Dilworth Paxson LLP

DIRECT DIAL NUMBER:
(215) 575-7286

Thomas S. Wyatt
twyatt@dilworthlaw.com

September 5, 2017

VIA E-FILING
Secretary Rosemary Chiavetta
Pennsylvania Public Utility Commission
400 North Street, 2nd Floor North
P.O. Box 3265
Harrisburg, PA 17105-3265

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 Secretary Chiavetta:

Enclosed please find our Joint Reply Brief on behalf of the Municipal Authority of the City of McKeesport and the City of McKeesport in the above-captioned proceeding:

Should you have any questions or concerns, please contact me at 215-575-7286.

Very truly yours,

/s/ Thomas S. Wyatt
Thomas S. Wyatt

cc: Administrative Law Judge Mark A. Hoyer
Administrative Law Judge Mary D. Long
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 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

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

Thomas Wyatt, Esquire
PA I.D. # 89342
Dilworth Paxson LLP
1500 Market Street, Suite 3500E
Philadelphia, PA 19102
(215) 575-7286
twyatt@dilworthlaw.com

Attorney for the City of McKeesport and the Municipal Authority of the City of McKeesport

DATED: September 5, 2017

Table of Contents

Table of Citations

Cases

Statutes

Regulations

Rules

I. INTRODUCTION

This proceeding concerns the Application (the "Application") of Pennsylvania-American Water Company-Wastewater ("Pennsylvania-American"), filed with the Public Utility Commission ("Commission") for approval of its acquisition of the wastewater system assets (the "System") of the Municipal Authority of the City of McKeesport (the "Authority") pursuant to Sections 1102 and 1329 of the Public Utility Code.

Pursuant to the procedural schedule established and in accordance with Commission Regulations at Section §5.501, the Authority and the City of McKeesport (the "City") hereby jointly submit this Reply Brief.

This Reply Brief is supplemental to Main Brief of the Authority and the City and is limited to those matters that require additional discussion as a result of the Main Briefs filed by the Office of Consumer Advocate ("OCA") and Bureau of Investigation and Enforcement ("I&E").

II. SUMMARY OF ARGUMENT

A. Reply to I&E Main Brief

I&E offers insufficient support for its claims regarding the public benefit of the proposed transaction, relying on innuendo and misleading information. I&E also relies on misleading or irrelevant information in its criticisms of HRG's appraisal, which is made clear by its lack of recommended substantive changes. I&E's argument against using a going value add-on is unsupported, and its criticisms concerning the version of USPAP used by HRG have no practical effect. I&E's recommended adjustments should be rejected.

B. Reply to OCA Main Brief

Pennsylvania-American has provided significant evidence as to the many public benefits of this transaction. OCA refuses to acknowledge any of the public benefits established by

Pennsylvania-American, even those benefits that have been previously recognized by the Commission and are supported by the record, and even those benefits recognized by I&E as applicable in this transaction. Citing only possible negative, and ignoring all positive, consequences, OCA wrongly concludes that there is no public benefit. The record of this case clearly supports a finding of an affirmative public benefit.

OCA makes inconsistent, groundless adjustments to HRG's appraisal figure, belaboring resolved disputes and making broad assertions without providing evidence to back them up. OCA repeatedly attempts to dismiss tens of millions of dollars of value without discussion or adequate explanation. OCA's inconsistent recommended adjustments also cast doubt on the accuracy of their review. OCA's recommended adjustments should be rejected by the Commission.

III. ARGUMENT

A. Reply to I&E Main Brief

1. Public benefit

I&E admits that the transaction will have significant public benefit for current customers of the Authority, expressing concern only that there is a "vast disparity" between the quantifiable benefits that will be enjoyed by Authority customers and the "tentative benefits"[1] that Pennsylvania-American's existing customers may receive. Some of the "substantial benefits" to Authority customers that I&E recognizes include "rectifying the environmental compliance issues that exist"[2] within the System. Improved environmental compliance does not simply benefit Authority customers, but also benefits all members of the public in the Commonwealth.

[1] I&E Main Brief at 12.
[2] I&E Main Brief at 14.

I&E acknowledges that Pennsylvania-American has identified many benefits to the public and to existing Pennsylvania-American customers, benefits that are "substantially similar, if not more numerous, than the public benefits that the Commission sanctioned in the first Section 1329 proceeding filed by Aqua to acquire New Garden."[3] I&E's primary objection to these benefits, then, seems to be that Pennsylvania-American "cannot quantify" the length of time before operational efficiencies will provide a benefit. This criticism should carry no weight with the Commission. As Pennsylvania-American pointed out in their Main Brief, a public benefit does not need to be capable of precise measurement for the Commission to consider it.[4] Pennsylvania-American is required to show through a preponderance of the evidence that the transaction will have an affirmative public benefit. It has more than met this burden. As Pennsylvania-American witness Bernard Grundusky testified in his direct testimony, there are numerous benefits to the acquisition, some of which will only become apparent and quantifiable over the long term.[5]

2. Port Vue

Throughout its Main Brief, I&E relies on vague suggestion that it does not approve of the Authority's 2016 acquisition of the Port Vue sewer system from the Borough of Port Vue. I&E suggests that the "manner in which MACM acquired Port Vue" has aroused its suspicion and necessitates further examination.[6] The closest I&E comes to actually articulating the source of this suspicion is that they have doubt as to "whether MACM ever intended to retain the Port Vue System" when it was acquired or whether the Authority purchased the Port Vue System

[3] I&E Main Brief at 15 (citations omitted).
[4] *Popowsky v. Pa. Pub. Util. Comm'n*, 594 Pa. 583 (2007).
[5] PAWC Statement No. 1 at 16-17; PAWC Statement No. 1-R at 2-3.
[6] I&E Main Brief at 17.

