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August 22, 2017

VIA E-FILING

Deputy Chief Administrative
Law Judge Mark A. Hoyer
P.O. Box 3265
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Administrative Law Judge Mary D. Long
P.O. Box 3265
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RE: APPLICATION OF PENNSYLVANIA-AMERICAN WATER COMPANY - WASTEWATER UNDER SECTION 1329 OF THE PENNSYLVANIA PUBLIC UTILITY CODE, 66 PA. C.S. §1329, FOR APPROVAL OF THE USE FOR RATEMAKING PURPOSES OF THE LESSER OF THE FAIR MARKET VALUE OR THE NEGOTIATED PURCHASE PRICE OF THE MUNICIPAL AUTHORITY OF THE CITY OF MCKEESPORT'S ASSETS RELATED TO ITS WASTEWATER COLLECTION AND TREATMENT SYSTEM AND OTHER RELATED TRANSACTIONS; DOCKET NO. A-2017-2606103

Dear Deputy Chief ALJ Hoyer and ALJ Long:

Enclosed please find a copy of the Main Brief of the Municipal Authority of the City of McKeesport and the City of McKeesport in the above-referenced matter.

Copies have been served on all active parties as indicated on the enclosed Certificate of Service. Should you have any questions or concerns, please contact me at 215-575-7286.

Very truly yours,



Thomas S. Wyatt

cc: Rosemary Chiavetta, Secretary (Cover Letter and Certificate of Service only)
All Parties Per Certificate of Service

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

The Honorable Mark A. Hoyer and the Honorable Mary D. Long, Presiding

Application of Pennsylvania-American Water	:	
Company-Wastewater under Section 1329 of the	:	
Pennsylvania Public Utility Code, 66 Pa. C.S.	:	
§ 1329, for approval of the use for ratemaking	:	
purposes of the lesser of the fair market value or the	:	Docket No. A-2017-2606103
negotiated purchase price of The Municipal	:	
Authority of the City of McKeesport's assets related	:	
to its wastewater collection and treatment system	:	
and other related transactions.	:	

JOINT MAIN BRIEF OF
THE MUNICIPAL AUTHORITY OF THE CITY OF MCKEESPORT
AND THE CITY OF MCKEESPORT

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DATED: August 22, 2017

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I. INTRODUCTION

Pursuant to the procedural schedule established and in accordance with Commission Regulations at Section §5.501, the Municipal Authority of the City of McKeesport (the “Authority”) and the City of McKeesport (the “City”) hereby jointly submit this Main Brief in support the Application (the “Application”) of Pennsylvania-American Water Company-Wastewater (“Pennsylvania-American”), filed with the Public Utility Commission (“Commission”) pursuant to Sections 1102 and 1329 of the Public Utility Code.

A. Procedural History

This proceeding concerns Pennsylvania-American’s Application, filed with the Commission on June 14, 2017, for approval of its acquisition of the wastewater system assets of the Authority (the “System”) pursuant to Sections 1102 and 1329 of the Public Utility Code. The Application was assigned Docket No. A-2017-2606103.

The Bureau of Investigation and Enforcement (“I&E”) filed a Notice of Appearance on June 21, 2017. On the same date, June 21, 2017, the Office of Consumer Advocate (“OCA”) filed a Protest in this proceeding. On June 28, 2017, the Authority and the City filed Petitions to Intervene in the proceeding.

Deputy Chief Administrative Law Judge Mark A. Hoyer and Administrative Law Judge Mary Long were assigned to preside over the proceeding. An Initial Prehearing Conference was held on July 13, 2017. All parties participated in the initial prehearing conference.

On July 17, 2017, the Authority served the direct testimony of Adrienne M. Vicari, P.E.¹ Direct testimony by I&E and OCA was also served on July 17, 2017. Rebuttal testimony was served by Pennsylvania-American, OCA, and the Authority on July 26, 2017, and surrebuttal testimony was served by Pennsylvania-American, OCA, and the Authority on August 2, 2017.

An evidentiary hearing was held on August 3, 2017. At the hearing, testimony and exhibits were entered into the record and cross examination was conducted. The Authority presented the testimony of Ms. Vicari, a representative of the Utility Valuation Expert (“UVE”) selected by the Authority as the Seller. Pennsylvania-American presented, *inter alia*, the testimony of Jerome C. Weinert, ASA, PE, CDP, a representative of AUS Consultants, Inc. (“AUS”), the UVE selected by Pennsylvania-American, as Buyer. I&E, and OCA also actively participated.

B. Overview of the Proposed Transaction

The Authority currently provides wastewater service to approximately 12,780 customers (approximately 21,953 customers when including indirect customers receiving bulk service), including within the City of McKeesport, the City of Duquesne, Port Vue Borough, the Borough of Dravosburg, and a portion of West Mifflin Borough, Allegheny County, Pennsylvania and to three bulk service interconnection points located in Liberty Borough, White Oak Borough, and North Versailles Borough, Allegheny County, Pennsylvania (collectively, the “Service Area”). Pennsylvania-American proposes to acquire the wastewater assets owned by the Authority for \$162 million. Pennsylvania-American submitted the winning bid after an extensive process using

¹ Adrienne M. Vicari, P.E., manages the Financial Services Group as the Financial Services Practice Area Leader for Herbert, Rowland & Grubic, Inc. She has a bachelor’s of science in Civil Engineering from Valparaiso University and she is a Professional Engineer with licenses in the Commonwealth of Pennsylvania and the State of Ohio. Herbert, Rowland & Grubic, Inc. (“HRG”), is a Commission-certified Utility Valuation Expert (“UVE”). Ms. Vicari’s experience and qualifications are attached as MACM Exhibit AMV No. 1 to AMV Statement No. 1.

a competitive bidding structure. The form of Asset Purchase Agreement was negotiated with all bidders at arm's length prior to the bidding.²

The Application asks the Commission for an order approving this acquisition and allowing Pennsylvania-American to begin wastewater service within the Service Area. Pennsylvania-American is also seeking an order approving the acquisition that includes the ratemaking rate base of the wastewater system assets pursuant to Section 1329(c)(2) of the Public Utility Code and for such other approvals, certificates, registrations and relief, if any, under the Public Code that may be required with respect to the acquisition.

II. STATEMENT OF QUESTIONS PRESENTED

Question No. 1

Is Pennsylvania-American's acquisition of the wastewater system assets of the Authority and related expansion of certificated service territory into the Service Area necessary or proper for the service, accommodation, convenience or safety of the public?

Suggested Answer to Question No. 1

Yes. Pennsylvania-American's acquisition of the wastewater system assets of the Authority and related expansion of certificated service territory into the Service Area is necessary or proper for the service, accommodation, convenience or safety of the public.

Question No. 2

What is the ratemaking rate base of the wastewater system assets of the Authority pursuant to Section 1329 of the Public Utility Code?

² PAWC Exhibit No. 1, Application ¶¶ 23-24.

Suggested Answer to Question No. 2

The ratemaking rate base determined pursuant to Section 1329(c)(2) of the Public Utility Code is \$162,000,000, being the lesser of (i) the revised purchase price of \$162,000,000 negotiated by Pennsylvania-American, the City, and the Authority and (ii) the average of the fair market value appraisals, \$176,091,500 – the average of \$161,343,000 (rounded)³ valuation presented in the appraisal of AUS and the \$190,840,000 valuation presented in the revised appraisal of HRG.⁴

III. LEGAL STANDARDS

A. Burden of Proof

Under Sections 315(c) and 332 of the Public Utility Code, the burden of proof rests with the Applicant. The Pennsylvania Supreme Court has held that “burden of proof” means a duty to establish a fact by a preponderance of the evidence, meaning that the party has presented evidence which is more convincing than the evidence by the opposing party.⁵ Once a presumption as to a particular fact is established, the burden of proof shifts to the opposing party to rebut the assumption.⁶

B. Legal Standard for Section 1102 Approvals

Pennsylvania-American is seeking from the Commission a certificate of public convenience to expand its service territory into the Service Area and to acquire property used or

³ Revised appraisal as of the revised May 17, 2017. AUS’s original appraisal as of November 8, 2016 found a fair market value of \$157,600,000.

⁴ During informal discovery, HRG discovered an error in the average age of the collection system assets that they used. The error affected their Cost Approach and Income Approach valuations. HRG revised both approaches to reflect the correct information, and explained their revisions through the testimony of Adrienne Vicari.

⁵ *Se-Ling Hosiery v. Margulies*, 70 A.2d 854 (Pa. 1950).

⁶ *In Re Byerly*, 270 A. 2d 186 (Pa. 1970).

useful in public service, as required under 66 Pa. C.S. §§ 1102(a)(1) and 1102(a)(3) . The burden of proving entitlement to such a certificate is on Pennsylvania-American.

The Commission will issue a certificate of public convenience pursuant to Section 1102 only if the Commission finds that the granting of such certificate “is necessary or proper for the service, accommodation, convenience, or safety of the public.” 66 Pa. C.S. § 1103(a). Courts have interpreted this provision to require a showing that the proposed transaction will “affirmatively promote the ‘service, accommodation, convenience, or safety of the public’ in some substantial way.”⁷

The party acquiring the assets to be used in public service and obligation to provide service must be technically, legally, and financially fit.⁸ A certified Class A public utility such as Pennsylvania-American is presumed fit based on its certification.⁹

C. Legal Standard for Section 1329 Approvals

Act 12 of 2016 amended Chapter 13 of the Public Utility Code to add a new section, Section 1329, 66 Pa. C.S. § 1329. Section 1329 provides an alternative method of valuation for municipal or authority-owned water and wastewater systems acquired by investor-owned water and wastewater utilities. Under Section 1329, an acquiring entity may establish ratemaking rate base with fair market valuation rather than requiring it be tied to the original cost of construction of the facilities.¹⁰ Fair market value is defined as the average of two fair market value appraisals,

⁷ *City of York v. Pennsylvania Pub. Util. Comm’n*, 449 Pa. 136, 141, 295 A.2d 285, 828 (1972) (quoting 66 Pa.C.S.A. § 1103).

⁸ *Joint Application of Peoples Natural Gas Company LLC, Peoples TWP LLC, and Equitable Gas Company, LLC*, Docket No. A-2013-2353647, 309 P.U.R.4th 213 (2013).

⁹ *In re Pennsylvania-American Water Company*, 85 Pa. P.U.C. 548 (1995).

¹⁰ *Application of Aqua Pennsylvania Wastewater, Inc. Pursuant to Sections 1102 and 1329 of the Public Utility Code for Approval of its Acquisition of the Wastewater System Assets of New Garden Township and the New Garden Township Sewer Authority*, Docket No. A-2016-2580061, Opinion and Order entered February 15, 2017 (“New Garden Feb. Order”), slip op. at 5.

one commissioned by the buyer and one by the seller.¹¹ The appraisals must be performed by UVEs who are chosen from a list of qualified UVEs maintained by the Commission.¹² Commission regulation of the UVEs protects the public interest and avoids increasing costs for the statutory advocates. Under the Commission's *Final Implementation Order* implementing Section 1329, UVEs must establish their qualifications, have utility valuation experience, and conduct their evaluations in accordance with accepted standards.¹³ For certification, UVEs must fill out a registration form under oath and subject to penalty of perjury that sets forth their qualifications, technical fitness, and potential for conflicts of interest.¹⁴

After the buyer and seller choose their UVEs from the Commission's list, each UVE conducts an independent fair market value appraisal of the system using the Uniform Standards of Professional Appraisal Practice ("USPAP") using three different approaches: cost, market, and income.¹⁵ The appraisals are conducted independently of both the other UVE and the hiring party (either the buyer or the seller) to preserve accuracy and reliability in the appraisal value. The buyer and seller also jointly select a qualified engineer, who prepares a comprehensive list of the system's assets to be used by both appraisers. For ratemaking purposes, the valuation is the lesser of the average of the two appraisals and the negotiated purchase price.¹⁶

Section 1329 is a voluntary process that both buyer and seller must opt into in order to use. The underlying idea is to help selling municipalities obtain true value when monetizing their assets, and to allow the acquiring utility's post-acquisition improvement costs not recovered

¹¹ 66 Pa. C.S. § 1329(g).

