous discrepancies and factual errors in [Aqua witness] Vicari's analysis. The intention of this testimony is not necessarily to lower the FMV, but to provide the Commission with the information needed to adequately review the analyses composing the appraisals and ultimately, to make a determination on the ratemaking rate base proposed by Aqua." OCA St. 1S at 17.

the ENR result. Aqua Exh. R at 6, Sch. C; OCA St. 1 at 25; OCA M.B. at 15. Aqua witness Vicari noted that she considered the ENR results to be too low and found another way to calculate reproduction cost, which inflated the overall cost appraisal. Aqua Exh. R at 6.; OCA M.B. at 15-16. She did not establish a reasonable basis for treating this item differently. OCA M.B. at 16. Also, as Ms. Everette indicated, Aqua witness Vicari incorrectly included land in her reproduction cost analysis. Aqua Exh. R, Sch. C; OCA St. 1 at 26-27; OCA M.B. at 17.

Further, Aqua claims that, with regard to the income approach, Mr. Watkins improperly considered the buyer's and seller perspective. Aqua M.B. at 45-46. During the rebuttal stage of this matter, Aqua witness Vicari clarified that she modeled her DCF analysis using the buyer's perspective. Aqua St. 4R at 16. In response, Mr. Wakins stated only his analysis from the buyer's perspective should be used. OCA St. 2S at 4-5.

The Company also claims that Mr. Watkins incorrectly proposed changes in the discount rate, which Aqua witness Vicari argues should be based on the "rate Aqua is currently earning from operations." Aqua M.B. at 46-48. However, Aqua witness Vicari's selected discount rate of 2.5% does not comport with accepted financial theory or practice. OCA St. 2 at 6-7. The discount rate is customarily the firm's total cost of capital. OCA St. 2 at 13; OCA M.B. at 26-27. As Mr. Watkins explained, current rate of return on existing business "has absolutely nothing to do with its opportunity costs." OCA St. 2S at 2; OCA M.B. at 27.

Aqua's criticisms of Ms. Everette and Mr. Watkins identified above and in the OCA's Main Brief are without merit. Both experts corrected errors and removed unsupported adjustments in the UVE appraisals. As Section 1329 does not delegate or otherwise eliminate the Commission's authority to determine rate base for ratemaking purposes and to consider testimony by statutory advocates regarding fair market valuation, the OCA respectfully submits

that, if the transaction is approved, the Commission should establish a rate base of \$60,976,180 for the Limerick system, rather than a rate base of \$75.1 million as proposed by Aqua.

B. The Commission Cannot Approve an Acquisition That Is Not In the Public Interest.

Under Sections 1102 and 1103 of the Public Utility Code, the standard for reviewing the benefits of an application is whether the transaction will provide substantial, affirmative benefits to the public. See City of York, 295 A.2d 825, 828 (1972); 66 Pa.C.S. §§ 1102, 1103. The transaction must affirmatively promote the service, accommodation, convenience or safety of the public in some substantial way; the mere absence of any adverse effect is not sufficient. 295 A.2d at 828. When the “public interest” is considered, the benefits and detriments to all affected parties must be considered. See Middletown Twp. v. Pa. P.U.C., 482 A.2d 674, 682 (1984).

In this proceeding, it is undisputed that Limerick Township would benefit from the proposed transaction. Limerick Township will receive \$75.1 million or 63% more than the net book value of the system. OCA St. 1 at 3; OCA M.B. at 53. Aqua is planning capital investment projects over the next ten years, which it estimates will cost \$8.3 million. OCA St. 1 at 3; Aqua Exh. V at 8; OCA M.B. at 53. In addition, the seven existing Limerick employees will be hired by Aqua to continue operating the Limerick system. Aqua Exh. V at 10. The “benefits” that Aqua ascribes to the proposed transaction, however, do not outweigh the harms to Aqua’s existing customers and the Limerick customers. OCA M.B. at 54-62.