"strategically" in order to "increase the plant value for its pending acquisition."[7] Such innuendo is unwarranted.

The Authority purchased the Port Vue sewer system in an arm's length transaction for a negotiated purchase price. I&E notes that this purchase price is less than the replacement cost for the system calculated by AUS[8] and HRG.[9] Yet I&E also notes that the Port Vue system requires "substantial remediation and capital improvement measures,"[10] which could easily account for a purchase price less than replacement cost or replacement cost less depreciation.

I&E suggests—without citing any authority for the assertion—that acquiring the Port Vue System in order to include it in the sale of the System would be somehow impermissible or looked on disfavorably. Since I&E's arguments are based on innuendo, we have a theory of our own: the Port Vue acquisition was a "strategy" that makes sense for all involved parties. Prior to its acquisition by the Authority Port Vue sewer system was a small system with limited financial resources and technical expertise.[11] Port Vue's sewer system was in need of substantial investment in order to bring it into environmental compliance. Port Vue sold its system knowing it would be managed by a larger, more experienced entity, whether the Authority or ultimately an investor-owned utility. In selling to the Authority, Port Vue was relieved of the risk of bearing the cost of bringing the system into environmental compliance.

It is not clear why I&E treats rational, efficient behavior as inherently suspicious. Reducing the efficiencies achieved through consolidation by requiring separate records for one portion of the System on the basis of nothing more than speculation is not rational, and should not be pursued by the Commission.

---

[7] I&E Main Brief at 28.
[8] In AUS's case, it was less than replacement cost less depreciation. I&E Main Brief at 28.
[9] I&E Main Brief at 28.
[10] I&E Main Brief at 29.
[11] PAWC Statement No. 1-R at 11.

3. Section 1329

I&E begins its criticism of HRG's Section 1329 appraisal by suggesting that the difference between the fair market value appraisals of AUS and HRG is enough to raise concerns about the appraisals.[12] I&E uses HRG's original appraisal finding of $207,010,000 to make this point, despite the fact that the Authority and HRG have not relied on this figure for over a month. The Authority has repeatedly made it clear that it is no longer relying on that appraisal amount and has submitted revised Application exhibits (with no objection by I&E) to reflect that HRG's fair market valuation appraisal figure should be $190,840,000.[13] I&E's use of the old figure at this stage is misleading, and ignores the record evidence of this Application.

a. Going Value

I&E's purported criticism of the going value add-on used by HRG in its cost and income approaches actually only serves to prove our argument. I&E argues that the purchase price clearly includes some value for going value because it is higher than the depreciated original cost of the System.[14] We could not agree more. This real-world evidence that investor owned utilities are willing to pay a premium above traditional cost calculations to compensate a System for its going value only supports HRG's position that a going value add-on is necessary to arrive at fair market value. I&E goes on to argue that the inclusion of going value in the purchase price means that going value should not be included in an appraisal of the value of the assets.[15] This claim is confusing. The cost approach and income approach for appraisal purposes are each calculated independently of the purchase price for the system. Many factors taken into account in arriving at the purchase price – the condition of the assets, the type of assets, etc.—were also taken into

---

[12] I&E Main Brief at 32.
[13] MACM Statement No. 1 at 6-8.
[14] I&E Main Brief at 33.
[15] I&E Main Brief at 33.

account in preparing the cost approach. This is not duplicative. While I&E finds it "notabl[e]" that the representative of HRG testifying on behalf of the appraisal, Adrienne Vicari, did not know whether the Authority was receiving a going value premium as part of the purchase price,[16] this information is irrelevant. The purchase price was not used in calculating either the cost approach or income approach.

I&E is also incorrect to assert that the testimony of the Mayor of McKeesport suggests that Pennsylvania-American places no value on the Authority's existing customer base, employees, accounting processes, record keeping, and operating and management policies and procedures.[17] The Mayor noted that Pennsylvania-American will be keeping on the forty-five Authority employees to run the System.[18] While the System will benefit from Pennsylvania-American's resources, expertise, and expanded customer service capabilities, it is also true that Pennsylvania-American will benefit from the local knowledge of the employees, the Authority's existing relationships with other local governments, and the training and processes in place at the time of the closing. That the Authority has not retained all records of its utility plant costs from the 1950s is not an indication that every intangible asset and all processes of the System should be valued at $0, as I&E seems to suggest.

