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PHILADELPHIA WATER, SEWER AND STORM WATER RATE BOARD TECHNICAL HEARING

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Technical Hearing, taken at 1515 Arch Street, 18th Floor, Philadelphia, Pennsylvania 19102, beginning at 10:03 a.m. on Tuesday, May 15, 2018, before Lori A. Guyer, Court Reporter and Notary Public, there being present:

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PROCEEDINGS

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MS. BROCKWAY: This is a continuation of the technical hearings in the Philadelphia Water, Sewer and Storm Water Rate Board rate case for fiscal years 2019 to 2012 -- 2019 to 2021.

And this morning I gather we're having a financial panel from the department?

MR. DASENT: We're completing with Black & Veatch --

MS. BROCKWAY: Oh, right.

MR. DASENT: And then we have the financial panel after that, and cross examination of Mr. Morgan, as well.

In terms of housekeeping we have, first of all, a summary of public advocate adjustments acceptable to the water department we handed up yesterday, and we would like to mark it for identification PWD Hearing Exhibit-2.

MS. BROCKWAY: So marked.

(Document marked as Exhibit PWD Hearing

Exhibit-2 for identification.)

MR. DASENT: And we also have an Errata Sheet that we would like to hand up, and it's for PWD's rebuttal statement number two.

And I think it's self-explanatory, so we would like to hand that up, as well.

And it's my understanding that Mr. Ballenger --

MS. BROCKWAY: I'm sorry?

MR. DASENT: We'd like to hand up our Errata Sheet for --

MS. BROCKWAY: Yes, I got that, but what is the last thing you said?

MR. DASENT: Robert also has an Errata Sheet for his testimony, Robert Ballenger.

MS. BROCKWAY: Okay. I've got that --

MR. DASENT: Just for the record, also Errata Sheets for the rebuttal testimony of Valarie Allen of Ballard Spahr, Katherine Clupper, PFM, Peter Nissen from Acacia Financial, Melissa Labuda from the water department and Steve Furtek from the water department, and that is as it relates to statement number two of our rebuttal.

MS. BROCKWAY: Thank you. Mr. Ballenger, do you have something else that you wanted to identify for the record?

MR. BALLENGER: Yes, if I may. Just one moment. I was just looking for that Errata Sheet that Andre referred to. Did we receive that yesterday, Andre?

MR. DASENT: No.

MS. BROCKWAY: Let's go off the record.

(Discussion held off the record.)

MS. BROCKWAY: All right. We're back on the record. So there is a public advocate Errata Sheet that you would like to mark?

MR. BALLENGER: Yes, Madam Hearing Officer. And I would like to go ahead and distribute this.

It is marked as Errata Sheet for Public Advocate Statement Number Two, errata sheet to direct testimony of Jerome Mierzwa.

And I did already distribute this to the department and the panel, as you see here, prior to the hearing.

I would just like to quickly go over this, because Mr. Mierzwa was not here when we moved his testimony yesterday, and this should not come as a surprise. There is a table on page 16 of Mr. Mierzwa's testimony --

MS. BROCKWAY: Before you talk about it, please let us have it.

MR. BALLENGER: Okay. So there is a table on page 16 of Mr. Mierzwa's testimony, and in response to a discovery request that was designated as -- I believe it was PWD set four, number four, requests of the public advocate.

Mr. Mierzwa was asked to identify the source of the revenues depicted in the table, and in preparing his response he discovered that an error was made in this table. And the error is for the amount shown in the second to the bottom row of wholesale revised cost of study, he shows 3,444,000.

And in response to discovery he

modified that to 3,788,000, and that causes some adjustments to the rest of the table, and I won't discuss it, I just wanted to let you know that that adjustment had already been identified through discovery, so this is just more last --

MS. BROCKWAY: What was the original testimony? I don't have that in front of me.

MR. BALLENGER: The original testimony included --

MS. BROCKWAY: I don't need to know what it included. I'm sorry. What was the number for that --

MR. BALLENGER: I'm sorry, are you asking what the number was that's been modified?

MS. BROCKWAY: Yes.

MR. BALLENGER: 3,444,000 in the column number two, revised for wholesale.

MS. BROCKWAY: Okay. And you said other changes would be made. The change here increases the allocation wholesale.

We understand that the other numbers above have slightly decreased?

MR. BALLENGER: No, Madam Hearing Officer. That is the only change. There are no changes to the numbers above. The change is to the different calculations column four as a result of the mathematical application of that wholesale number.

MS. BROCKWAY: So the total of 273,268 in the column revised was not an error, just that one number was --

MR. BALLENGER: No, it is a typo. And the total number is changed from the original testimony, as well, as a result of the change to the wholesale number.

MS. BROCKWAY: Can you give us -- so this number, 273,000 --

MR. BALLENGER: That is also a modified number from what was presented in the original testimony.

