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Pennsylvania Public Utility Commission
PO Box 3265
Harrisburg, Pennsylvania 17105-3265

Re: M-2016-2543193
Implementation of Section 1329
of the Public Utility Code
Tentative Supplemental Implementation Order

Dear Pennsylvania Public Utility Commission:

The purpose of this letter is to provide comments on the proposals set forth in Pennsylvania Public Utility Commission's (Commission) Tentative Supplement Implementation Order (TSIO) Document M-2016-2543193.

Herbert, Rowland and Grubic, Inc. (HRG) is an engineering company that provides various services including municipal, water and wastewater, land development, transportation, water resources, geographic information systems, survey, environmental, construction phase, and financial services. In addition, the Commission has approved HRG as a Utility Valuation Expert (UVE).

HRG agrees with the Commission that Section 1329 procedures and guidelines should be amended to improve the procedural process, improve the quality of the valuations, and for the process to be more fair and efficient.

We have two concerns regarding the TSIO: (a) the use of current range of values from previous Section 1329 proceedings to check for reasonableness of negotiated purchase price, and (b) the correctness and fairness of the proposed changes to the Cost Approach. These two items are further discussed below.

<u>The Use of Current Data to Check for Reasonableness of Negotiated Purchase Price</u>:

On Page 18, second paragraph of the TSIO, the Commission asked for comments as to whether the Commission should use values from previously completed Section 1329 proceedings to check the reasonableness of a future negotiated purchase price.

Although it is an interesting concept, we have reservations in the Commission drawing conclusions based on previously completed value proceedings for several reasons. Firstly, the number of Section 1329 completed proceedings may be a relatively small data set to draw any fair and reasonable conclusions at this time. After a few more years of proceedings completing Section 1329, perhaps some type of statistical deviation/model could be produced with a larger data set.

Secondly, we believe that location has an impact on the price. For example, given two identical systems, one located in an urban area (e.g. Philadelphia) and the other located in a rural area (e.g. northern western Pennsylvania); these two systems could have different valuation prices because of the original cost. Using a data set that is weighted with say, urban valuations, will not be fair for the valuations being performed in the rural areas, and vice versa.

Thirdly, we are tracking transactions that have proceeded through Section 1329 and Non-Section 1329 and are noticing a *possible* trend for those that have a plant (water plant or wastewater plant) and those that are strictly collection and conveyance/distribution systems. Again, without a larger data set, fair and reasonable conclusions cannot be drawn.

Fourthly, although the number of customers is the current means for the Market Approach, it may not be the best means for checking on the reasonableness of a negotiated purchase price. For example, two communities each have 5,000 customers and their wastewater plants are both rated at 10 million gallons per day. The first community is mostly built out with limited future customers, but the second community has lots of open parcels and the ability to grow their system. Both plants are underutilized, but checking on the reasonableness of a negotiated purchase price only using a customer count for the community that has the open parcels and the ability to grow may not be fair or reasonable.

Overhead Costs:

On Page 20 of the TSIO, the Commission proposes to exclude overhead costs from the Cost Approach. We believe that overhead costs should be permitted in the Cost approach. The overhead cost includes: engineering (designing of the system), review fees (including Township/Authority zoning review fees), legal fees (including obtaining rights-of-way and purchase of land), permitting (including environmental permits, county permits, township permits, and possibly PennDOT permits), surveying (staking out the location and depth of the water and/or sewer locations), financing, and construction administration and inspection.

The definition of Reproduction Cost is the cost of replacing the same facilities that are being transferred in the sale. The overhead costs are proper and required to replace the same facilities (Reproduction Cost) prior to the actual construction cost of the sanitary sewers. In HRG experience, depending upon the size of the project, an overhead percentage in the range of 30% to 35% covers the soft cost of the project.

Total project cost includes the cost to physically construct the asset along with the overhead cost which are integral to the project and necessary for what is physically constructed to properly function, meet regulatory requirements, have the legal ability to be installed, etc. These soft costs make sure the gravity pipe, for instance, is properly bedded and at the right slope. If someone were to install gravity pipeline without including engineering design to determine proper slope, the pipeline would not function and, therefore, the system would not be of value. Similarly, if the necessary environmental permits were not secured and design was not performed to meet environmental regulations, the assets would not be permitted and the value would be greatly diminished. Design, permitting, financing and legal fees are all fundamental to the construction of water and wastewater assets. In our opinion, it would be improper to not include these costs. They are fundamental in reproducing the system and, in fact, the system could not be reproduced without these services.

It is our experience, as an engineering company, to estimate an additional 30-35% for these non-construction costs. Of these costs, 10%-12% is design engineering, 5%-8% is permitting, 5% is legal, 5% is construction administration and inspection, and 5% is financing. Perhaps the Commission would consider allowing 25% to 30% of overhead costs, which is a conservative estimate, to be included in the Cost Approach.

Thank you for your consideration and please let us know if you have any questions.

Sincerely,

Herbert, Rowland & Grubic, Inc.

Kevin M. Fox

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Service Group Manager, Financial Services

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