I&E also suggests that Ms. Vicari is artificially inflating valuations in Section 1329 appraisals by including a going value add-on.[19] This is a serious accusation based upon absolutely no record evidence. I&E asserts that "there is nothing in Section 1329 that contemplates a going value adjustment or premium." Section 1329 explicitly requires appraisers

[16] I&E Main Brief at 33.
[17] I&E Main Brief at 33-34.
[18] PAWC Statement No. 6 at 3.
[19] I&E Main Brief at 34.

to utilize the standards set forth in USPAP. USPAP requires that intangible assets be considered where appropriate in appraisals.[20]

b. Industrial Appraisal Company

I&E's next criticism should not be given weight by the Commission. In direct contradiction to explicit testimony by Ms. Vicari,[21] I&E asserts that HRG relied upon a report produced by Industrial Appraisal Company to develop the cost of the Authority's utility plant. As was made clear in the Direct Testimony of Ms. Vicari filed on July 17, 2017, HRG's cost approach was initially developed based on the Industrial Appraisal report, but was updated upon receipt of the Asset Listing prepared by KLH Engineers, Inc. on April 4, 2017. During informal discovery, HRG realized that some information had inadvertently not been updated to reflect the more accurate information available in the KLH report. HRG moved swiftly to correct this error upon discovery and provide all parties with an updated appraisal. These updates were explained to I&E in Direct Testimony and in the Evidentiary Hearing held on August 3, 2017. It is unclear why I&E is treating this as an open issue. In this part of their brief, I&E does at least recognize—finally—that HRG has adjusted their appraisal valuation, though it inaccurately reports the adjustment ("...[the adjustment] lowered [HRG's] appraised value of the MACM assets by $16,170,000, from $207,010,000 to $190,000,000").[22]

Industrial Appraisal prepared its report and certified that it had been prepared in compliance with USPAP, as recognized by I&E.[23] An additional certification from HRG as to the preparation of Industrial Appraisal's report is a strange thing to demand and entirely unnecessary. It is reasonable for HRG to rely on the certification of Industrial Appraisal.

---

[20] Transcript of Evidentiary Hearing of August 3, 2017 ("Transcript") at 118-120 (citing USPAP Rule 1-4(e)).
[21] MACM AMV Statement No. 1 at 9-11.
[22] I&E Main Brief at 35.
[23] I&E Main Brief at 35.

c. USPAP

I&E next diversionary tactic is its lengthy objection to HRG's use of the 2014-2015 version of USPAP. It is true that Ms. Vicari consulted the 2014-2015 version of USPAP in preparing her surrebuttal testimony, and that she could not immediately call to mind the year of the most recent publication of USPAP when quizzed at the hearing.

The differences between the 2014-2015 USPAP and 2016-2017 USPAP are laid out on page vi of the 2016-2017 Edition of USPAP. The changes include revisions to the definition of "report" and to the record keeping rule; revisions to standard 3 (regarding appraisal review); revisions to the definition of "Assignment Result" and the Confidentiality section of the Ethics Rule; revisions to the Reporting Standards; revisions to Exposure Time; retirement of the Statements of Appraisal Standards; revisions of Advisory Opinion 7; and the creation of other Advisory Opinions. The Authority and the City respectfully repeat their request, first stated in their Main Brief, for the Commission to take official notice of the 2016-2017 USPAP standards in accordance with 52 Pa. Code §5.408. The Commission and Pennsylvania courts have recognized that "administrative bodies as well as courts may take judicial notice of matters of common knowledge."[24] Under the Pennsylvania Rules of Evidence, a court may judicially notice a fact that is not subject to reasonable dispute because it can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned.[25] A court may take judicial notice at any stage of a proceeding.[26] OCA and I&E have now had a chance to respond to this request and be heard on the matter in accordance with §5.408(c).

[24] *Alko Express Lines v. Pa P.U.C.*, 30 A.2d 440 (1943)
[25] Pa.R.E. 201.
[26] *Drake Mfg. Co., Inc. v. Polyflow, Inc.*, 2015 PA Super 16, 109 A.3d 250 (2015)

That I&E knows their objection to the use of the prior version of USPAP is an elevation of form over substance is clear from the absence of any suggested adjustments to the appraisal as a result of the updated USPAP manual. I&E can point to no violations of USPAP in HRG's appraisal. If I&E had consulted USPAP at all in its review of the HRG appraisal, they may have realized that there have been no changes to the rules cited in Ms. Vicari's surrebuttal testimony between the 2014-2015 edition and 2016-2017 edition of USPAP.

I&E asserts that there have been two editions since the 2014-2015 edition that Ms. Vicari cites.[27] I&E does not provide a citation to the record for this fact, likely because there is nothing in the record to support this assertion and because it is untrue. The Appraisal Foundation publishes updates to USPAP every two years, and the 2014-2015 edition is the second most recent.[28]

It is worth repeating that I&E did not take USPAP into account when reviewing HRG's appraisal, and has only raised USPAP now for the sole point of calling out this oversight—at great length—despite its complete lack of impact on the HRG appraisal. I&E did not recommend any adjustments to HRG's appraisal based on USPAP, and no adjustments are required because the applicable rules did not change in the 2016-2017 edition.[29] If I&E were actually concerned about the effect of the use of the 2014-2015 USPAP, the responsible thing to do is to undertake some review of the changes in the new edition, or present an argument that the changes have had some effect. Instead, I&E merely requested that the Commission make it clear that UVEs must use the latest edition of USPAP in conducting their appraisals. The Authority and the City have

---

[27] I&E Main Brief at 36.