MS. BROCKWAY: Are there any of the numbers on the page that were modified?

MR. BALLENGER: Yes. In the right column under difference, column four, the number presented in the errata for wholesale is 541,147, and in the original testimony the number was 197,147.

And then in addition, the total number reflected in the very bottom column as shown in the errata is 1,470,367. In the original testimony that number was 703,367.

And as Mr. Dasent was just whispering to me, this is just a correction of a typo, which causes the numbers in the total column to change.

MS. BROCKWAY: I'm sorry to take time with this, but since we're not having a witness I need to understand this errata sheet.

The total of 273 million in columns PWD filed and revised, who revised the PWD filed for this purpose? Column number two, who created or who gave us those numbers?

MR. BALLENGER: These are the revised numbers as determined by Mr. Mierzwa using the cost of service model.

MS. BROCKWAY: So in other words, these are the numbers -- if Mr. Mierzwa took the total revenue requirement as filed by the department he would have a different allocation?

MR. BALLENGER: Correct.

MS. BROCKWAY: And so the total numbers, they are all taken from the file, so revenues is existing rates, that was something given by the department.

MR. BALLENGER: That is my understanding.

MR. DASENT: I haven't verified these numbers. I did note in going through informal discovery that there was a typo, and I think that's what's getting corrected, and then it falls down to the other columns.

Other than that, the principles Mr. Mierzwa stated are about the same.

MS. BROCKWAY: So let's go backwards. We are going to start by identifying the Errata Sheet for Public Advocate Statement Number Two, and I take it that that's included in the record without objection.

MR. DASENT: Yes.

MS. BROCKWAY: And we had the Errata Sheet for PWD Rebuttal Statement Number Two. Is there any objection to that?

MR. BALLENGER: No objection.

MS. BROCKWAY: It's in the

record. And finally, we are marking PWD Hearing Exhibit Number Two, Summary of Public Advocate Adjustments acceptable to the Philadelphia Water Department.

Is there anything else that we need to take up before we continue with your re-direct?

MR. DASENT: That's it.

MS. BROCKWAY: I turn it over to you, Mr. Dasent.

MR. DASENT: I have a series of questions on redirect, and I will just identify the witness I am addressing, starting with Ann Bui.

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EXAMINATION

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BY MR. DASENT:

Q. Ms. Bui, first of all, good morning.

A. Good morning, everyone.

Q. Mr. Ballenger cross examined you yesterday concerning multi-year rate requests, and that was in reference to your testimony on page two.

Why did you reference other jurisdictions that allow multi-year rate increases --

A. Yes, what I'd like to do, Madam Hearing Officer, if we can pull PWD rebuttal statement one and go to page two, there are some things I want to point out in that --

MS. BROCKWAY: While I'm looking for that can you repeat the question, because I don't know what document you were starting with.

MR. DASENT: I'm sorry. It is the rebuttal statement from Black & Veatch, and that would be statement number one. And on page two of that statement --

MS. BROCKWAY: Which rebuttal statement?

THE WITNESS: Number one.

MS. BROCKWAY: I'm there.

MR. DASENT: And on page two.

THE WITNESS: So what I'd like to start with is explicitly lines 17 and 19, where we note that the Philadelphia -- the Pennsylvania PUC has seen multi-year requests.

We actually say requests. We do not indicate that it has been approved, that any of them have been approved.

And what I would also like to point out is that if you go to our response, Q & A four and five, the approval of multi-year rate increases for municipal utilities is common. That's what we say.

And utilities elect to take this approach for a variety of reasons, including trying to manage the cost of rate proceeding, establishing revenue certainty and managing their resources in capital improvement programs.

And the table on page four of the rebuttal statement presents a list of -- representative list of various multiple -- municipal utilities that follow this practice. And you can see that these are multi-year rate increases.

Now, within the regulated world this --

MS. BROCKWAY: Before you go further, you said rate increases. On line eight you say establish rates.

I was going to ask you later, but since you just changed the testimony, do all of these contain increases from the first rate year to the last rate year?

THE WITNESS: Yes.

MS. BROCKWAY: All of them?

THE WITNESS: Yes.

MS. BROCKWAY: There are no stay-outs --

THE WITNESS: No.

MS. BROCKWAY: -- there are no zero --

THE WITNESS: I will point out that as a municipal entity many of them go back in front of their city council as part of their budgeting process every year.

And so -- to test whether or not that revenue adjustment that's been approved still needs to be implemented, okay.

So -- but yes, there's no zeros in there. It's their annual increases and adjustments. And they are not necessarily the same. They can be up and down.

MS. BROCKWAY: Up and down?

THE WITNESS: Well, you might have a two one year, a four and a three. That's what I meant.

MS. BROCKWAY: Oh, okay.