¹² 66 Pa. C.S. § 1329(a)(1).

¹³ *Final Implementation Order*, Implementation of Section 1329 of the Public Utility Code, Pennsylvania Public Utility Commission, at Docket No. M-2016-2543193 ("Final Implementation Order") at 4-5.

¹⁴ *Final Implementation Order* at 4.

¹⁵ 66 Pa. C.S. § 1329(a)(3).

¹⁶ 66 Pa. C.S. § 1329(c)(2).

through a distribution system improvement charge (“DSIC”) to be deferred for book and ratemaking purposes.¹⁷

Section 1329 includes a streamlined timeline for the entire process, including a 90-day limit for the appraisals and a deadline for Commission approval of the transaction of six months from the date of application.¹⁸

D. Legal Standard for DSIC, AFUDC, and Section 507 Approvals

The Authority and the City adopt the position of Pennsylvania-American as to the legal standards for Distribution Service Improvement Charge, allowance for funds used during construction and deferred depreciation, and Section 507 approvals, and endorse the Main Brief of Pennsylvania-American as to Sections III.D, III.E, and III.F thereof.

IV. SUMMARY OF ARGUMENT

A. Section 1102 Approvals

Pennsylvania-American requested in its Application that the Commission grant a certificate of public convenience to expand its service territory and acquire property used or useful in the public service. In order to grant such a certificate to Pennsylvania-American under Section 1102 of the Public Utility Code, the Commission must find that granting of a certificate is necessary or proper for the service, accommodation, or safety of the public, and that the party receiving the assets and service obligation is technically, legally, and financially fit.

As an existing provider of public utility service, Pennsylvania-American is presumed to be fit. No party has offered evidence to overcome this presumption. Pennsylvania-American is fit

¹⁷ Final Implementation Order at 1; New Garden Feb. Order, slip op. at 6.

¹⁸ 66 Pa. C.S. § 1329(a)(5) and (d)(2).

to acquire the Authority wastewater system assets and to initiate wastewater service in the Service Area.

Pennsylvania-American has demonstrated through a preponderance of the evidence that its acquisition of the Authority wastewater system assets and initiation of wastewater service in the Service Area will affirmatively promote the service, accommodation, convenience, or safety of the public in substantial ways. The acquisition and service will promote the public interest, in particular through regionalization and consolidation of wastewater operations within the Commonwealth of Pennsylvania (the “Commonwealth”) and remediation of environmental problems within the Commonwealth.

B. Section 1329 approvals

Pennsylvania-American, the City, and the Authority have agreed to use Section 1329 of the Public Utility Code to value the wastewater system assets and to establish ratemaking rate base. Under Section 1329, the ratemaking rate base is the lower of the purchase price and the average of two independent fair market appraisals conducted by UVEs. The Authority engaged HRG as its UVE, which arrived at a revised fair market appraisal of \$190,840,000. Pennsylvania-American engaged AUS, which arrived at a revised fair market appraisal of \$161,343,000. The average of these appraisals is \$176,091,500. The negotiated purchase price of the wastewater assets was \$162,000,000. Under Section 1329, the ratemaking rate base is \$162,000,000.

C. DSIC, AFUDC, and Section 507 Approvals

The Authority and the City endorse and adopt the position of Pennsylvania-American as to DSIC, the accrual of Allowance for Funds Used During Construction (“AFUDC”) for post-

acquisition improvements not recovered through DSIC for book and ratemaking purposes, and Section 507 approvals.

V. ARGUMENT

A. Section 1102 Approvals (transfer of assets and rights, service territory)

1. Fitness

Pennsylvania-American is a regulated public utility that furnishes water and wastewater to the public in various counties throughout Pennsylvania, and it has the experience necessary to demonstrate that it is able to operate wastewater treatment and collection systems in a safe, reliable and efficient manner. Pennsylvania-American is an existing provider of public utility service, and thereby presumed fit. No party has offered evidence to rebut the presumption of Pennsylvania-American's fitness.

The Asset Purchase Agreement ("APA") among the Authority, the City, and Pennsylvania-American¹⁹ was the result of a bidding process with multiple steps that took over a year. The Authority first issued a Request for Qualifications ("RFQ") to vet potential bidders on the system in June of 2015.²⁰ Pre-qualified bidders who were deemed eligible to bid based on their demonstrated technical and financial qualifications detailed in a response to the RFQ were the only entities permitted to respond to the Request for Bids ("RFB").²¹ Pennsylvania-American submitted information as to its qualifications to the Authority and the City in response to the RFQ. This information was reviewed by the Authority, the City, and their financial and legal

¹⁹ PAWC Exhibit No. 1, Application, Appendix A-24.

²⁰ PAWC Statement No. 6, at 9, line 13-14.

²¹ PAWC Exhibit MEC-1.

professional advisors, who determined that Pennsylvania-American was qualified to be certified as a Pre-Qualified Proposer for the RFB process.²²

Pennsylvania-American is a viable operator of the Authority's wastewater system, its viability will not be impaired by the acquisition, and it maintains the managerial, technical, and financial capabilities to safely and adequately operate the Authority's system in compliance with the Public Utility Code, the Pennsylvania Safe Drinking Water Act²³ and other requisite regulatory requirements. The Commission should find that Pennsylvania-American meets the requirement for legal, technical, and financial fitness under Section 1102.

2. Public Benefits

The duly-elected Board of the Authority and the democratically-elected officials of the City believe that the sale of the Authority's wastewater system is in the best interest of the residents of the Service Area, and they therefore have agreed to the sale to Pennsylvania-American pursuant to a heavily negotiated APA. These are assets owned by the public, and the City and the Authority are compelled to achieve the true value for its citizens and surrounding communities.

a. Benefits to the Service Area

As supported by the direct testimony of Mayor Michael Cherepko, there are numerous public benefits that will result from the acquisition.²⁴ The City of McKeesport has been struggling financially for many years as a result of blight, socio-economic barriers of poverty,

²² PAWC Exhibit MEC-3.

²³ 35 P. S. §§ 721.1--721.17

²⁴ PAWC Statement No. 6, at 8 lines 14-16.

single-parent households, and a lack of employment opportunities.²⁵ The City is in need of an infusion of capital for basic infrastructure investment and community development programs that could build up a tax base for future balanced budgets.²⁶ Funds from the proceeds of the sale will go toward funding the removal of blighted properties, the undertaking of critical infrastructure projects, stabilizing the City's pension funds and programs to combat the City's pervasive poverty.²⁷ The Mayor explained that Section 1329 provides the City the opportunity to monetize the true value of a public asset in order to improve the lives of those in the community (and surrounding communities).²⁸

The City has been operating at a deficit for several years as a result of its financial challenges and economic downturn, surviving on various capital infusions from asset sales and reserve funds while rightsizing its budget. This major capital infusion will allow the City to take its first steps in years toward investing in future economic development rather than just trying to stay afloat.²⁹ Additionally, private ownership of the wastewater system will mean another large institutional taxpayer in the Service Area.³⁰

The Authority currently has forty-five active employees., including thirty-three union employees and fourteen non-union employees.³¹ In the APA, PAWC committed to offering employment to all eligible Authority employees after closing.³² The median household income in the City of McKeesport is \$23,715, and the median income for a family is \$31,577.³³ The

²⁵ Transcript of Evidentiary Hearing of August 3, 2017 ("Transcript") at 75, lines 21-5.

²⁶ PAWC Statement No. 6, at 4, lines 17-23; at 5, lines 1- 8; Transcript at 75-6.

²⁷ Transcript at 77, lines 17-21. PAWC Statement No. 6, at 8, lines 3-10.

²⁸ PAWC Statement No. 6, at 6, lines 21-23; at 7, lines 1-5.

²⁹ PAWC Statement No. 6, at 4, lines 2-19.

³⁰ PAWC Statement No. 6, at 9, lines 8-9.

³¹ PAWC Statement No. 2 at 14, lines 21-22; PAWC Application Appendix 24-A at Schedule 7.03.

³² PAWC Statement No. 2 at 15. Eligibility is dependent on passing a background check and drug screening. *Id.*

³³ PAWC Statement No. 6 at 5, lines 19-21.

retention of these good-paying, family-sustaining jobs is a significant benefit to the community and will ensure managerial and operational continuity for the System.

While the Authority is staffed by competent and skilled professionals, the City and the Authority do not have the resource network to match Pennsylvania-American in terms of expertise in the field of wastewater service, and anticipated upcoming capital expenditures could exhaust the Authority's resources.³⁴ This acquisition will permit the Authority to take advantage of Pennsylvania-American's financial wherewithal and expertise in operating wastewater utility systems and regulatory compliance.³⁵

b. Benefits to the Public

Pennsylvania-American is better equipped than the Authority to remediate any environmental problems. Pennsylvania-American has a record of environmental compliance, a commitment to invest in necessary capital improvements and resources, and the experienced managerial and operating personnel necessary to provide safe and reliable sewer service to the residents of the Service Area.³⁶ Pennsylvania-American's operations of the System will have the support of Pennsylvania-American's surrounding water and wastewater system operations, as well as its operations throughout the Commonwealth and the nationwide resources of its parent, American Water Works Company, Inc. ("American Water").³⁷ The Service Area is located adjacent to Pennsylvania-American's Mon Valley/Elizabeth and Pittsburgh Operations, and Pennsylvania-American currently provides water service to the Authority's Dravosburg Borough

³⁴ PAWC Statement No. 6, at 8, line 22.

³⁵ PAWC Statement No. 6, at 9, lines 1-3.

³⁶ PAWC Statement No. 1 at 14, 15.

³⁷ PAWC Statement No. 2 at 7.

customers.³⁸ In addition, as a subsidiary of American Water, Pennsylvania-American has access to the highly-trained professionals with expertise in specialized areas and other resources of American Water Works Service Company, Inc.³⁹

The Commission has a longstanding policy in favor of consolidation and regionalization of water and wastewater systems in Pennsylvania.⁴⁰ This policy recognizes the public benefits achievable through economies of scale, shared costs across a broad customer base, and the established expertise of a professional public utility with national resources, access to capital, and operational efficiencies. All of these Commission-recognized benefits are present in this Application.

Additionally, some of the sewer assets to be purchased by Pennsylvania-American are in need of improvements. Pennsylvania-American has the resources to devote substantial capital investments to address deficiencies in the Port Vue, Duquesne, and Dravosburg portions of the System.⁴¹ These improvements will have benefits that extend beyond customers within the Service Area, as environmental contamination and pollution caused by the System is not confined to the Service Area.

The Commonwealth's Constitution includes a right for the people to have "clean air, pure water, and the preservation of the natural, scenic, history and esthetic values of the environment."⁴² All public natural resources within the Commonwealth are "the common

³⁸ PAWC Statement No. 2 at 7.

³⁹ PAWC Statement No. 2 at 5.

⁴⁰ Pennsylvania Public Utility Commission, Final Policy Statement on Acquisitions of Water and Wastewater Systems, Docket No. M-00051926, Final Order at 18 (Aug. 17, 2006) (the "2006 PUC Policy Statement"), 52 Pa. Code § 69.721.

⁴¹ PAWC Statement No. 3 at 11-15.

⁴² PA. CONST. Art. 1, § 27

property of all the people, including generations yet to come.”⁴³ The Commonwealth must act as a trustee of these resources to “conserve and maintain them for the benefit of all the people.”⁴⁴ This Constitutional provision is clear that environmental protection is a public interest and an affirmative public benefit for “all the people” of the Commonwealth.