[28] The publication schedule of USPAP is available at the website of the Appraisal Foundation, https://www.appraisalfoundation.org/imis/TAF/Standards/Appraisal_Standards/Uniform_Standards_of_Professional_Appraisal_Practice/TAF/USPAP.aspx

[29] *See* Note 24, *supra*.

no objection to this, and would request that the Commission also make it clear to I&E and OCA that they should also use the latest edition of USPAP in conducting their appraisal reviews.

d. Market Approach

Finally, I&E criticizes HRG's market approach because Ms. Vicari did not personally visit each wastewater system used in her sample of comparable market transactions before including them.[30] If I&E wishes to assert that an accurate understanding of the value of a wastewater system cannot be understood without personal inspection of the system assets, they and OCA would have to retract the testimony of all of their witnesses as unqualified to opine as to the value of the System. Ms. Vicari used her professional judgment to develop a sample of reasonably comparable transactions. A sample of multiple transactions is used in order to cover a range of system conditions with a variety of environmental compliance issues.[31] I&E criticizes this method as imprecise, but that is simply the nature of appraisal practices -- they require assumptions and professional judgment because they are ultimately an estimation. I&E seems to propose that Ms. Vicari personally visit every sewer system sold in Pennsylvania and only use data derived from a system in the same condition with the same need for capital improvements as the Authority's System. This is impractical and unlikely to result in more accurate results -- even if such a system sale existed, the sale would not have taken place using the Section 1329 valuation method.

e. Summary

I&E's criticisms of HRG's appraisal are based on shifting standards, misleading facts, innuendo of nefarious purpose, and baseless attacks that have no effect on the outcome of the appraisal. HRG's revised appraisal valuation should stand.

---

[30] I&E Main Brief at 39.
[31] PAWC Application, Appendix 5, at 8.

B. Reply to OCA Main Brief

1. Public Benefit

Many of OCA's claims have been previously addressed in our Main Brief, and will be only addressed here to the extent clarification is required.

First, OCA discusses public benefit and warns that that if the transaction is approved, current Authority customers will see "potentially higher rate increases"[32] than if MACM continued to provide service. This argument is based entirely on the status of Pennsylvania-American as an investor-owned utility that pays taxes and returns profits to shareholders. There is no statutory basis to prefer public ownership of utilities over private ownership in this manner if, as here, the proposed owner is fit and there is affirmative public benefit.

Additionally, the loss of Pennvest financing does mean that Pennsylvania-American generally has a higher cost of capital. As OCA notes,[33] however, Pennsylvania-American is eligible for some forms of Pennvest financing, and the System's ratepayers may benefit from it again in the future. The loss of a single low-interest loan must be weighed against the numerous other benefits.

OCA does not dispute that the System is in need of significant capital improvements. These improvements will be funded through increased rates by ratepayers within the Service Area whether or not the transaction is approved. The relevant question is, who is better suited to get it done? Pennsylvania-American's large customer base means that the costs of large capital investments can be spread across larger ratepayer base. [34] Over time, capital improvements in other areas of Pennsylvania-American's service territory will be required, and those costs can also be spread across the entire customer base. This risk-sharing strategy helps to spread out

---

[32] OCA Main Brief at 15.
[33] OCA Main Brief at 15, note 5.
[34] PAWC Statement No. 1 at 17.

significant costs over time and over a larger customer base. OCA points out only the first half of this arrangement – that the immediate effect of the transaction could be costs borne by existing Pennsylvania-American customers. This ignores the equivalent long-term benefit that costs for the future capital projects from all areas of the system can be spread across a larger customer base.

As discussed in our Main Brief, OCA witness Ashley Everette's concerns for Dravosburg and Duquesne are guesswork. She does not identify negative consequences from the transaction, merely states that they will not be receiving the same benefit as the residents of the City of McKeesport at the same time. This is incorrect. The benefits that will accrue to McKeesport residents as a result of sale proceeds – paying off of Authority debt, investment in infrastructure, removal of blight, and other community projects—will also benefit residents of McKeesport's surrounding communities, including Duquesne and Dravosburg. Reevaluating the purchase price of sales transactions voluntarily entered into by the two boroughs and the Authority from several years ago is not the role of the OCA.

OCA states that the record does not support a finding of an affirmative benefit even for current Authority customers.[35] Even I&E admits that current Authority customers will see a substantial benefit from this transaction.[36] The many public benefits have been enumerated in our Main Brief and in the Main Brief of Pennsylvania-American. The Commission should approve the transaction based on these significant benefits.

[35] OCA Main Brief at 22.
[36] I&E Main Brief at 14.

