PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PENNSYLVANIA 17105-3265

Application of Aqua Pennsylvania Wastewater, Inc. Pursuant to Sections 1102, 1329 and 507 of the Public Utility Code for Approval of its Acquisition of the Wastewater System Assets of Cheltenham Township and Contracts between Aqua Pennsylvania Wastewater, Inc. and Cheltenham Township	**PUBLIC MEETING: October 24, 2019** **3008491-OSA** **Docket No. A-2019-3008491**

STATEMENT OF COMMISSIONER ANDREW G. PLACE

Before us for disposition is the Recommended Decision (R.D.) of Administrative Law Judge (ALJ) Angela T. Jones and the related Exceptions and Reply Exceptions that have been submitted in this proceeding by various parties. I appreciate the work that has been done by ALJ Jones, the participating parties, and our Staff for analyzing one more litigated case that involves complex Section 1329 valuation issues within the very tight six-month timeframe.

I am not convinced that the acquisition of the Cheltenham Township wastewater assets by Aqua Pennsylvania Wastewater, Inc. (Aqua) provides affirmative benefits that outweigh the costs of the ratemaking effects this acquisition will potentially cause, especially for the existing ratepayers of Aqua's water and wastewater services. In addition, I disagree with how certain valuation methodologies have been applied in establishing the fair value of the acquired assets.

I seriously question the $50.25 million acquisition price for the acquired assets that have an original cost value of only $15.41 million. The offer of an acquisition price of $50.25 million for a wastewater system where Aqua will commit a further $54.80 million of additional upgrades and improvements over a 10-year period is counterintuitive and the acquisition premium of $34.84 million is 226.12% above the original cost of the acquired system. Similarly, the fair value figure of $44.56 million that will be used in the future for Aqua's rate base addition and for regulatory ratemaking purposes produces an acquisition premium of $29.15 million, or 189.19% over the original cost figure of $15.41 million.

Such high acquisition premiums generate substantial future revenue requirement and ratemaking effects both for the Cheltenham system consumers but also, notably, for the existing ratepayers of Aqua's water and wastewater services.[1] Since the acquired system is in need of upgrades and improvements, additional revenue requirement and ratemaking effects will arise from the additional $54.80 million that Aqua intends to invest. In short, the public interest is not served by socializing the revenue requirement costs of a $44.56 million acquisition (that contains a substantial $29.15 million premium), *and* those associated with the future $54.80 million in capital investments. These future revenue requirements substantially outweigh the acquisition's potential, insufficiently quantified, benefits, and the transaction does not meet the applicable net benefits test under applicable

[1] Although the potential rate effects of the Cheltenham system acquisition for existing Aqua water and wastewater customers have been computed on the basis of the $50.25 million acquisition price, a rate base fair value figure of $44.56 million will also have substantial revenue requirement effects that will be shared among Aqua's existing ratepayers. *See, e.g.*, Aqua Notice of Proposed Acquisition and Rate Base Addition, Docket No. A-2019-3008491, filed March 28, 2019. (under the $50.25 million acquisition price and under certain assumptions, Aqua's existing wastewater service customers would have been impacted by a 5.83% increase in their monthly rates).

statutory law and relevant court decisions.[2] Furthermore, this combination of future revenue requirements creates an issue whether the return of and on the adopted fair value of the acquired assets will be compatible with the statutory principle of just and reasonable rates.

I also disagree on how certain methodologies were applied in the valuation of the acquired assets, especially under the Income Approach. I believe that the Office of Consumer Advocate (OCA) has presented credible evidentiary testimony that justifies its proposed adjustments to the estimates that were reached by the utility valuation experts (UVEs) from AUS (Cheltenham) and Gannett Fleming (Aqua). I do not think that an Income Approach analysis can start with a beginning plant investment of the acquired assets that is based on anything else but original cost (original cost new less accumulated depreciation – OCNLD), for the estimation of future revenues and earnings. And, original cost (OCNLD) figures were utilized as beginning investment values both by OCA and Gannett Fleming (Aqua), while the corresponding AUS estimate was based on replacement cost less accumulated depreciation.

Similarly, the OCA testimony clearly demonstrated that certain assumptions of the AUS and Gannett Fleming UVEs lack solid foundation when accounting for the future revenue and earning streams and the terminal values of the assets at issue. Simply put, an asset that is depleted through a depreciation expense cannot generate revenues and earnings if periodic capital investment expenditures do not exceed such depreciation expenses.[3]

Furthermore, I find the OCA testimony credible and persuasive on the use of calculations and variable values that comply with commonly accepted public utility regulation parameters in the Income Approach analysis. The calculation of appropriate cost of capital and rate of return (ROR) figures depends on the selection of appropriate capital structure components and corresponding cost rates that are suitable for assets that will operate under the jurisdiction and future ratemaking parameters of this Commission. Thus, I agree with OCA's use of a capital structure that consists of 45% in long-term debt and 55% in common equity capital with an associated cost of common equity capital of 9.95%. I do not agree with the capital structures of 30% long-term debt and 70% common equity put forward by AUS (Cheltenham), and 24.8% long-term debt and 75.3% common equity utilized by Gannett Fleming.[4] For these reasons, I believe that OCA's Exception No. 2 should be granted. The relevant outcome would have produced a more rational valuation figure for the acquired assets and would have preserved OCA's sound methodology parameters within the Income Approach valuation analysis.[5]

Since this transaction does not meet the net public benefits test it should not be approved.

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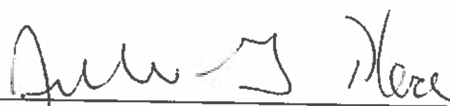
[2] *See, e.g., McCloskey v. Pa. Public Utility Commission*, 195 A.3d 1055 (Pa. Cmwlth. 2018) at 1067.
[3] OCA M.B. at 13-36, and demonstrative tables at 29, 34.
[4] OCA M.B. at 26, 31.
[5] Granting OCA's Exception No. 2 on the Income Approach while accepting the R.D.'s recommended adjustments in the Cost and Market analyses would have produced a fair value of $33.26 million for the acquired assets. This figure would still have included a substantial acquisition premium of $17.86 million or 115.88%.

I note that municipal water and wastewater system acquisitions under Section 1329 of the Public Utility Code will inevitably contain acquisition premiums because of the statutorily mandated fair value estimation methods. However, such acquisition premiums should be kept within a zone of reasonableness and the estimation methods should follow applicable and well-established principles of public utility regulation.

Dated: October 24, 2019



Andrew G. Place
Commissioner