Pennsylvania-American is in a better position to improve the System to reduce environmental deficiencies and increase environmental compliance because of its above-described technical expertise, access to national resources, and access to capital. Additionally, Pennsylvania-American has experience in bringing noncompliant wastewater systems in the Commonwealth into environmental compliance after acquiring them.⁴⁵ These environmental benefits will accrue to all residents of the Commonwealth.

In approving past applications for the acquisition of a public utility, the Commission has cited as a benefit the acquiring utility’s “size, its considerable experience and technical expertise in the operation and maintenance of wastewater systems, and its superior financial resources” which would better position the utility to “efficiently operate and maintain the combined system, and to successfully fulfill environmental requirements in a safe and economical manner.”⁴⁶ The acquiring utility in that case was also Pennsylvania-American. The Commission in that decision also noted that the addition of tens of thousands of new customers to Pennsylvania-American’s existing customer base would provide “enhanced economies of scale” and “additional revenues” benefiting all Pennsylvania-American customers.⁴⁷ The Commission further recognized that

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ PAWC Statement No. 3-R at 2-3.

⁴⁶ *Joint Application of Pennsylvania-American Water Company and the Sewer Authority of the City of Scranton*, Docket No. A-2016-2537209, Opinion and Order entered October 19, 2016, at 50.

⁴⁷ *Scranton Sewer Authority* slip op. at 50.

existing Authority customers would also benefit from the new economies of scale.⁴⁸ These same benefits apply here – the acquisition will benefit both existing Authority customers, who will benefit from Pennsylvania-American’s expertise, economies of scale, and financial resources, and existing Pennsylvania-American customers, who will benefit from the additional revenues, improved environmental compliance, and growing economies of scale that accompany expansion of service territory.

c. OCA Assertions of a Lack of Public Benefit Should be Given No Weight

In her direct testimony, OCA witness Ashley Everette stated that the proposed transaction was not in the public interest for four reasons: (1) the acquisition results in a loss of ratepayer benefit from PENNVEST grant funds; (2) private ownership is more expensive than public ownership; (3) the acquisition will unfairly burden the ratepayers within Dravosburg and Duquesne; and (4) claims that the acquisition will mitigate the per-customer cost of investment and lower or slow the increase in the cost of operating the system are not supported.⁴⁹

In Ms. Everette’s testimony, she argues that the ratepayers within the Service Area will suffer if the acquisition is approved because Pennsylvania-American is not eligible for the favorable financing terms offered by PENNVEST.⁵⁰ The continued ability of the Authority to incur debt is uncertain. Per the testimony of the Mayor of McKeesport, the Authority was nearing its debt capacity as a result of recent capital expenditures required under Act 537.⁵¹ Low-interest rate loans are not beneficial to an entity not able to borrow additional funds, or to a distressed municipality that cannot repay debt no matter how favorable the terms. Arguing that

⁴⁸ *Scranton Sewer Authority* slip op. at 49-50.

⁴⁹ OCA Statement 1, at 8, lines 20-33.

⁵⁰ *Id.* at 9.

⁵¹ PAWC Statement No. 6, at 8, lines 3-4.

the people of McKeesport and surrounding communities will be better served by the ability to incur debt at favorable interest rates rather than by the removal of blight, the building of parks, and the incentivizing of economic development is an excessively narrow view of public benefit.

Access to capital is important for the owner of a public utility system, as the Commission has recognized.⁵² Pennsylvania-American has access to a \$400 million line of credit through American Water Capital Corp., a wholly-owned subsidiary of Pennsylvania-American's parent company, American Water.⁵³ Pennsylvania-American has a corporate credit rating of "A3" from Moody's Investors Service and an "A" rating from Standard and Poor's Global Ratings.⁵⁴

There is no statutory basis for Ms. Everette's stated preference for public ownership under claim (2) or evidence that, over time, this is a correct assessment. The General Assembly clearly intended to incentivize acquisitions of wastewater systems by either public or private entities. The additional costs of private ownership, including taxes and shareholder profits, can be alleviated or eliminated through strategic financial planning and economies of scale.⁵⁵ If such costs were to be found by the Commission to be evidence of a lack of a public benefit, no transfer of a public utility from a municipal entity to a private entity could ever be approved under Section 1102. This might be an expression of her personal opinion, but this is clearly not the intent of the General Assembly. Ms. Everette's analysis of the implications of these additional costs also does not take into account the benefit to the public of taxes paid by Pennsylvania-American.

⁵² *Scranton Sewer Authority*, slip op. at 46-50.

⁵³ PAWC Statement No. 5 at 4, lines 9-12.

⁵⁴ PAWC Statement No. 5 at 4, lines 14-15

⁵⁵ 2006 PUC Policy Statement.

Ms. Everette's claims regarding the ratepayers within the Boroughs of Dravosburg and Duquesne under claim (3) are utterly without merit. The Authority purchased the wastewater system of Dravosburg in 2011 and the wastewater system of Duquesne in 2010.⁵⁶ The democratically-elected governments of the Boroughs of Dravosburg and Duquesne each voluntarily entered into the agreements to sell their systems at prices they presumably thought to be fair and reasonable. Neither Ms. Everette nor the Office of Consumer Advocate was involved in the sale of these systems, nor do either have direct knowledge of the benefits (other than the purchase price), that accrued to the ratepayers of Dravosburg and Duquesne.⁵⁷ Despite this, Ms. Everette testified that the ratepayers of these systems will be "unfairly and unreasonably burden[ed]"⁵⁸ by this acquisition. This assertion was based solely on the respective ratios of the prior purchase prices to the acquired systems' original depreciated cost compared to the ratio of this acquisition's purchase price to the System's original depreciated cost. This drastic oversimplification not only fails to take into account any of the other benefits that may have been negotiated in the Dravosburg and Duquesne sales, it relies on a valuation calculation (original depreciated cost) that is irrelevant. It is not within the purview of the OCA to question the purchase price for transactions that occurred six and seven years ago outside of its jurisdiction, particularly where they have no information as to the context of why the sales occurred.

This emphasis through OCA's testimony on the ratio of the purchase price to original depreciated cost⁵⁹, used in traditional ratemaking, is entirely misguided in this analysis. Section 1329 set forth a new valuation method for ratemaking because the General Assembly believed

⁵⁶ OCA Statement 1, at 14, lines 13-14.

⁵⁷ Transcript at 180, line 18; at 181, line 1-2; 6-7.

⁵⁸ OCA Statement 1, at 8, lines 28-29.

⁵⁹ See, e.g., OCA Statement 1, at. 12.

the traditional ratemaking valuation to be inadequate.⁶⁰ That the new method results in a different valuation is wholly unsurprising.

Claim (4) will be addressed in the Main Brief of Pennsylvania-American, and the Authority and the City adopt the position of Pennsylvania-American on that issue.

Ms. Everette's many assertions of a lack of public benefit are based on shifting constituencies that defy logic. Her claim based on the loss of PENNVEST grant funds purportedly concerns all ratepayers within the Service Area, but fails to consider the fiscal strain the City is under and how that might impact public services generally in the community. Her claim about private ownership and her claim that other claims of public benefits are unsupported both concern all Pennsylvania-American ratepayers, who will obviously benefit from a larger and more efficient Pennsylvania-American. Her claim about Dravosburg and Duquesne is concerned with only ratepayers within those jurisdictions, and ignores the benefits that will accrue to those ratepayers as a result of, inter alia, capital improvements and the resulting environmental compliance. OCA's arguments rely on both a changing definition of "public" and the contraction of the notion of what is a "benefit" to the head of a pin. These maneuvers allow OCA to argue that there is no public benefit whenever a potentially negative consequence can be identified. This narrow view ignores the larger picture and the long-term focus of the Commission, and it is not how public benefit is typically evaluated – any negative consequences must be weighed against the positive consequences for all constituencies. This is evidence of creative advocacy by Ms. Everette, but not evidence of the lack of a public benefit. Taking this transaction as a whole, it becomes crystal clear that there is a significant affirmative public

⁶⁰ Final Implementation Order at 2.

benefit. Claims by OCA that Pennsylvania-American failed to demonstrate a substantial affirmative public benefit should be given no weight.

3. Cost of Service Studies

The Authority and the City endorse the Main Brief of Pennsylvania-American and adopt the position of Pennsylvania-American as to Cost of Service Studies laid out therein.

B. Section 1329 Approvals

1. Ratemaking rate base

Pennsylvania-American, the City, and the Authority have agreed to use the process presented in Section 1329 of the Public Utility Code, 66 Pa. C.S. § 1329, to determine the fair market value of the wastewater system assets and the ratemaking rate base.⁶¹

a. Section 1329 Process

Section 1329 was enacted by the Commonwealth's General Assembly and signed into law by Governor Tom Wolf on April 14, 2016.⁶² Prior to the passage of Section 1329, original cost less depreciation was the only statutorily permissible method of valuation. Section 1329 was enacted in responses to concerns that under this valuation method, a municipality could not receive true value for its assets, and transactions were rare because a utility may not be able to fully recover its investment.⁶³

Pennsylvania-American and the Authority each engaged the services of a Commission-certified UVE to perform an independent appraisal of the value of the Authority's sewer system

⁶¹ PAWC Exhibit No.1, Application ¶ 2.

⁶² Act of Apr. 14, 2016, P.L. 76, No. 12, Cl. 66, Session of 2016, No. 2016-12.

⁶³ Order entered February 15 at 6.

assets in accordance with USPAP as required by Section 1329.⁶⁴ Pennsylvania-American engaged AUS and the Authority engaged HRG. Both UVEs are on the list of qualified appraisers maintained by the Commission. Neither AUS nor HRG had an affiliation with the Authority or with Pennsylvania-American prior to their engagement.⁶⁵ The Authority and the City understand that the fair market value appraisal of AUS will be discussed at length in the Main Brief of Pennsylvania-American, and will use this brief to discuss the fair market appraisal of HRG.

b. Procedural and Substantive Protections

Section 1329 is structured so as to build into the process multiple layers of protection for the public interest. Under Section 1329, the ratemaking rate base of the wastewater system assets is set based on the lower of the purchase price or the average of two independent fair market value appraisals. Both the buyer and seller must affirmatively opt in to the Section 1329 valuation method for it to be used in a sale. Each of the buyer and the seller then engage a UVE from a list maintained by the Commission of qualified experts. The UVE must be certified by the Commission as a qualified appraiser based upon experience, education, licensure, and certifications.⁶⁶ In addition to technical qualifications, a UVE must acknowledge that it has a fiduciary duty to provide a thorough, objective, and fair valuation to be placed on the Commission's registry of qualified UVEs.⁶⁷ Each UVE then conducts an independent fair market value appraisal of the system assets. The buyer and seller together select a licensed engineer to conduct an assessment of the tangible assets of the seller that is then incorporated into the

⁶⁴ I&E noted in the Hearing that Ms. Vicari was consulting the 2014-2015 version of USPAP, rather than the most up-to-date version from 2016-2017. The most recent version of USPAP is available at <http://www.uspap.org/index.html#4>. The Authority asks the Court *sua sponte* to take notice of the 2016-2017 USPAP standards. OCA and I&E will have the opportunity to argue against taking notice of the 2016-2017 USPAP standards or in favor of the Court's taking notice of additional facts in their respective Reply Briefs in accordance with 52 Pa. Code § 5.408.

⁶⁵ AMV Statement 1 at 4, lines 15-19.

⁶⁶ Final Implementation Order at 9.