2. Section 1329

a. Due Process

OCA cites a pair of Supreme Court labor law cases from the 1930s for the proposition that the Commission cannot delegate its authority to determine ratemaking rate base to the UVEs.[37] It is not clear from the short paragraph devoted to the constitutional issue whether OCA is intending to make a constitutional challenge to Section 1329 as it stands, or simply to some potential interpretations of Section 1329. The 1994 Supreme Court case cited by the OCA for the proposition that the Commission "arguably has no authority to adopt" an interpretation of the statute that delegated its authority to determine ratemaking rate base is a case concerning the scope of the Federal Communication Commission's authority under a federal statute, the Communications Act of 1934. While OCA does not elaborate why this opinion would "arguably" restrict the Commission's interpretation of a Pennsylvania state law, the opinion was based on the language of a federal statute that is inapplicable here ("The dispute between the parties turns on the meaning of the phrase 'modify any requirement' in § 203(b)(2)").[38] The case was not about what authority related to rate filing *could be* delegated, it was about what authority *had been* delegated by Congress in the Communications Act.

OCA (and I&E) seem to suggest that the Commission has only two possible choices: allowing OCA and I&E to second-guess every exercise of professional judgment made within a UVE's appraisal, or not permit any review of the appraisal. There is a more reasonable solution that protects the due process concerns raised by the OCA.[39] The OCA could have an "opportunity to be heard" before the Commission is permitted to make a binding decision

---

[37] OCA Main Brief at 31, citing *Carter v. Carter Coal Co.*, 298 .S. 138 (1936) and *A.L.A. Schecter Poultry Corp. v. United States*, 295 U.S. 495 (1935).
[38] *MCI Telecommunications Corp. v. Am. Tel. & Tel. Co.*, 512 U.S. 218, 225 (1994).
[39] These concerns are set forth in OCA Main Brief at 29-30.

approving or rejecting the transaction by reviewing the appraisals for abuse of UVE's professional judgment and for compliance with USPAP. This level of review ensures an opportunity to correct error and allows the OCA to be heard, but is able to be accomplished within six months and does not undercut the statutory scheme constructed by the General Assembly. This standard also comports with that laid out by the Commission in *New Garden.*[40]

OCA asserts their right to question any exercise of professional judgment made by a UVE, and then complains that the six-month review period is not sufficient for such an extensive and extra-statutory review.[41] OCA's complaints about the compressed timeline only lend credence to the argument that the legislative intent was never to permit such exhaustive second-guessing of professional judgment. OCA suggests that the remedy is instead to split the Section 1102 and Section 1329 proceedings. Given that OCA has opposed every Section 1329 proceeding so far on both Section 1102 and Section 1329 grounds, such a split would remove any benefit of finality that is gained by the statutorily required six-month deadline. The better solution is to limit review of Section 1329 appraisals for abuse of professional judgment and compliance with USPAP, in accordance with the Commission's conclusions in the *New Garden* decision.[42] The focus of the proceedings can then be on the public benefit of the transaction and verifying the appraisals for accuracy.

Having complained about the condensed time period clearly established by the General Assembly, OCA proceeds to divert the Commission's focus from the true issues to issues that have been resolved through discovery, pot shots with no alleged or actual consequences on the

---

[40] *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) at 34.
[41] OCA Main Brief at 32.
[42] *New Garden*, slip op. at 34.

fair market valuation, and baseless innuendo about the motives of the Authority and the City. The Commission should not grant these arguments any weight.

b. Cost Approach

On HRG's cost approach, OCA belabors discussion of in-service dates and depreciation when HRG has already revised its appraisal to account for the prior error. Once HRG realized its use of inaccurate in-service dates, they revised their cost approach and income approach numbers to reflect the more accurate information as explained in Direct Testimony and our Main Brief. The incident serves as a good example of the type of error that OCA should be looking for in its review. The revised numbers were provided to OCA with Direct Testimony of Ms. Vicari on July 17, 2017. It is clear that OCA received this information, because Ms. Everette discussed it in her Rebuttal Testimony of July 26, 2017.[43] Ms. Everette stated in that testimony, and OCA repeats in its brief, that they are not recommending any changes to the in-service dates or depreciation calculations of HRG's cost approach. Despite this, they spend a substantial portion of their brief critiquing decisions of professional judgment made by Ms. Vicari in the original preparation of the cost approach. While apparently cathartic for the OCA, superfluous arguments with no resulting recommended appraisal adjustments are not helpful at this stage of the proceedings.

As discussed in our Main Brief, USPAP requires that overhead costs be considered when calculating reproduction value.[44] OCA's brief provides no elucidation as to why eliminating overheard costs produces a more accurate appraisal than an estimate of those costs produced by a professional engineer. OCA's recommendation to ignore overhead costs should be rejected by the Commission.

---

[43] OCA Statement 1R at 7-8.
[44] MACM Statement No. 1-S at 3 (*citing* MACM Exhibit AMV No. 1, USPAP Rule 1-2(e)).