THE WITNESS: Depending on the need. So within the regulated world, as I am sure many of you are intimately familiar, we do see multi-year rate increases, for example, with the scale of the national grid, and that occurs most regularly in other states, like Minnesota, Colorado, Rhode Island.

And in these jurisdictions PUC has approved three to four year rate increases, which happens to vary from year to year and from case to case.

Within the regulated water utility industry probably the best example of where you are going to see a multi-year rate increase is going to be with the Rhode Island PUC.

And some recent ones with multi-year three separate rate increases were the Pawtucket Water Supply Board, Kent County Water Authority and Newport Water.

MS. BROCKWAY: Can I write those down before you go further?

THE WITNESS: Sure.

MR. DASENT: Pawtucket Water Supply Board --

MS. BROCKWAY: Excuse me. I want to write it on the correct page. Those are not listed on this --

THE WITNESS: Right. These are regulated water utilities, and the three that I named are regulated in --

MS. BROCKWAY: So I've got Pawtucket --

MR. DASENT: The second one is Newport Water that she mentioned. And --

THE WITNESS: Kent County.

MS. BROCKWAY: How do you spell that, Cash County?

THE WITNESS: Kent, and Newport Water.

MS. BROCKWAY: So that's four --

THE WITNESS: Yes.

MS. BROCKWAY: You're saying these are all investor-owned.

THE WITNESS: Not necessarily. They all are regulated. Two of them are municipal. Rhode island regulates everybody.

MS. BROCKWAY: Which ones are the municipals --

MR. DASENT: Pawtucket is --

THE WITNESS: Yes. I thought Newport was. We'd have to double-check that and --

MS. BROCKWAY: I don't know that you have to spend time on it. I'm sorry to interrupt.

BY MR. DASENT:

Q. You were also crossed yesterday by the reasonableness of the rate period.

What sections or section of 13-101 of the Philadelphia Code did you rely upon in compiling your testimony?

A. Right. Thank you. Upon conferring with my team yesterday, I realized that I was mistaken in attributing that statement. On page eight, lines one to four, to legal counsel.

I will just pause as everyone

moves to that page. It was really based upon our reading of section 13 dash 101 of the code.

And specifically the last sentence -- if we can go to maybe Exhibit-7, that the public advocate kindly provided us, and if we could move to page 23 of 57. I will just wait while we find that.

MS. BROCKWAY: I'm there.

THE WITNESS: 23 of 57. Page 23. So if we -- which is copies or representations of title 13, we can see that in --

MS. BROCKWAY: I'm sorry, excuse me.

THE WITNESS: 23, Exhibit-7. It is the big thick one.

MS. BROCKWAY: I am on 53. So please go ahead.

THE WITNESS: That's okay. So we are at section 4-B, the last sentence.

One of the statements that we relied upon in making this interpretation was such rates and charges may provide for sufficient revenues to stabilize the -- a reasonable period -- number of years.

The second one that we used is actually on page 22 of 57, and it is 1 C, which reads that the reserves necessary to stabilize rates for three, four and five periods -- year periods, excuse me.

And from these particular statements we interpreted that to mean that multi-year rate requests are allowed.

MS. BROCKWAY: Thank you.

MR. DASENT: I would like to direct my next question to --

MS. BROCKWAY: I do have a question. Who do you mean by team?

THE WITNESS: The Black & Veatch the panel that's here.

MS. BROCKWAY: But not including the department?

THE WITNESS: No.

MR. DASENT: Ms. Kumar, you were cross-examined yesterday concerning operation of the Black & Veatch rates model.

Do you recall that?

MS. KUMAR: Yes.

BY MR. DASENT:

Q. Can you confirm whether the rate model will automatically make changes on the assumptions or inputs of change?

A. As I said yesterday, when certain parameters are changed depending on what parameter is being changed, then other parameters that may be interdependent on that also have to pay the debt.

So, for example, in yesterday's discussion it was specifically mentioned that if you change the all-number requirement -- if you use the all-number requirement then will the revenue adjustment -- will it automatically change, and we explained that no, it will not automatically change.

And to kind of discuss that, if it is acceptable, we have provided a maturation today to show how these things would actually work.

MR. DASENT: Why don't you give us the narrative and I will hand out these.

MS. BROCKWAY: Why don't we wait for the exhibit, and then you can give the narrative.

MR. DASENT: With Your Honor's permission, it will be PWD Hearing Exhibit-3. Today is the 15th.

MS. BROCKWAY: So marked.

(Document marked as Exhibit PWD Hearing-3 for identification.)

BY MR. DASENT:

Q. Do you remember the question?

A. Yes.

Q. Basically we're asking whether the rate model will automatically make changes --

MS. BROCKWAY: Sorry. Another robo call.