⁶⁷ *Id.*

appraisals. To ensure reliability, the UVEs are required to comply with USPAP and utilize three different valuation methods in performing their appraisals. The UVEs are specifically required to consider, but look beyond, original cost. The UVEs have 90 days from their date of hire to complete and provide a copy of their valuations. As an additional layer of consumer protection for the rate base, the results of the appraisals are then averaged. This average will still not control the ratemaking final rate base if the parties have negotiated a lower purchase price, as the lower of the two numbers is used. This is a carefully crafted process that has the potential impact on ratemaking rate base and rates at the forefront. The legislative structure, as implemented by the Final Implementation Order, strikes a calculated balance between the need for communities to obtain the true value of public assets and the potential impact on future rates.

The use of the appraiser's professional judgment is inherent in the appraisal process. Estimates based on professional judgment are required in a number of areas as a result of incomplete information, the impossibility of predicting the future, underlying theories of proper valuation, differing beliefs in appropriate levels of inflation and discount rate, and various unknowns. Decisions have to be made between competing possibilities at multiple points in a valuation process. USPAP deals with such uncertainties by requiring professional appraisals to disclose their assumptions and conform with certain uniform standards and rules. Section 1329 deals with such uncertainties by requiring the use of two independent UVEs, by requiring the UVEs to be prequalified by PUC based upon experience and licensure, by requiring those UVEs to comply with USPAP, by requiring the UVEs to use three different valuation methods pursuant to USPAP in calculating the fair market value recommendation, and by the averaging of the two independent fair market appraisals.

When asked if he was able to identify any abuse of discretion in Ms. Vicari's analysis as a UVE, Glenn Watkins, a witness testifying on behalf of the Office of Consumer Advocate, stated that he was not.⁶⁸ It is simply impermissible for OCA to assert that their judgment should substitute for the judgment of HRG, a Commission-certified qualified appraiser and UVE, with respect to decisions that require professional judgment. Under Section 1329, UVEs are statutorily required to develop their appraisals using USPAP. Not only did OCA not review the appraisals for "compliance with the USPAP standards", it did not consult USPAP at all in making their suggested adjustments to the appraisals.⁶⁹ The end result was that several of OCA's recommended adjustments would require the UVE to violate USPAP in direct contravention of Section 1329 and the intent of the General Assembly for USPAP to provide the standards for the appraisals.⁷⁰ This is at least the third proceeding under Section 1329 before the Commission, yet the OCA continues to ignore the statutory requirements and the Commission's direction to review the appraisals for compliance with USPAP. OCA witnesses should not still be asking UVEs to make adjustments to their approaches piecemeal without considering USPAP requirements.

c. Scope of Review

Section 1329 does not provide a role for I&E or the OCA substituting their judgment regarding appraisal value for that of the certified UVEs. The scope of the Commission's review of the UVE evaluations is laid out in the *New Garden* decision.⁷¹ According to *New Garden*, the Commission should review an independent appraisal conducted under Section 1329 "to

⁶⁸ Transcript at 153, lines 1-4.

⁶⁹ Transcript at 169, lines 1-2.

⁷⁰ See *infra* Section V.B.1.f and V.B.1.g; 66 Pa. C.S. § 1329(a)(3).

⁷¹ *Application of Aqua Pennsylvania Wastewater, Inc. Pursuant to Sections 1102 and 1329 of the Public Utility Code for Approval of its Acquisition of the Wastewater System Assets of New Garden Township and the New Garden Township System*, Docket N. A-2016-2580061 (Opinion and Order entered June 29, 2017) ("*New Garden*").

determine compliance with the USPAP standards and whether the three methods were accurately applied to the UVE's analyses."⁷² This level of review and analysis is appropriate under the statutory scheme, and can be understood as an abuse of professional judgment standard. That this is the appropriate level of review is reflected in the six-month time limit for the Commission to issue a final decision. Where I&E has previously argued that the six-month statutory review period would be an unnecessarily long time limit if all applications were to be granted without some review of the appraisals,⁷³ the Authority and the City submit that the six-month period would be an equally strange time limit if the statutory intent was for all submitted appraisals to undergo a review that second-guesses every independent professional decision made by the certified appraiser.

In compliance with *New Garden*, appropriate review of the fair market appraisals would include review for compliance with USPAP and review for accuracy – factual mistakes or other clear errors in the calculations that have a significant effect on the resulting appraisal. I&E and OCA supplanting the discretionary professional judgment of the UVEs is clearly not permitted. The Commission should reject their efforts.

d. USPAP

I&E and the OCA have not submitted credible evidence that UVEs abused their professional judgment in this case. Neither I&E nor the OCA submitted the testimony of a UVE to opine with respect to compliance with USPAP. Neither I&E nor the OCA reviewed the independent fair market appraisal for compliance with USPAP—indeed, their review and

⁷² *New Garden*, slip op. at 34.

⁷³ *New Garden*, slip op. at 19.

suggested changes ignore USPAP altogether.⁷⁴ Further, neither of their witnesses studied the UVE reports in their entirety. The refusal of both I&E and the OCA to consult USPAP in contravention of the clear statutory language of Section 1329 and the Commission’s opinion in *New Garden* is baffling.

Instead, OCA submitted testimony from Ashley Everette, a Regulatory Analyst employed by OCA, and Glenn Watkins, an economist with an economics and financial consulting firm in Virginia. Neither Ms. Everette nor Mr. Watkins conducted a site visit or any other visual or in-person inspection of the sewer assets.⁷⁵ Neither spoke with management of the Authority or conducted other traditional inspections or interviews required by professional appraisal standards. Neither are a licensed appraiser or a member of the American Society of Appraisers. Neither hold engineering licensure within the Commonwealth. Neither are registered UVEs. Even if Ms. Everette were a registered UVE, she would not meet the independence requirements of Section 1329 since she is employed by OCA.

Rather than reviewing whether HRG’s appraisal was conducted in “compliance with USPAP” or if the three methods were “accurately applied to the UVE’s analysis” as established by *New Garden*, or even speculating whether resulting rates at some future rate case would be “just and reasonable” under Section 1301, Ms. Everette’s stated purpose for recommending adjustments to HRG’s appraisal was to guarantee that the ratemaking rate base is determined on “accurate, unbiased information”,⁷⁶ which she further explained to mean that the appraisals the

⁷⁴ Transcript at 161, lines 9-12 (“Q: ‘Did you follow USPAP in making your suggested adjustments? A: No. My adjustments were not based on a comparison with the Uniform Standards.’”)

Transcript at 145, lines 14-17 (“[Mr. Zambito]: So in this response you say that you did not undertake an analysis of whether the suggested adjustments are in accordance with USPAP? Mr. Watkins: “That’s correct. However, with that being said, this response was filed before I reviewed the USPAP manuals...””).

⁷⁵ Transcript at 153, lines 5-11.

⁷⁶ OCA Statement 1 at 26.

Commission uses to establish the ratemaking rate base don't "favor an adjustment in either direction."⁷⁷ The source of this standard is not clear and has no discernible relationship to Section 1329. Ms. Everette appeared to dismiss traditional indicia of lack of bias, such as an arm's length-negotiated contract, consistent application of uniform professional standards, statutory limits on fees or other material financial benefits, and prohibitions on conflicts of interest or familial relationships, in favor of her own judgment, as an employee of OCA, as to whether the appraisals are unbiased.

The representative from AUS, Mr. Weinert, testified that he believed HRG's fair market appraisal was conducted in conformance with USPAP performance requirements.⁷⁸ Thus, the only evidence before the Commission in this case put forth by a Commission-certified UVE who is an expert in USPAP is that HRG's fair market value appraisal is in compliance with the USPAP standards. Additionally, when asked if HRG had abused its discretion in its fair market appraisal, Mr. Watkins stated that it had not.⁷⁹

OCA's review for accuracy did identify one place where HRG's appraisal included incorrect information. Relying on an Industrial Appraisal dated December 31, 2016, HRG had assumed the Collection System gravity pipelines, NARUC account 361 had a 50-year expected life and were placed into service in 2008.⁸⁰ HRG inadvertently failed to update this information when it received the official inventory used by both UVEs in their fair market appraisals by KLH Engineers, Inc. ("KLH"), received on April 4, 2017.⁸¹ As Ms. Everette notes in her rebuttal testimony, the KLH asset list noted that many of the mains were placed in service in the 1950s,

⁷⁷ Transcript at 160, lines 5-10.

⁷⁸ Transcript at 94, lines 14-22.

⁷⁹ Transcript at 153, lines 1-4.

⁸⁰ Adrienne M. Vicari, P.E. Statement No. 1 ("AMV Statement No. 1") at 7, lines 3-13.

⁸¹ AMV Statement No. 1 at 7, lines 14-18.

1960s, and 1970s, and were still in use.⁸² This information called into question both the in-service date used and the 50-year expected life, as some of the mains had obviously been in used for over 65 years and still had useful life remaining.

During informal discovery, OCA brought this issue to the attention of HRG, and HRG reevaluated the Collection System's in-service dates and reasonable expected life. In keeping with the standard of *New Garden*, once the error was found, HRG moved quickly to correct it. Using professional judgment, HRG concluded that the accumulated depreciation represented 51% of the reproduction cost of the gravity mains.⁸³ HRG adjusted the estimated service life to eighty-five years and obtained bids in the relevant geographic area to obtain accurate unit costs for its Reproduction Cost analysis. HRG, relying on its extensive experience in advising municipalities on constructing and valuing sewer systems and in compliance with USPAP, then added project overhead costs of 20% to account for engineering, construction observation, legal and financing fees that would typically be capitalized as project costs. HRG submitted direct and rebuttal testimony explaining these changes, along with revised Application exhibits. The changes affected both the Cost Approach and Income Approach analysis.

The revised results of the HRG analyses and calculations for each applicable approach are detailed throughout the HRG Report and are summarized as follows:⁸⁴

<u>Valuation Approach</u>	<u>Indicated Value</u>
Market Approach	\$190,130,000
Cost Approach	\$170,040,000
Income Approach	\$212,360,000
Recommendation	\$190,840,000

⁸² OCA Statement IR at 6, lines 13-14.

⁸³ AMV Statement No. 1 at 7, lines 19-22.

⁸⁴ PAWC Application, Appendix A-5at 2 (as revised).

Taking into account the appropriate adjustment to HRG's Cost Approach and Income Approach, HRG arrived at a revised appraisal value of \$190,840,000. For all of the below approaches, HRG relied on and utilized the asset list prepared by KLH in accordance with Section 1329(a)(4).⁸⁵ This inventory included the assets of Port Vue Borough.⁸⁶

e. Market Approach

HRG's Market Approach resulted in a valuation of \$190,130,000. HRG's Market Approach consisted of reviewing comparable transactions in the Commonwealth within a reasonable time period, constructing a sample of recent comparable municipal wastewater acquisitions to approximate the value on a per-customer basis and averaging the findings to arrive at a reasonable average value per customer. This per-customer cost was then multiplied by the number of existing Authority customers. The use of this number reflects an assumption of no customer growth of the twenty-year time span of HRG's analysis. The customer number used was 21,953, the approximate number of current direct and indirect customers. There has been no testimony or other evidence suggesting that this methodology was an abuse of HRG's professional judgment as a UVE or based on inaccurate inputs. Based on comparable transactions, HRG used its judgment as a registered UVE to arrive at an average per customer value of \$8,661. Only one Section 1329 transaction had been completed at the time of this Application, and that transaction was taken into account. That transaction, New Garden, had a much higher per-customer value than the other reviewed transactions, suggesting that an even higher per customer value could reasonably be used. HRG assumed no growth in the system over twenty years and used the current number of customers as supplied by the Authority, 21,953. This resulted in the Market Approach valuation of \$190,130,000.

⁸⁵ Transcript at 112, line 25; at 113, lines 1-2.

⁸⁶ PAWC Statement 7 at 16-17.