OCA's next criticism is remarkable. In a footnote, they attempt to dismiss nearly twenty million dollars of value by asserting that the critique of their witness Glenn Watkins, an economist employed by a consulting firm, as to the use of a going value adder in the income approach is equally applicable to the cost approach, stating that "the flaws that he identifies are applicable in each circumstance where the Going Value adder is used."[45] This is unsupportable. Mr. Watkins' review of the HRG appraisal was "limited to the technical aspects of her discounted cash flow as they relate to accepted economic theory in practice."[46] He reviewed only the income approach of HRG, and not the cost approach. Most of his criticisms of going value add-on are clearly rooted in the income approach. For example, Mr. Watkins criticized the going value adder based on the perspective used in the income approach[47] and for including start-up costs, cash flows, and debt service costs that are also included in the discounted cash flow analysis.[48] These criticisms are inapplicable to the cost approach, which is not based on a discounted cash flow analysis. Despite this, OCA repeats these criticisms in its Cost Approach section of its Main Brief. OCA even includes—in its Cost Approach section—Mr. Watkins' criticism of the erosion of cash flow deduction, though no such deduction was made in HRG's cost approach. It is misleading for OCA to assert that such criticisms are equally applicable to the cost approach, and it is unacceptable that they would attempt to eliminate nearly twenty million dollars of value without providing a rationale.

[45] OCA Main Brief at 38, note 22.
[46] Transcript at 154.
[47] OCA Main Brief at 39.
[48] OCA Main Brief at 40.

USPAP requires that intangible assets and the going value of an enterprise be considered in an appraisal, and HRG did so. Neither Mr. Watkins nor Ms. Everette considered USPAP in their review of HRG's appraisal.[49]

Additionally, OCA misstates HRG's cost approach valuation on page 42. It is not $150,240,000, it is $170,040,000.[50] Further, while OCA cites Mr. Watkins for its proposed adjustment to HRG's cost approach, his testimony does not include a recommended cost approach valuation because he did not examine the cost approach. The reference to Gannett Fleming on that page is also, presumably, a mistake, as Gannett Fleming did not participate in this case. The Commission should reject OCA's proposed adjustments to the cost approach.

c. Income Approach

The problem of the standard of review becomes clear upon review of OCA's criticism of HRG's income approach. OCA's recommended adjustments to HRG's income approach are based on the testimony of Mr. Watkins. Mr. Watkins cites the following standards that he is looking to or applying in his review of HRG's income approach: "accepted financial theory or practice",[51] a "range of reasonableness",[52] "level of reasonable opportunity cost",[53] "appropriate",[54] a fact that is "well-known",[55] a "theory of public utility regulation",[56] a theory that is "universally accepted",[57] "universally recognized and accepted",[58] "accepted economic theory in practice",[59] and, finally, consistency with "my economic expertise and experience."[60]

---

[49] Transcript at 145, 161.
[50] AMV Statement No. 4-R at 9.
[51] OCA Statement 2 at 6
[52] OCA Statement 2 at 7.
[53] OCA Statement 2 at 8.
[54] OCA Statement 2 at 9, 12
[55] OCA Statement 2 at 19
[56] OCA Statement 2 at 19.
[57] OCA Statement 2 at 20.
[58] OCA Statement 2S at 2.
[59] Transcript at 154.
[60] Transcript at 154.

None of these standards are further explained, and not one of these standards is backed up with a citation to a source or legible standard. These standards are not written down, but contained in the head, presumably, of OCA's witness, a consultant from Virginia.[61] The Authority and the City do not doubt the expertise of Mr. Watkins, but his personal understanding of economic theory cannot be the standard UVEs are asked to meet, particularly where a statutory standard already exists.[62]

Though Mr. Watkins did not review the appraisals for compliance with USPAP,[63] he asserted at the evidentiary hearing that he read the USPAP manuals after Rebuttal Testimony.[64] When then asked which USPAP standards he retroactively applied to the appraisals after reading USPAP, he did not cite any specific standards, but stated that "what standards are or are not applied I don't know."[65]

UVEs should not be required to apply such vague standards with only the hope that whatever consultant OCA hires will find every exercise of the appraiser's professional judgment to be in accordance with his practice. HRG's Income Approach was conducted in compliance with the clear, uniform standards mandated by the General Assembly in Section 1329: USPAP.

While discussing HRG's income approach, OCA's brief states that Mr. Weinert, witness for Pennsylvania-American, cited an excerpt published by the American Society of Appraisers.[66] Mr. Watkins and OCA then go on to state that this excerpt is "fully consistent with accepted practice in conducting DCF analyses."[67] OCA and Mr. Watkins appear to have confused reviewing HRG's appraisal for compliance with USPAP with reviewing a separate set of

---

[61] OCA Statement No. 2 at 1.
[62] Section 1329(a)(3).
[63] Transcript at 145.
[64] OCA Main Brief at 145.
[65] Transcript at 155.
[66] OCA Main Brief at 47.
[67] OCA Main Brief at 47 quoting OCA Statement 2S at 2.

standards, introduced by a different witness, for compliance with Mr. Watkins' understanding of accepted practices. This assertion is not relevant.