C. There Is No Affirmative Benefit for Existing Aqua Customers and Harm Will Result to Limerick Customers After Year 3.

Aqua contends that its existing wastewater customers will benefit from the addition of Limerick customers through cost sharing and economies of scale. Aqua M.B. at 24. The Company argues that the Commission should use a “long-term philosophy” to evaluate the benefits of the transaction. Aqua M.B. at 32. As a general rule, it is inequitable and

economically unsound to ask one “generation” of captive ratepayers to bear the cost of providing service to another. See Re Minnegasco, Inc., 143 PUR4th 416, 426 (Minn. 1993); See also Barasch v. Pa. P.U.C., 491 A.2d 94, 98, 104 (1985). The benefits of a transaction should accrue to customers in some reasonably close time compared to the costs that are being expended so that existing ratepayers see some benefits from the acquisition and consolidation.<sup>8</sup>

Even in the long-term, no affirmative public benefits that outweigh the harms to existing customers are present in this transaction. Aqua claims that the acquisition will “not have an immediate impact on the rates of either the Limerick customers or the existing customers of Aqua.” Aqua Exh. 1; Aqua M.B. at 29. Aqua also asserts that its rate stabilization plan will create a “positive rate benefit for existing customers as early as Year 15/16.” Tr. 22-23; Aqua M.B. at 29. Aqua ignores the negative impact on existing customers in the interim. Limerick customers will not be paying the full cost of the acquired system until Year 15, meaning that existing customers will bear the risk and cost of the shortfall and experience significantly increased rates. Aqua St. 1, Exh. C, D; OCA St. 1S at 3; OCA M.B. at 11, 47-48, 58. Even after 15 years, Aqua predicts that existing customers may save only 3 cents per month. OCA. St. 1S at 3; OCA M.B. at 55. A 3 cent monthly savings after more than a decade of increased rates is not indicative of substantial affirmative public benefits. Id.; See Aqua Exh. D; OCA-V-3.

Aqua discounts Ms. Everette’s concerns regarding a significant increase in rate base per customer as a result of the acquisition. Aqua M.B. at 33. Aqua states that Limerick’s rates are charged according to Equivalent Dwelling Units (EDUs), not number of customers. Id. When asked for the number of existing EDUs served by Aqua, Mr. Packer indicated that Aqua does not

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<sup>8</sup> In the context of discussing acquisition policy, the Commission has stated its expectation that “every ratepayer in the Commonwealth” will benefit from sharing the impact of major capital additions over a larger rate base. Policy Statement Re: Incentives for the Acquisition and Merger of Small, Nonviable Water and Waste Water Systems, 168 PUR4th 45 (Pa. 1996). The Commission has rejected normalization where it threatened to deny ratepayers a chance to reap the benefit of normalization for 22 years. Pa. P.U.C. v. Duquesne Light Co., 43 PUR4th 27, 69 (1982).

track its customers on the basis of EDUs. OCA-V-6; OCA St. 1S at 5. Therefore, in terms of comparing the cost of the proposed ratemaking rate base with the cost of Aqua's existing rate base, it is **not** appropriate to consider a cost per EDU analysis in lieu of a cost per customer analysis. OCA St. 1S at 5. Because the number of EDUs in Aqua's existing customer base is unknown, the number of EDUs for Limerick is irrelevant in a comparison. Id.

Despite the Company's claim to the contrary, acquiring 5,343 customers for \$75.1 million, a purchase price 63% over net book value, will increase costs substantially. The average rate base cost of each Limerick customer, \$13,820, would be nearly four times that of an existing Aqua customer, only \$3,595. OCA St. 1 at 16-17; OCA M.B. at 56. In other words, the number of customers would increase by only 27%, while Aqua's average rate base cost would increase by 60% per customer. Id. Additionally, Aqua estimates that its system expenses would be the same or greater than those experienced by Limerick. Aqua Exh. I1 at 29; Aqua St. 1, Exh. C, D; OCA M.B. 60-61. There is no indication that Aqua can operate and maintain the Limerick system with planned improvements at a lesser cost than Limerick Township. OCA M.B. at 60.

In addition, ratepayers are subject to bearing the risk of a shortfall between the revenues Aqua is permitted to recover under its agreement with Limerick and the costs that Aqua will incur with respect to the acquired system. OCA M.B. at 47-48, 53. Under Section 1329(f)(2), Aqua is permitted to use special ratemaking treatment for its projected \$8.3 million of capital improvements. OCA M.B. at 45; 66 Pa. C.S. § 1329(f)(2). If the Company does so, the shortfall in the Limerick customers' rates relative to their actual cost of service will increase even more. OCA M.B. at 45. The OCA submits that the transaction should be conditioned to ensure that excess costs are borne by Aqua's shareholders. OCA M.B. at 47-48, 62. Moreover, as Aqua has structured the transaction, Aqua's existing water customers are at risk to bear the costs of acquiring the Limerick system if the Company seeks approval to allocate a portion of its

wastewater revenue requirement to a combined water and wastewater customer base under Section 1311(c). OCA M.B. at 57; 66 Pa. C.S. § 1311(c).