OCA also criticized HRG's market valuation for not including PAWC's planned capital improvements.⁸⁷ The transactions in the sample that included capital expenditures did so because such capital improvements were part of the acquisition deal and were reflected in the purchase agreements. The improvements were not speculative or discretionary, but a part of total compensation negotiated for the acquisition and a contractual obligation of the buyer—that is, municipalities presumably⁸⁸ agreed to take a lower amount of cash in exchange for the commitment to make certain future capital improvements.⁸⁹

If HRG were to take into account only the single transaction that was approved after Section 1329 was passed, the per customer cost would be \$14,008⁹⁰, resulting in a Market Approach appraisal of \$307,517,624. Very few reasonably comparable municipal wastewater system transactions occurred in the Commonwealth in recent years, and HRG used its judgment to include in its sample a reasonable representation of comparable market transactions.

OCA initially criticized HRG's Market Approach for using a customer number of approximately 21,953, rather than the individual customer number of 12,780.⁹¹ The higher number takes into account indirect customers of the Authority that receive wastewater treatment through bulk customer service points.⁹² OCA no longer disputes that approximately 21,953

⁸⁷ OCA Statement 1 at 21, lines 17-18.

⁸⁸ Neither HRG nor undersigned counsel were privy to the negotiations of the five transactions.

⁸⁹ Transcript at 105, lines 17-22.

⁹⁰ AMV Statement No. 1R at 3, lines 8-11.

⁹¹ OCA Statement 1S at 17, lines 4-6.

⁹² Transcript at 60, lines 1-17.

customers are served by the Authority and uses this number in its suggested calculation for market value.⁹³

OCA suggested removing capital improvements from the purchase price of the transactions used in the market value approach, resulting in a lower per customer value of \$7,317 and a total market value of \$160,630,101.⁹⁴ Artificially removing components of the total compensation of the transactions in order to arrive at a lower market value is not consistent with USPAP or the statutory requirements. As noted in testimony, any appraisal needs to reflect the changing market conditions as reflected in USPAP Standards Rule 1-3 (a), which requires the consideration of “economic supply and demand” and “market area trends.” The sharp jump in valuation in the New Garden transaction suggests that Section 1329’s passage has had the intended effect of permitting municipalities to obtain true value for their wastewater systems, and HRG’s average per customer value of \$8,661 is reasonable and well within its discretion as a UVE.

OCA has failed to demonstrate any inaccurate information and does not allege any inaccuracy, abuse of professional judgment, or failure of compliance with USPAP in HRG’s Market Approach. Therefore, the Commission should reject OCA’s recommendations as the HRG’s Market Approach, and HRG’s conclusion of \$190,130,000 Market Approach should stand.

⁹³ The system has approximately 12,780 individual customers and eight bulk connections. The 21,953 number reflects that the small number of bulk connections actually reflect thousands of individuals receiving wastewater service from the system. *See* Transcript at 60, lines 20-25; at 61, lines 1-5.

⁹⁴ OCA Statement 1 at 22, lines 1-5.

f. Cost Approach

HRG's revised Cost Approach resulted in a valuation of \$170,040,000 based on an analysis of the reproduction cost of the system less the depreciation.

(i) Overheard Costs

Reproduction costs are intended to represent the costs of identically reproducing the system with the same materials and specifications based on today's prices. To estimate reproduction costs for account 361 assets, HRG used bids from construction firms operating in Western Pennsylvania. These bids only reflected the construction portion of the total project cost; not the full project cost that would be incurred by an entity reproducing the wastewater system. As a professional engineer, Ms. Vicari regularly prepares opinions of probable project cost.⁹⁵ Such opinions include estimates for overhead costs including engineering, inspection, professional fees, and land acquisition. USPAP Standard Rule 1-2(e) requires the appraiser to consider intangible items relative to the assets in addition to the cost of easements, as explained in Ms. Vicari's testimony.⁹⁶ Ms. Everette suggests eliminating all overhead costs from the Cost Approach calculations because "in contrast" to the "detailed breakdown of the cost per linear foot exclusive of overhead,"⁹⁷ Ms. Vicari uses an estimate for the overhead costs. As Ms. Vicari testified, she used her experience as a professional engineer and UVE to arrive at a reasonable estimate of overheard costs.⁹⁸ Again, there is no evidence of an abuse of HRG's professional judgment and OCA did not allege an abuse of professional judgment in including overhead costs.

It is hard to reconcile Ms. Everette's stated desire for "accurate, unbiased" information and her suggestion that the cost of reproducing a wastewater system should be revised to

⁹⁵ See AMV Statement No. 1, MACM Exhibit AMV No. 1.

⁹⁶ MACM AMV Exhibit No. II; AMV Statement No. 1SR at 3, lines 13-34.

⁹⁷ OCA Statement 1R at 8, lines 10-18.

⁹⁸ AMV Statement 1 at 8, lines 8-12; AMV Statement 1SR at 3, lines 13-34.

eliminate costs for overhead because only an estimate of such costs from an experienced professional engineer conducting an independent appraisal is available. A wastewater system that services approximately 22,000 customers is a complex network of personal and real property that includes easements and private, permanent rights-of-way negotiated with individuals and corporate entities. As Ms. Vicari explained in her surrebuttal testimony, this fee also includes costs of construction observation.⁹⁹ An estimate of twenty percent of construction costs for engineering fees, legal fees, easement payments, and other miscellaneous fees to reestablish such a complex network of pipelines and property rights is likely conservative, according to Ms. Vicari. Ms. Everette offers no justification for OCA's position that overhead costs would be nonexistent. Such a position is in violation of the statutorily required USPAP standards because intangible and overhead costs are required to be considered.¹⁰⁰ Ms. Vicari's use of overhead costs should stand.

(ii) *Service Life*

OCA criticizes Ms. Vicari's use of an eighty-five year service life for the Collection System based on assumptions about Ms. Vicari's process for determining such service life.¹⁰¹ Ms. Vicari discussed the condition of the collection system with operating personnel of the Authority and determined that in large part the system is in good repair, regularly flushed, and repaired as needed. She also determined that over 85% of the collection system is constructed with vitrified clay, terra-cotta pipe.¹⁰² Based upon her analysis, conservative estimates for the service life of such pipe range from 100 years to 400 years with proper maintenance.¹⁰³ Given this information, HRG felt comfortable that 85 years was a conservative service life for

⁹⁹ AMV Statement ISR at 3-4.

¹⁰⁰ MACM AMV Exhibit No. II; AMV Statement No. ISR at 3, lines 13-34.

¹⁰¹ OCA Statement 1R at 6-7.

¹⁰² MACM Response to Interrogatories of the Office of Consumer Advocate Set V, OCA-V-5.

¹⁰³ *Id.*

depreciation purposes. OCA did not ultimately make a recommendation of an adjustment to Cost Approach based on a revised service life.¹⁰⁴ Thus, Ms. Vicari's original Cost Approach valuation of \$170,040,000 should stand.

(iii) *Going Value*

As a preliminary matter, Ms. Everette did not review Mr. Watkins' report for accuracy or compliance with USPAP.¹⁰⁵ Despite that, she adopted his report lock, stock, and barrel. Ms. Everette cites Mr. Watkins' testimony regarding the use of a going value add-on in the Income Approach to recommend eliminating any add-on in HRG's Cost Approach. Ms. Everette does not provide any justification or explanation as to why it would be inappropriate to apply the going value add-on to the Cost Approach valuation. USPAP Standard rule 1-4(e) requires an appraiser to consider when analyzing the assemblage of various component parts of a property to also analyze the effect on value, if any, of the assemblage. The going value add-on reflects the value associated with the development of the municipal utility system as an organization and an institution. It is compensation for the up-front investment required for a municipality to establish a utility system.¹⁰⁶ As Ms. Vicari explained in her surrebuttal testimony:

“Going Value is an estimate to reflect the real cost for a start-up business that is not captured in the value of the assets or reflected in the income but for which a seller should receive compensation....The underlying assumption is that a certain level of expense will be incurred that exceeds the revenue growth resulting in cumulative losses during the first years of operation. Going value reflects the value of the going concern, a value not imbedded in the reproduction cost of the assets and needs to be added to reflect the Fair Market Value of the Utility.”¹⁰⁷

HRG, following USPAP, included an additional value for the going value of the wastewater system in its Cost Approach. OCA argues that such a value should not be included in

¹⁰⁴ OCA Statement No. 1R at 8, lines 22-23; at 9, lines 1-5.

¹⁰⁵ Transcript at 165, lines 12-14.

¹⁰⁶ Transcript at 119, lines 1-25.

¹⁰⁷ AMV Statement 1SR at 5, lines 6-8 and 11-14.

the Cost Approach because Mr. Watkins does not believe it should be included in the Income Approach. OCA did not allege an inaccuracy, a violation of USPAP, or an abuse of professional judgment in using the going value add-on. Absent further details on why OCA believes that the Cost Approach should not include the going value of the enterprise, it is impossible to know their reasoning for such exclusion. To maintain compliance with USPAP and avoid complete guesswork on the part of this Commission, a going value add-on must be included in the Cost Approach.¹⁰⁸

Based on OCA's belief that the reproduction costs should not include any overhead costs and that the Cost Approach should not include an amount for going value, OCA recommended a Cost Approach of \$135,202,468. Overhead costs are required to be considered under USPAP. No testimony has been provided to support OCA's recommendation to eliminate going value from HRG's valuation. Therefore, the appropriate Cost Approach is \$170,040,000.

g. Income Approach

HRG's revised Income Approach resulted in a valuation of \$212,360,000.

Mr. Watkins testified that he reviewed the Income Approach utilized by HRG in developing its fair market appraisal.¹⁰⁹ Ms. Everette did not conduct an independent analysis of HRG's Income Approach, but adopted Mr. Watkins' recommendations in her testimony.

As in the Cost Approach, HRG's Income Approach valuation reflected USPAP Rule 1-4(e) by considering the enterprise value of the system through incorporation of a going value add-on. In contrast to Ms. Everette's lack of testimony supporting the conclusion that going value is inappropriate in a Cost Approach analysis, Mr. Watkins provided testimony against

¹⁰⁸ AMV Statement ISR at 4, lines 30-34

¹⁰⁹ Transcript at 142, lines 8-13.

HRG's use of going value in its Income Approach, stating his belief that its use was inappropriate.

Going value/enterprise value has not been part of the Commission's ratemaking formula since the traditional approach relied on depreciated original cost, however, it is an accepted concept in valuations and an important component when valuing municipal systems.¹¹⁰ Section 1329 establishes a new process for arriving at rate base through a valuation based upon USPAP.

Both HRG and AUS gave consideration for going value/enterprise value in their Income Approach valuation, applying USPAP Standards Rule 1-4(e). HRG included this enterprise value as an add-on to the market value developed through both the Cash Flow Basis and the Rate Base and Return Basis. AUS took a different approach, and included enterprise value through the use of a perpetual term in their discounted cash flow calculation.¹¹¹ If going value were to be removed from the valuation, no consideration would be given to the value of the franchise rights, the start-up costs and the initial investments in the System. Mr. Weinert testified that, due to the elimination of going value in the calculations prepared by Mr. Watkins, he did not believe that Mr. Watkins' adjustments "reached a level of fair market value of the business enterprise that's being purchased and sold in this case."¹¹²

As previously mentioned, USPAP does not provide specific formulas for arriving at fair market value, but instead provides standards to which professional appraisers must apply judgment to arrive at a determination of value.¹¹³ In performing independent analysis, both UVEs determined going value/enterprise value to be a component of market value of the utility

¹¹⁰ AMV Statement ISR at 5, lines 5-14.

¹¹¹ Transcript at 86, lines 7-23.

¹¹² Transcript at 86, lines 24-25, at 87 lines 1-14.