The Commission is asked to consider two different versions of the income approach: (1) that prepared and defended by HRG and Ms. Vicari, and (2) that prepared and defended by Mr. Watkins. HRG staff personally visited the System, inspected the assets, conducted discussions with management, and prepared a full appraisal considering market, cost, and income Approaches. HRG regularly consulted USPAP standards throughout its preparation as required by Section 1329, and produced a final appraisal that was certified to comply with USPAP. Mr. Watkins never personally visited the System and reviewed piecemeal only one portion of HRG's appraisal. He did not use USPAP or any other recognizable uniform or professional standards. Both Ms. Vicari and Mr. Watkins have defended their rationale through testimony.

The unreliability of OCA's adjustments is clear not only from their methodology, but from their shifting conclusions. OCA appears to have changed its recommended income approach result from the $165,550,000[68] cited at the evidentiary hearing of August 3 to $122,420,000 (stating that the OCA "recommends that $122,420,000 be utilized in place of Ms. Vicari's [discounted cash flow] result of $211,340,000" and that "the OCA's recommended [discounted cash flow] result is the same as the OCA's recommended Income Approach Result").[69] OCA returns to the $165,550,000 number in their final recommendation. OCA's inconsistency leaves their ultimate recommended adjustment unclear, but using the lower number would be yet another attempt to eliminate tens of millions of dollars in value with no explanation and should not be permitted.[70] Additionally, OCA's final recommendation for

[68] Transcript at 167; OCA Exhibit AEE-1R.
[69] OCA Main Brief at 52.
[70] OCA Main Brief at 52.

income approach cites an incorrect figure for HRG's discounted cash flow valuation prior to the going value adder and subtraction for erosion of cash flow, which should be $194,970,000.[71]

The Authority and the City believe that it is clear that HRG's income approach should prevail, and OCA's recommended adjustments should be rejected.

d. Market Approach

OCA's criticism of HRG's market approach begins ill-advisedly and goes downhill. The first listed "problem" with the analysis is that Ms. Vicari "selectively chose acquisitions that she used in her [market] analysis."[72] Stated such, we presume this is intended to imply nefarious purposes, rather than a straightforward description of how a professional appraiser would analyze the market—by choosing a sample of comparable transactions from available options in the region. OCA then dwells on its prior misunderstanding of Ms. Vicari's use of the word "focus," as used in Ms. Vicari's statement, "HRG focused on known transactions that have occurred after or in anticipation of the passage of" Section 1329.[73] During discovery, OCA expressed its mistaken belief that she had asserted that all of the transactions reviewed occurred after Section 1329 passed. Ms. Vicari clarified that while HRG found the single transaction that has occurred post-Section 1329 particularly helpful, HRG was obliged to include pre-Section 1329 sales in the sample so as to broaden it beyond the single transaction.[74] It is unclear why OCA lingers on this misunderstanding, or what consequences it suggests have arisen from including pre-Section 1329 cases in the sample. As noted in our Main Brief, including just the post-Section 1329 transaction would result in a market value of nearly double HRG's conclusion.

OCA also continues to insist that the number of customers used by Ms. Vicari is

[71] OCA Main Brief at 52, which cites HRG's discounted cash flow valuation as $211,340,000.
[72] OCA Main Brief at 59.
[73] OCA Main Brief at 59, citing OCA Statement No.1 at 20.
[74] MACM AMV Statement No. 1-R at 3.

"incorrect",[75] though there is no basis for this claim. The System serves approximately 21,953 customers through direct and indirect connections. Thousands of these customers receive service through bulk connection points, so that it is possible to produce a much lower individual customer count of approximately 12,780 by counting only connections and ignoring the reality of how many customers are being served. OCA asserts that the lower number is "correct" because it is unknown whether any bulk customers of the systems in the sample were counted as a single connection. However, Ms. Everette has provided no evidence that bulk customers of other systems are being under counted, and her assertion that a number that does not accurately reflect how many customers receive service is "correct" while the actual number of those receiving service is "incorrect" is unsupportable. Moreover, after criticizing HRG for using this number, OCA does not propose to use the lower number but instead uses the full customer count in its own adjusted market value.[76]

HRG's inclusion of capital improvements in the purchase price where the negotiated agreement reflected both a purchase price and a commitment to make a certain amount of capital improvements is logically sound, as explained in the Authority and the City's Main Brief.

The Commission should use HRG's market value of $190,130,000.[77]

e. Final Recommendation

Resistance to the new statutory scheme is apparent throughout OCA's arguments. OCA repeatedly invokes the old valuation method of depreciated original cost rather than the method the parties opted to use for this transaction under Section 1329, despite the fact that no study of depreciated original cost was performed (because the parties were not relying on it for the

[75] OCA Main Brief at 59.
[76] OCA Main Brief at 60.
[77] On page 61 of its Main Brief, OCA again misstates HRG's conclusion, which is a market value of $190,130,000 and not $190,000,000.

purchase). Though Section 1329 clearly requires UVEs to use USPAP to conduct appraisals, OCA refuses to acknowledge these binding guidelines in reviewing the appraisals or in making recommendations to adjust the appraisals. OCA's resistance seems to be rooted more in ideological opposition to this category of transaction than a close examination of the benefits of individual cases. Indeed, OCA provides a full critique of the appraisals to arrive at a fair market value it deems more appropriate, but then asserts that "even the $152 million rate base calculated by the OCA" would harm existing and acquired ratepayers. The Commission should not be persuaded by this stance, which is clearly contradicts the will of the General Assembly.