Further, Aqua avers that its “rate stabilization plan is based on extremely conservative assumptions,” including a \$70 per month rate for Limerick customers, and leads to an eventual benefit to existing customers. Aqua M.B. at 50. Aqua notes that “[w]ith less conservative assumptions” any claimed benefit would occur sooner. Id. The \$70 per month rate is an increase from the current rate of \$38 for Limerick customers. OCA St. 1 at 11-12, 14; OCA M.B. at 58. Aqua’s statement that \$70 is an extremely conservative estimate suggests that Aqua will possibly set rates above \$70, resulting an even greater harm to Limerick customers.

For all of these reasons, Aqua has not established, under Section 1102 and 1103, that the transaction provides any substantial, affirmative public benefit to the existing Aqua customers. The record shows instead that both Aqua’s current customers and the Limerick customers could suffer considerable harm. The OCA submits that the Commission must deny the Application.

D. If the Commission Permits the Proposed Acquisition, Certain Protections Must Be In Place.

As set forth above, the OCA recommends that the Commission deny the relief requested in the Application. OCA M.B. at 62. If, however, the Commission declines to do so, the OCA recommends that the Commission include in its approval conditions to ensure that the risk of a shortfall between what can be collected from Limerick customers under the rate freeze and what would be allocated based on cost of service in future rate cases would be borne by Aqua shareholders. OCA M.B. at 48. The APA provides no flexibility regarding the application of the rate freeze. Although the Commission has ultimate jurisdiction regarding rates charged to customers for utility service, only by having a condition in the Commission’s approval of the application would it be expressly required. Aqua St. 1-R at 8; OCA M.B. at 47-48. The OCA’s complete recommended conditions include the following:

- The Commission retains the authority to allocate revenues, if appropriate, to the Limerick Township customers that are inconsistent with the restrictions contained in the APA;
- Aqua and its shareholders should bear all risk of a shortfall between the revenues Aqua is permitted to recover under its agreement with Limerick and the costs that the Company will incur with respect to the acquired system. To the extent that Aqua is unwilling or unable to charge costs in excess of the limitations provided in the Asset Purchase Agreement, the excess costs should be borne by shareholders and not spread to other ratepayers;
- Aqua and its shareholders should bear all risk of a shortfall between the revenues it is permitted to recover under its agreement with Limerick and the costs that the Company will incur with respect to this system.
- The regulatory asset should not be approved in this case;
- If Aqua proposes the regulatory asset treatment in its next base rate case, the Commission should require Aqua to provide a net present value analysis showing the impact on ratepayers of using a regulatory asset as compared to the impact of depreciating the total \$75.1 million rate base;
- If Limerick customers will begin paying a DSIC prior to effective date of rates established in Aqua's next base rate case, the Commission should require that Aqua file the required tariff changes and revised LTIP no later than 30 days after entry of the Commission order in this proceeding; and
- The Commission should adopt the OCA's proposed adjustments to the appraisals, resulting in an overall ratemaking rate base of \$60,976,180 (prior to closing and transaction costs).

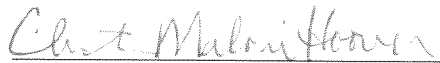
OCA St. 1S at 22-23; OCA M.B. at 62-63.



## CONCLUSION

For the reasons set forth above and in the OCA's Main Brief, the Office of Consumer Advocate respectfully requests that the Commission deny Aqua's Application for a Certificate of Public Convenience to purchase the Limerick wastewater assets and provide wastewater service. In the alternative, the Certificate should be conditioned such that Aqua's existing water and wastewater customers are not penalized by bearing the cost of a transaction that does not provide affirmative benefits that outweigh the harms to customers. The Office of Consumer Advocate requests that, in order to provide the necessary protection to customers, the Commission adopt the OCA's proposed conditions and approve a fair market value of \$60,976,180 for ratemaking rate base. Finally, Aqua's proposed findings of fact and conclusions of law should be rejected to the extent they are inconsistent with the OCA's recommendations.

Respectfully Submitted,



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