¹¹³ AMV Statement ISR, MACM AMV Exhibit No. 1.

under the Income Approach. The going value of the system should not be stripped out of fair market value simply because it was not included in ratemaking rate base prior to the passage of Section 1329. While OCA might be philosophically opposed to the use of fair market value, the General Assembly has made it the law of the Commonwealth.

Mr. Watkins made a variety of other adjustments to the discounted cash flow analysis used by HRG in its income approach. HRG maintains that its approach was accurate and in compliance with USPAP standards, and that its income approach valuation of \$212,360,000 should stand. Even if HRG accepted OCA’s adjustments to its Income Approach—with the exception of the removal of the going value add-on which would result in a direct violation of USPAP—the revised Income Approach valuation would hypothetically be \$185,350,000.¹¹⁴

h. Fair Market Value Appraisal

The revised rounded results of the HRG analyses, are as stated above in Section B.1.d. The Authority and the City believe HRG’s revised appraisal, finding a fair market value of \$190,840,000 is accurate, in compliance with USPAP, and should thus be used for ratemaking rate base purposes.

Even if OCA’s suggested adjustments to the Income Approach are taken into account, the approaches are summarized as follows:¹¹⁵

<u>Valuation Approach</u>	<u>Indicated Value</u>
Market Approach	\$190,140,000
Cost Approach	\$170,040,000
Income Approach	\$185,350,000
Fair Market Value	\$181,840,000¹¹⁶

¹¹⁴ This number reflects OCA’s recommended Income Approach value of \$165,550,000 (OCA Exhibit AEE-1R), plus HRG’s going value addition of \$19,800,000.

¹¹⁵ PAWC Application, Appendix A-5 at 2.

2. DSIC, AFUDC and deferred depreciation

The Authority and the City endorse the Main Brief of Pennsylvania-American and adopt the position as to DSIC, AFUDC, and deferred depreciation laid out therein.

3. Rate Freeze/No Rate Stabilization Plan

Pursuant to the Asset Purchase Agreement, the acquisition will not have any immediate impact on the rates of the Authority customers.

4. Revised *pro forma* tariff supplement

As to the revised *pro forma* tariff supplement, the Authority and the City endorse the Main Brief of Pennsylvania-American and adopt the position laid out therein.

C. Section 507 Approvals

The Authority and the City adopt the position of Pennsylvania-American as to Section 507 approvals.

VI. CONCLUSION

For the reasons set forth above, the Authority and the City support the Application of Pennsylvania-American and request that the Public Utility Commission approve its Application filed pursuant to Sections 1102 and 1329 of the Public Utility Code and issue certificates of public convenience under Section 1102 authorizing Pennsylvania-American to acquire the wastewater system assets of the Authority and begin offering, rendering, furnishing, and supplying wastewater service to the public within the Service Area. Additionally, the Authority requests that the Commission, as part of its Order approving the Application, include a

¹¹⁶ Rounded. The Authority and the City note that, additionally, even if the going value add-on were removed from Cost Approach AND Income Approach (which would be in violation of USPAP), the fair market value average would be approximately \$168,600,000, higher than the \$162,000,000 purchase price.

determination that the ratemaking rate base of the Authority system is \$162,000,000 pursuant to Section 1329(c)(2), and issue any other such approvals, certificates, registrations, and relief, if any, as may be appropriate under the Public Utility Code.

APPENDICES

APPENDIX A: PROPOSED FINDINGS OF FACT

A. Parties

1. This proceeding concerns the Application (the “Application”) of Pennsylvania-American Water Company-Wastewater (“Pennsylvania-American”), filed with the Public Utility Commission (“Commission”) on June 14, 2017, for approval of its acquisition of the wastewater system assets of the Authority (the “System”) pursuant to Sections 1102 and 1329 of the Public Utility Code.

2. Pennsylvania-American is a subsidiary of American Water Works Company, Inc., and the largest regulated public utility corporation in Pennsylvania. It provides water and wastewater service to the public in a service territory encompassing more than 400 communities in 36 counties. It serves a combined population of over 2,300,000. PAWC Statement No. 1 at 13-14.

3. As of December 31, 2016, PAWC furnished wastewater services to 54,691 customers in the Commonwealth and water services to 654,770 customers. PAWC Statement No. 1 at 15.

4. The City is a city of the third class under the Constitution and laws of the Commonwealth of Pennsylvania and the City’s Home Rule Charter. PAWC Exhibit No. 1, Application Appendix A-24, Asset Purchase Agreement (“APA”) p. 1.

5. The City is located in Allegheny County. PAWC Statement No. 6 p. 4. It had 19,731 residents in 2010. PAWC Statement No. 6 at 4.

6. The Authority is a body corporate and politic, duly organized under the Pennsylvania Municipal Authorities Act. APA a 1.

7. The Authority is run by a duly-appointed board, independent of the City. Transcript of Evidentiary Hearing of August 3, 2017 (“Transcript”) at 80.

8. I&E is the prosecutory bureau within the Public Utility Commission for purposes of representing the public interest in ratemaking and service matters.

9. OCA is an agency created by Act 161 of 1976 to represent the interests of consumers before the Pennsylvania Public Utility Commission.

B. The MACM System

1. The Authority currently provides wastewater service to approximately 12,780 customers (approximately 21,953 including indirect customers receiving bulk service),

including within the City of McKeesport, the City of Duquesne, Port Vue Borough, the Borough of Dravosburg, and a portion of West Mifflin Borough, Allegheny County, Pennsylvania and to three bulk service interconnection points located in Liberty Borough, White Oak Borough, and North Versailles Borough, Allegheny County, Pennsylvania (collectively, the “Service Area”).

2. The Authority accepts and treats bulk sewage from eight communities via direct or adjoining municipal sewer systems. Three of these interconnections are located slightly outside of the applied-for service territory, and Pennsylvania-American has requested Commission approval to continue providing bulk service at these points of interconnection. PAWC Statement No. 1 at 19.

C. The Asset Purchase Agreement and the First Amendment to the Asset Purchase Agreement

1. Pennsylvania-American proposes to acquire the wastewater assets owned by the Authority for \$162 million. Pennsylvania-American submitted the winning bid after an extensive process using a competitive bidding structure. The Asset Purchase Agreement was negotiated with all bidders at arm’s length prior to the bidding. PAWC Exhibit No. 1, Application ¶¶ 23-24.

2. The Asset Purchase Agreement among the Authority, the City, and Pennsylvania-American was the result of a bidding process with multiple steps that took over a year. PAWC Exhibit No. 1, Application, Appendix A-24.

3. The Authority first issued a Request for Qualifications (“RFQ”) to vet potential bidders on the system in June of 2015. PAWC Statement No. 6, at 9, line 13-14.

4. Pre-qualified bidders who were deemed eligible to bid based on their demonstrated technical and financial qualifications detailed in a response to the RFQ were the only entities permitted to respond to the Request for Bids (“RFB”), which was issued on February 26, 2016. PAWC Exhibit MEC-1.

5. Pennsylvania-American submitted information as to their qualifications to the Authority and the City in response to the RFQ. This information was reviewed by the Authority, the City, and their financial and legal professional advisors, who determined that Pennsylvania-American was qualified to be certified as a Pre-Qualified Proposer for the RFB process. PAWC Exhibit MEC-3.

6. On September 9, 2016, the Authority and Pennsylvania-American entered into the Asset Purchase Agreement (“APA”) for the sale of substantially all of the assets, properties and rights of the System to PAWC for an agreed-upon price. PAWC Statement No. 1 at 8.

7. When Pennsylvania-American was advised that the Authority’s UVE had appraised the System as having a fair market value of \$207,010,000, the Authority, the City and Pennsylvania-American negotiated the First Amendment to the APA. PAWC Statement No. 1 at 11-12; PAWC Statement No. 1-R at 9.

8. On May 15, 2017, the City, the Authority and Pennsylvania-American entered into the First Amendment to the APA, which revised the purchase price of the System to be \$162,000,000. PAWC Statement No. 1 at 8.

9. Following the execution of the First Amendment to the APA, the UVEs were advised of the new purchase price, and were given an opportunity to adjust their appraisals, as appropriate, in their independent discretion. PAWC Statement No. 1 at 12.

10. In May of 2017, Pennsylvania-American's UVE subsequently re-appraised the System. At that time, he found that the System has a fair market value of \$161,343,000. Application, Attachment A-5 (correspondence dated May 17, 2017 p. 1).

11. The Authority's UVE did not re-appraise the System following the negotiation of the First Amendment to the APA. During discovery, however, it was determined that the Authority's UVE understated the age of the collection system. Upon further review, the Authority's UVE appraised the System as having a fair market value of \$190,840,000. MACM Statement No. 1 at 6-7.

12. The Authority will receive a portion of the purchase price under the APA. APA Section 3.02. Some of these proceeds will be used to pay off debt. APA Section 3.02(c). The Authority will then be dissolved and terminated. PAWC Statement No. 6 Exh. MEC-3.

13. The City will receive a portion of the purchase price under the APA. APA Section 3.02. The City will use these funds to balance the budget, invest in infrastructure improvements, market the City and improve services to existing businesses and residents. PAWC Statement No. 6 at 9.

D. The Application and the UVE's Appraisals

1. The Application was filed May 24, 2017. Application (correspondence dated May 24, 2017).

2. On June 3, 2017, the Commission's Bureau of Technical Utility Services notified Pennsylvania-American that it believed the Application did not contain certain information. PAWC Response to Bureau of Technical Utility Service's Deficiency Letter (Correspondence dated June 8, 2017 p. 2).

3. Pennsylvania-American responded to TUS's "Deficiency Letter" on June 8, 2017. PAWC Response to Bureau of Technical Utility Service's Deficiency Letter (Correspondence dated June 8, 2017 p. 2).

4. The Commission acknowledged receipt of the complete Application on June 14, 2017. Secretarial Letter dated June 14, 2017.

5. Notice of the Application was published in the *Pennsylvania Bulletin* on June 24, 2017. 47 Pa. B. 3568.

6. As required by Section 1329, the parties to the APA engaged an engineer (KLH Engineers) to conduct an assessment of the tangible assets of the System. PAWC Statement No. 7 at 13, 16.

7. As required by Section 1329, the Application included the appraisals of Pennsylvania-American's UVE and the Authority's UVE. Application, Attachment A-5.

E. Witness Qualifications

1. The Authority's UVE is Herbert, Rowland & Grubic, Inc. ("HRG"). MACM Statement No. 1 at 2

2. HRG is on the Commission's registry of UVEs. MACM Statement No. 1 at 2.

3. Adrienne M. Vicari, P.E., manages the Financial Services Group as the Financial Services Practice Area Leader for Herbert, Rowland & Grubic, Inc. She is a Professional Engineer with licenses in the Commonwealth of Pennsylvania and the State of Ohio. MACM Exhibit AMV No. 1 to AMV Statement No. 1.

4. HRG's appraisal of the System was prepared by staff under the supervision of Ms. Vicari. MACM Statement No. 1 at 6.

5. PAWC's UVE is Associated Utility Services, Inc. ("AUS"). PAWC Statement No. 7 at 13.

6. AUS is on the Commission's registry of UVEs. PAWC Statement No. 7 at 6-7.

7. Jerome C. Weinert, ASA, PE, CDP, is a Principal and Director in AUS's consulting operation. PAWC Statement No. 7 at 2. He has been an Accredited Senior Appraiser in the American Society of Appraisers since 1982. PAWC Statement No. 7 at 3.

8. AUS's appraisal of the System was prepared by, or under the supervision of, Mr. Weinert. PAWC Statement No. 7. at 12.

9. OCA introduced the testimony of Ashley E. Everette, who is not registered with the Commission as a UVE. Transcript at 156.

10. Ms. Everette is not a licensed appraiser. Transcript at 160.

11. OCA introduced the testimony of Glenn A. Watkins, who is not registered with the Commission as a UVE. Transcript at 140.