In its final recommendation, OCA yet again misrepresents HRG's position by quoting HRG's original appraisal numbers rather than the revised appraisal. OCA also returns to recommending $165,550,000 for the income approach,[78] rather than $122,420,000, as it seemed to recommend just nine pages prior.[79] Additionally, OCA appears to misrepresent its own position in another approach in its final recommendation, using $111,739,476 for its cost approach,[80] rather than $135,202,468 recommended just nineteen pages prior.[81] Because of these inconsistencies of approximately $43 million and $24 million, respectively, it is completely unclear what OCA actually believes is the appropriate appraisal amount.[82] Numbers with so little reliability should not be relied upon by the Commission.

---

[78] OCA Main Brief at 61.
[79] OCA Main Brief at 52.
[80] OCA Main Brief at 61. This $111,739,476 recommendation was expressly disavowed by OCA's own witness, Ms. Everette, in her rebuttal testimony: "...I am no longer recommending any changes to [Ms. Vicari's] calculation of accumulated depreciation."
[81] OCA Main Brief at 42.
[82] OCA goes on to state that the average of their adjusted HRG recommendation of $145,973,192 and their adjusted AUS recommendation of $151,105,207is a number higher than either of the two, $151,949,698. This is mathematically incorrect.

OCA has failed to satisfy its burden of persuasion that the UVE appraisals should be modified in any manner. The Commission should uphold the USPAP-certified appraisal figures of the Authority and the City's certified Utility Valuation Expert, HRG, as follows:

Cost Approach	$170,040,000
Income Approach	$212,360,000
Market Approach	$190,130,000
Appraised Value:	**$190,840,000**

IV. CONCLUSION

Litigation is costly, and taxpayers are ultimately bearing the brunt of the cost of these challenges. Section 1329 was designed with clear, enforceable standards to guide municipalities and investor-owned utilities in valuing their sewer systems and conducting a transaction. Many safeguards are built into the statutory scheme. OCA is attempted to craft for itself a role to which it is wholly unsuited as simultaneous judge, professional engineer, licensed appraiser, and utility-valuation expert.

This transaction has many demonstrated public benefits, and HRG's revised appraisal is well-support by the record. The Commission should take this opportunity to establish clear standards for review of appraisals and require compliance with USPAP by all parties in their appraisal recommendations. The Commission should also approve this transaction, and permit the negotiated purchase price of $162,000,000 to serve as the ratemaking rate base for Pennsylvania-American as provided under Section 1329.

CERTIFICATE OF SERVICE

I hereby certify that I have this 5th day of September, 2017, served a true and correct copy of the foregoing Reply 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

Susan Simms Marsh, Esquire
Pennsylvania-American Water Company
800 West Hershey Park Drive
Hershey, PA 17033

David P. Zambito, Esquire
Jonathan P. Nase, Esquire
George A. Bibikos, Esquire
Cozen O'Connor
17 North Second Street
Suite 1410
Harrisburg, PA 17101
Counsel for Pennsylvania-American Water Company

Gina L. Miller, Esquire
Erika L. McLain, Esquire
Bureau of Investigation and Enforcement
PA Public Utility Commission
Commonwealth Keystone Building
P.O. Box 3265
Harrisburg, PA 17105-3265

Deputy Chief Administrative Law Judge Mark A. Hoyer
Administrative Law Judge Mary D. Long
P.O. Box 3265
Harrisburg, PA 17105-3265
mhoyer@pa.gov
malong@pa.gov

Christine M. Hoover, Esquire
Erin L. Gannon, Esquire
Office of Consumer Advocate
555 Walnut Street
Fifth Floor, Forum Place
Harrisburg, PA 17101-1923

Thomas S. Wyatt
PA Attorney ID No. 89342

Respectfully submitted,

THE MUNICIPAL AUTHORITY OF THE CITY OF MCKEESPORT

THE CITY OF MCKEESPORT

By_____

Thomas Wyatt, Esquire
PA I.D. # 89342
Dilworth Paxson LLP
1500 Market Street, Suite 3500E
Philadelphia, PA 19102
(215) 575-7286
twyatt@dilworthlaw.com

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

Date: September 5, 2017

U.S. POSTAGE PITNEY BOWES

ZIP 19102 $ 002.03⁰
02 4W
0000336903 SEP 05 2017

Dilworth Paxson LLP

1500 Market Street • Suite 3500E
Philadelphia, PA 19102-2101

Secretary Rosemary Chiavetta
Pennsylvania Public Utility Commission
400 North Street, 2nd Floor North
P.O. Box 3265
Harrisburg, PA 17105-3265