12. Mr. Watkins is not a licensed appraiser. Transcript at 140; PAWC Statement No. 7-R, Exh. JCW-3 (answer to Interrogatory No. 14).

F. PAWC's Financial Fitness

1. Pennsylvania-American has access to a \$400 million line of credit through American Water Capital Corp., a wholly-owned subsidiary of Pennsylvania-American's parent company American Water Works Service Company, Inc. PAWC Statement No. 5 at 4, lines 9-12.

2. Pennsylvania-American has a corporate credit rating of "A3" from Moody's Investors Service and an "A" rating from Standard and Poor's Global Ratings. PAWC Statement No. 5 at 4, lines 14-15

3. Pennsylvania-American is a large, financially sound company that has the capability to finance necessary capital additions. Given its size, access to capital and recognized strengths in system planning, capital budgeting and construction management, PAWC is well-positioned financially to provide wastewater service meeting all federal and state requirements. PAWC Statement No. 5 at 3.

G. PAWC's Technical Fitness

1. Pennsylvania-American is the largest water and wastewater provider in Pennsylvania. PAWC Statement No. 1 p. 17. Pennsylvania-American currently operates 16 wastewater treatment plants in Pennsylvania. PAWC Statement No. 2 at 4; PAWC Statement No. 3 at 27.

2. Pennsylvania-American employs approximately 1,000 professionals with expertise in all areas of water and wastewater utility operations. PAWC Statement No. 1 at 14.

3. As a subsidiary of American Water, Pennsylvania-American has available to it the resources of American Water Works Service Company, Inc., which provides access to highly-trained professionals with expertise in specialized areas. When operational issues arise and facilities owned by Pennsylvania-American, the company mobilizes engineering talent from its central engineering team, drawing on resources from the Service Company team, to identify potential problems, recommend options, and develop action plans. PAWC Statement No. 2 at 5.

4. Pennsylvania-American has an ongoing program of capital investment focused on systematically replacing and adding new pipes and other infrastructure. PAWC Statement No. 3 at 18. Pennsylvania-American has funded more than \$1 billion in infrastructure investment in the past five years. PAWC Statement No. 3-R at 7.

5. Pennsylvania-American has experience working through transitions, and has already implemented a plan to integrate Authority employees, customers, and the Authority system into Pennsylvania-American's operations. PAWC Statement No. 2 at 10.

6. Pennsylvania-American maintains cyber security, physical security, business continuity and emergency plans. PAWC Statement No. 2 at 16.

7. Pennsylvania-American has strong relationships with PUC Emergency Response Staff, PEMA and local first responders. PAWC Statement No. 2 at 17.

8. Pennsylvania-American participates in the PA One Call system. PAWC Statement No. 2 at 18.

H. PAWC's Legal Fitness

1. Pennsylvania-American is a Commission-regulated public utility with a good compliance history. PAWC Statement No. 1 at 17.

2. Pennsylvania-American has the expertise, the record of environmental compliance, the commitment to invest in necessary capital improvements and resources, and experienced managerial and operating personnel necessary to provide safe and reliable sewer services to the residents of the Service Area. PAWC Statement No. 1 at 14, 15.

I. Affirmative Public Benefits of a Substantial Nature

1. The transaction fosters the Commission goal of regionalizing wastewater systems to provide greater environmental and economic benefits to customers. PAWC Statement No. 1 at 16.

2. After closing, the System will be operated as a standalone system. PAWC Statement No. 2 at 7. It will, however, have the support of Pennsylvania-American's surrounding water and wastewater system operations, as well as Pennsylvania-American's operations throughout the Commonwealth and American Water's nationwide resources. PAWC Statement No. 2 at 8.

3. Pennsylvania-American owns and operates water and wastewater facilities near McKeesport in the Pittsburgh Area and Southwestern Pennsylvania. PAWC Statement No. 2 at 6-7. The System is located adjacent to Pennsylvania-American's MonValley/Elizabeth and Pittsburgh operations. Pennsylvania-American provides water service to the Authority's Dravosburg Borough customers. PAWC Statement No. 2 at 7.

4. Pennsylvania-American has experience with the types of treatment technologies employed in the System, which involve activated sludge and SBR units similar to existing Pennsylvania-American plants. PAWC Statement No. 2 at 4-5.

5. Pennsylvania-American has experience operating a CSO system – the Scranton wastewater system. Pennsylvania-American also has experience operating a system that has substantial wet weather challenges due to high rates of infiltration and inflow. PAWC Statement No. 2 at 11, 26.

6. Although some public benefits are not capable of precise measurement, they are nevertheless real, supported, and not generalized. The Commission does not require benefits to be quantifiable. PAWC Statement No. 1-R at 4.

7. Portions of the System are in disrepair, Tr. 44, and Pennsylvania-American has made commitments to improve the System, including extensions of the System to eliminate sanitary flows discharged untreated into mine holes. PAWC Statement No. 1 at 13; PAWC Statement No. 3 at 11-15.

8. Pennsylvania-American has the resources to devote substantial capital investments to address deficiencies in the Port Vue, Duquesne, and Dravosburg portions of the System. PAWC Statement No. 1-R at 11.

9. Pennsylvania-American is better positioned than the Authority to deal with environmental problems of the System. PAWC Statement No. 3-R at 5, 6-8

10. Pennsylvania-American has a credit rating of A3 from Moody's and has access to equity markets that are unavailable to the Authority. PAWC Statement No. 3-R at 7-8

11. The Authority is reaching its debt capacity, due to expansions required by Act 537. PAWC Statement No. 6 at 8. The Authority also has the burden of meeting employee benefits and pension obligations. PAWC Statement No. 8.

12. Pennsylvania-American is in a better situation than the Authority to address the deficiencies and operate the system going forward, due to Pennsylvania-American's greater financial resources, including access to capital, and greater expertise in operating wastewater systems. PAWC Statement No. 3-R at 2.

13. Because of its large size and expertise and economies of scale, Pennsylvania-American will be able to improve efficiencies and lower costs that would otherwise be incurred to operate the System and fund necessary improvements to the System. These efficiencies will keep rates lower for System customers than would be the case if they were forced to go it alone. PAWC Statement No. 3-R at 8.

14. Pennsylvania-American has committed to offer employment to eligible Authority employees following closing. PAWC Statement No. 2 at 15.

15. The median household income in the City of McKeesport is \$23,715, and the median income for a family is \$31,577. PAWC Statement No. 6 at 5, lines 19-21. The retention of these good-paying, family-sustaining jobs is a significant benefit to the community and will ensure managerial and operational continuity for the System.

16. Pennsylvania-American provides enhanced and proven customer service, including access to Pennsylvania-American's customer assistance program and Pennsylvania-American's customer dispute resolution process. PAWC Statement No. 1 at 16; PAWC Statement No. 2 at 20.

17. I&E witness Cline admitted that the transaction benefits the customers of the System. I&E Statement No. 2 at 6.

18. Rates for Pennsylvania-American's existing customers will not increase in the short term due to the Transaction. PAWC Statement No. 4 at 8-9.

19. Authority assets have not been included in Pennsylvania-American's current base rate proceeding. PAWC Statement No. 1-R at 6.

20. The Transaction would add 22,000 direct or indirect customers to Pennsylvania-American's existing wastewater customer base of 54,691. PAWC Statement No. 1-R at 13 and PAWC Statement No. 2 at 6-7.

21. By adding additional connections to the entire Pennsylvania-American system, there are more customers to share future infrastructure investment costs, which promotes stable rates across the entire Pennsylvania-American system. Customers who benefit from near-term improvements will one day help pay for improvements on behalf of other customers on other parts of the Pennsylvania-American system. PAWC Statement No. 1 at 16-17. PAWC Statement No. 1-R at 5.

22. By enacting Section 1329 and Section 1311(c), the Pennsylvania General Assembly intended to facilitate the acquisition of municipal water and wastewater systems by investor-owned utilities. PAWC Statement No. 1 at 17.

J. Cost of Service Studies

The Authority and the City adopt and endorse Section A.10 of the Proposed Findings of Fact of Pennsylvania-American.

K. Ratemaking Rate Base

1. The Purchase price of the System, pursuant to the First Amendment to the APA, is \$162,000,000, which is lower than the average of the two UVE's appraisals (\$176,091,500). PAWC Statement No. 4 at 3.

2. AUS's appraisal was prepared in compliance with USPAP. PAWC Statement No. 7 at 13.

3. In compliance with Section 1329, AUS's appraisal used three approaches to value the System: cost, market and income approaches. PAWC Statement No. 7 at 14.

4. HRG's appraisal was prepared in compliance with the USPAP. MACM Statement No. 1 at 9.

5. In compliance with Section 1329, HRG's appraisal used three approaches to value the System: cost, market and income approaches. MACM Statement No. 1 at 6.

6. Ms. Everette's proposed adjustments to HRG's appraisal are not based on USPAP. Transcript at 161.

7. Ms. Everette did not use the cost, income and market approaches to value the System. She only considered HRG's market and cost approaches. OCA Statement No. 1 at 19-24.

8. Mr. Watkins' proposed adjustments to the appraisals prepared by HRG and AUS were not based on USPAP. Transcript at 141; PAWC Statement No. 7-R, Exh. JCW-3 (answer to Interrogatory No. 9).

9. Mr. Watkins did not review USPAP prior to recommending adjustments in the appraisals prepared by AUS and HRG. Transcript at 145.

10. Mr. Watkins did not use the cost, income and market approaches to value the System. He only reviewed the income approaches of Pennsylvania-American's UVE and the Authority's UVE.

11. HRG's use of \$8,661 average per customer value for its market approach analysis is reasonable, within its professional judgment as a UVE, and consistent with USPAP. AMV Statement No. 1R at 3.

12. HRG's inclusion of overhead costs and going value add-ons in its Cost Approach is a matter of professional judgment and consistent with USPAP. MACM AMV Exhibit No. II; AMV Statement No. 1SR at 3, lines 13-34.

13. The income approach model used by HRG and the going value add-on used therein included assumptions within HRG's professional judgment and in compliance with USPAP.

14. Going value must be considered under USPAP. AMV Statement 1SR at 5, lines 5-14.

15. Section 1329 valuation methods almost always result in a higher valuation than depreciated original cost. PAWC Statement No. R-4 at 19; Transcript at 176-177; 182

16. Professional judgment was exercised in developing the appraisal. PAWC Statement No. 7 at 17. An appraiser/UE has a reasonable range of judgment. PAWC Statement No. 7-R at 11.

L. Rate Stabilization Plan

The Authority and the City adopt and endorse the Section entitled “Rate Stabilization Plan” of the Proposed Findings of Fact of Pennsylvania-American.

M. DSIC, AFUDC and deferred depreciation

The Authority and the City adopt and endorse the Section entitled “DSIC, AFUDC, and Deferred Depreciation” of the Proposed Findings of Fact of Pennsylvania-American.

N. Rates

The Authority and the City adopt and endorse the Section entitled “Rates” of the Proposed Findings of Fact of Pennsylvania-American.

O. Municipal Agreements

The Authority and the City adopt and endorse the Section entitled “Municipal Agreements” of the Proposed Findings of Fact of Pennsylvania-American.

APPENDIX B. PROPOSED CONCLUSIONS OF LAW

A. Commission Jurisdiction

The Commission has jurisdiction over the parties and the subject matter of this proceeding. 66 Pa. C.S. §§1102 , 1103 and 1329.

B. Burden of Proof

1. The burden of proof rests with Pennsylvania-American as the party seeking a proposed rule or order. 66 Pa. C.S. §§ 315(c) and 332.

2. “Burden of proof” means a duty to establish a fact by a preponderance of the evidence, meaning that the party has presented evidence which is more convincing than the evidence by the opposing property. *Se-Ling Hosiery v. Margulies*, 70 A.2d 854 (Pa. 1950)

3. Any finding of fact necessary to support an adjudication of the Commission must be based upon substantial evidence, which is such relevant evidence as a reasonable mind might accept as adequate to support a conclusion. *Edan Transportation Corp. v. Pa. P.U.C.*, 623 A.2d 6 (Pa. Cmwlth. 1993); 2 Pa.C.S. § 704.

C. Legal Standards

1. The Public Utility Code requires Commission approval in the form of a certificate of public convenience for Pennsylvania-American to expand its service territory and to acquire property used or useful in the public service. 66 Pa.C.S. §§ 1102(a)(1) and 1102(a)(3).

2. The Commission will issue a certificate of public convenience pursuant to Section 1102 only if the Commissions finds that the granting of such certificate to Pennsylvania-American “is necessary or proper for the service, accommodation, convenience, or safety of the public.” 66 Pa.C.S. § 1103(a).

3. Pennsylvania-American must make a showing that the proposed transaction will “affirmatively promote the ‘service, accommodation, convenience, or safety of the public’ in some substantial way.” *City of York v. Pennsylvania Pub. Util. Comm’n*, 449 Pa. 136, 141, 295 A.2d 285, 828 (1972) (quoting 66 Pa.C.S.A. § 1103).

4. Pennsylvania-American must be technically, legally, and financially fit. *Joint Application of Peoples Natural Gas Company LLC, Peoples TWP LLC, and Equitable Gas Company, LLC*, Docket No. A-2013-2353647, 309 P.U.R.4th 213 (2013).

5. As an existing provider of public utility service, Pennsylvania-American is presumed fit based on its certification. *In re Pennsylvania-American Water Company*, 85 Pa. P.U.C. 548 (1995).

6. No party rebutted the presumption of fitness and Pennsylvania-American established its technical, legal, and financial fitness by a preponderance of the evidence and substantial evidence

7. Pennsylvania-American has the technical, legal, and financial fitness to acquire the Authority's wastewater system and initiate wastewater service in the Service Area.

8. Pennsylvania-American demonstrated through a preponderance of the evidence and substantial evidence that its acquisition of the Authority's wastewater system will affirmatively promote the service, accommodation, convenience, or safety of the public in substantial ways.

9. The Commission, as a trustee under the Environmental Rights Amendment, has an affirmative duty in its consideration of the application to consider the degradation, diminution, and depletion of the Commonwealth's public natural resources. PA. CONST. Art. 1, § 27; *see also Pa. Environmental Defense Foundation v. Cmwlth. of Pa.*, No. 10 MAP 2015 (Pa., Slip Op. issued Jun. 20, 2017), p. 32 (*citing Robinson Twp.*, 83 A.3d 901, 957 (Pa. 2013)).

10. Pennsylvania-American is better capable than the Authority to prevent the degradation, diminution, and depletion of the Commonwealth's public natural resources.

11. Pennsylvania-American's acquisition of the Authority's wastewater system and initiation of wastewater service in the Service Area will further the public interest.

12. Section 1329 provides an alternative method of valuation for municipal or authority-owned water and wastewater systems acquired by investor-owned water and wastewater utilities. Under Section 1329, an acquiring entity may establish ratemaking rate base with fair market valuation rather than requiring it be tied to the original cost of construction of the facilities. *Application of Aqua Pennsylvania Wastewater, Inc. Pursuant to Sections 1102 and 1329 of the Public Utility Code for Approval of its Acquisition of the Wastewater System Assets of New Garden Township and the New Garden Township Sewer Authority*, Docket No. A-2016-2580061, Opinion and Order entered February 15, 2017 ("New Garden Feb. Order"), slip op. at 5.

13. Fair market value is defined as the average of two fair market value appraisals, one commissioned by the buyer and one by the seller. 66 Pa. C.S. § 1329(g). The appraisals must be performed by UVEs who are chosen from a list of qualified UVEs maintained by the Commission. 66 Pa. C.S. § 1329(a)(1).

14. Under the Commission's *Final Implementation Order* implementing Section 1329, UVEs must establish their qualifications, have utility valuation experience, and conduct their evaluations in accordance with accepted standards. *Final Implementation Order, Implementation of Section 1329 of the Public Utility Code*, Pennsylvania Public Utility Commission, at Docket No. M-2016-2543193 at 4-5.

15. Section 1329 is a voluntary process that both buyer and seller must opt into in order to use. Section 1329 was enacted in responses to concerns that under this valuation method, a municipality could not receive true value for its assets, and transactions were rare because a utility may not be able to fully recover its investment. *Final Implementation Order* at 1.; *New Garden Feb. Order*, slip op. at 6.

16. Section 1329 includes a streamlined timeline for the entire process, including a 90-day limit for the appraisals and a deadline for Commission approval of the transaction of six months from the date of application. 66 Pa. C.S. § 1329(a)(5) and (d)(2).

17. Pursuant to the Commission's decision in *New Garden*, UVE appraisals should be reviewed only for accuracy and for compliance with USPAP. *New Garden*, slip op. at 34. This can be understood as an abuse of professional judgment standard.

18. There is no evidence in the record that the revised AUS and HRG appraisals are inaccurate or not in compliance with USPAP, and no allegations of an abuse of professional judgment.

19. The ratemaking rate base determined pursuant to Section 1329(c)(2) of the Public Utility Code is \$162,000,000, being the lesser of (i) the revised purchase price of \$162,000,000 negotiated by Pennsylvania-American, the City, and the Authority and (ii) the average of the fair market value appraisals, \$176,091,500.

20. Pennsylvania-American's proposed rate base value of \$162,000,000 is reasonable and in compliance with 66 Pa. C.S. § 1329.

APPENDIX C: PROPOSED ORDERING PARAGRAPHS

IT IS ORDERED:

1. That the Application filed by Pennsylvania-American on May 24, 2017 is granted.
2. That the Secretary's Bureau shall issue Certificates of Public Convenience under 66 Pa. C.S. §§ 1102(a) and 1103(a) evidencing Commission approval of: (a) the transfer, by sale, of substantially all of the Authority's assets, properties and rights related to the System to Pennsylvania-American; and (b) Pennsylvania-American's right to begin to offer, render, furnish and supply wastewater service in the areas served by the Authority in the City of McKeesport, the City of Duquesne, Port Vue Borough, and the Borough of Dravosburg, and a portion of West Mifflin Borough, Allegheny County, Pennsylvania and to three bulk service interconnection points located in Liberty Borough, White Oak Borough, and North Versailles Borough, Allegheny County, Pennsylvania.
3. That Pennsylvania-American shall, upon closing of the Transaction, be permitted to issue a compliance tariff supplement, consistent with the *pro forma* tariff supplement contained as Appendix A-13 of the Application (as modified by PAWC Exhibit RPN-1), to be effective on the date of issuance.
4. That, under 66 Pa. C.S. § 1329(c), a rate base addition of \$162,000,000 associated with the acquisition of the System is approved.

5. That, under 66 Pa. C.S. § 1329(d), Pennsylvania-American may collect a DSIC related to the System prior to the first base rate case in which the System plant-in-service is incorporated into rate base, subject to the conditions that Pennsylvania-American file, and the Commission approve, an amended wastewater LTIP incorporating the McKeesport area and that, upon Commission approval of the amended LTIP, Pennsylvania-American make a compliance tariff supplement filing incorporating the McKeesport area into Pennsylvania-American's existing wastewater DISC tariff provisions.

6. That, under 66 Pa. C.S. § 1329(f), Pennsylvania-American may accrue AFUDC for post-acquisition improvements not recovered through the DSIC for book and ratemaking purposes.

7. That, under 66 Pa. C.S. § 1329(f), Pennsylvania-American may defer depreciation related to post-acquisition improvements not recovered through the DSIC for book and ratemaking purposes.

8. That the Secretary's Bureau shall issue Certificates of Filing for the following agreements between Pennsylvania-American and a municipal corporation:

a. Asset Purchase Agreement By and Among the City of McKeesport, The Municipal Authority of the City of McKeesport, as Seller, and Pennsylvania-American Water Company, as Buyer, Dated as of September 9, 2016, as amended by First Amendment to the Asset Purchas Agreement, Dated as of May 15, 2017, along with related City of McKeesport General Obligation Note, Series of 2016, No. R-1, related Intercept Agreement, Dated November 30, 2016, and related Second Deposit Note, which is yet to be executed;

b. Service Agreement By and Among The Municipal Authority of the City of McKeesport and Liberty Borough, Dated as of July 28, 2010;

c. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and Liberty Borough, Dated as of July 28, 2008;

d. Service Agreement By and Among The Municipal Authority of the City of McKeesport and Lincoln Borough, Dated as of September 15, 2009;

e. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and Lincoln Borough, Dated as of September 15, 2009;

f. Service Agreement By and Among The Municipal Authority of the City of McKeesport and Elizabeth Township, Dated as of October 14, 2008;

g. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and Elizabeth Township, Dated as of October 14, 2008;

h. Service Agreement By and Among The Municipal Authority of the City of McKeesport and The Municipal Authority of Westmoreland County for White Oak Borough, Dated as of August 2009;

i. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and The Municipal Authority of Westmoreland County for White Oak Borough, Dated as of August 2009;

j. Service Agreement By and Among The Municipal Authority of the City of McKeesport, North Versailles Township, and The North Versailles Township Sanitary Authority, Dated as of October 1, 2008;

k. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport, North Versailles Township, and The North Versailles Township Sanitary Authority, Dated as of August 21, 2008;

l. Service Agreement By and Among The Municipal Authority of the City of McKeesport and East McKeesport Borough, Dated as of September 11, 2008;

m. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and East McKeesport Borough, Dated as of August 2008;

n. Service Agreement By and Among The Municipal Authority of the City of McKeesport and Versailles Borough, Dated as of October 22, 2008;

o. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and Versailles Borough, Dated as of October 22, 2008;

p. Service Agreement By and Among The Municipal Authority of the City of McKeesport and Glassport Borough, Dated as of August 19, 2008; and,

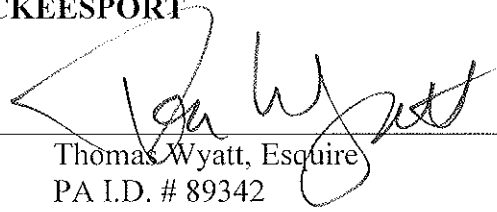
q. Corrective Action Agreement By and Among The Municipal Authority of the City of McKeesport and Glassport Borough, Dated as of August 19, 2008.

9. That all other approvals or certificates appropriate, customary or necessary under the Code to carry out the Transaction contemplated in the Application in a lawful manner are granted.

Respectfully submitted,

**THE MUNICIPAL AUTHORITY OF THE CITY OF
MCKEESPORT**

By

A handwritten signature in black ink, appearing to read "Tom Wyatt", is written over a horizontal line.

Thomas Wyatt, Esquire

PA I.D. # 89342

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*Counsel for the Municipal Authority of the City of
McKeesport*

Date: August 22, 2017

CERTIFICATE OF SERVICE

I hereby certify that I have this 22nd day of August, 2017, served a true and correct copy of the foregoing Main Brief of the Municipal Authority of the City of McKeesport and the City of McKeesport, upon the persons and in the manner set forth below:

VIA ELECTRONIC AND 1ST CLASS MAIL

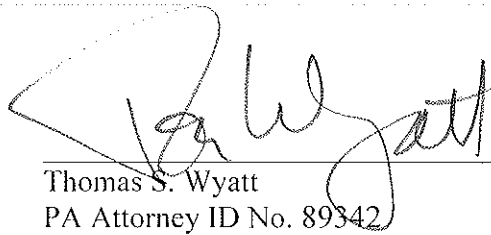
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