BY THE WITNESS:

A. Our response was really depending on what parameters are changed the model will not automatically change. So here is an example using this illustration.

So if you look at -- under the first column it says data and assumptions input. And item number four says O&M expenses, that little gray box.

So if you change the O&M expenses

the input to O&M expense -- and yesterday the example used was if you simply take away the ten million dollars from Smith and Garp, which was an O&M expense -- and if you simply take that, then what happens? What happens is if you look at the right in the financial plan projection itself, that projection of operating expenses, the total operating expenses, that will get reduced.

And that was pointed out, that the total operating expenses came down by ten million dollars. But then the question is, okay, if you don't do anything else then what will happen -- if you -- if you -- if you don't change anything else then the net revenues that are shown in the green line automatically come down in the absence of any other change.

But will that automatically change the amount of revenue adjustments that we need? No. The model will not automatically change the amount of revenue adjustment.

That is something the user will have to do and look at all the other interdependencies and adjust so that then in line two, where we see the revenue adjustment percentage, that has to -- the user has to make that judgment and make that adjustment, and that's what we were referring to yesterday.

Similarly, just for another example, if you look in the right -- in the left column, capital account deposit factor.

Yesterday in the example it was said that, oh, we changed the capital account deposit factor from one and a half percent back to one percent. If you change the capital account deposit factor back to one percent, then what will happen?

What happens was -- yes, on the right side if you look at the projector deposit to capital account deposit that number will change. However, then will the model then do automatically something? No, the model will not do automatically something, because then the user would have to go and say, okay, now I'm reducing the capital account deposit back to a one percent, which means I am reducing that component of cash financing to capital.

However, if the department's role

is to at least have up to 20 percent of cash financing of capital, and if you reduce that capital account deposit, then what should you do?

Then you have to go to the next line, which is the transfer to construction fund. And then you can adjust it so that if you do come back close to the 20 percent of the cash financing.

So these are the interdependencies we are talking about. What the model will not automatically do the rate specialist has to use prudence and responsible interpretation and adjustment so that the whole capital again is properly balanced to meet all the objectives.

Q. Thank you. Mr. Ballenger, Praba, also cross examined you yesterday concerning PA hearing Exhibit-7, and that is specifically with regard to table 11 in the 2012 rate proceeding and table C-1 in the 2016 proceeding.

Do you recall that?

A. Yes.

MS. BROCKWAY: What page was that

again?

THE WITNESS: Page 48 of 57 in Exhibit-7.

BY MR. DASENT:

Q. Ms. Kumar, does it make any sense?

A. 48 of 57 is the 2012 rate case filing, and then 49 of 57 is the 2016 rate case filing.

Q. Ms. Kumar, does it make any sense to compare revenue projections done in 2012 one page you just referred to in a given year to revenue projections done nearly four years later without a discussion of the underlying facts that will explain the variances that show up between the two tables?

A. Right. Just comparing numbers to numbers we think that that is not appropriate without really integrating the expenditure factors that go into it, and also the timing.

So when 2017 number was pointed at yesterday, fiscal 2017, from the 2012 rate case filing, that 2017 was five years away from 2012, but if you look at the 2016 rate case filing, the 2017 was really the other way.

But more than the timing there are also other things that changed. So in the 2012 filing at that time 2016 was supposed to have a six and a half percent revenue adjustment.

In the 2016 filing in reality what happened was in 2016 there was no adjustment. So when these factors happened the numbers are going to look different.

So it's not just saying that this number is different from that number. What is important is to look at not only the underlying factors that contribute to that, because during those timeframes some of the -- some of the refinements to financial projections changes.

And the projections that were done in 2012 were done in a certain known factor. For example -- I think Mr. Yarkin (ph) chimed in on this. For example, the performance on pensions -- because we project actual to budget, and what was happening then and what was happening in '16 and we are -- we chime in on that.

MR. JAGT: Just as an example of how the -- how the view of which the data at times can change is during that rate case in 2012 the actual budget factors that we had for the fringes and benefits, at that time we were experiencing 105 percent -- actuals were 105 percent of budget.

So in the rate proceeding applying 105 percent was very conservative and in the projection of the fringes of the benefits.

And since that time, you know, actual data continues to be refined and, you know, we've adjusted back, so it's not overstated. We are being very conservative on that point. So that was one of the cost drivers at that time that was pushing the revenue requirements up slightly higher.

The other thing I want to point out with this is also the fact that we are looking at the fiscal year 2017 and '18 as the variance. And that amount, while it looks like a larger number, it is approximately less than 10 percent variance in the total revenue.

It is the compounding effect over the five years which could equate back to one or two percent per year within each year.

MS. BROCKWAY: Which line are you looking at for that statement?

THE WITNESS: That would be line 11. It could be both pages in between. So on page 48 we are looking at line 11, which is the total water and waste water service revenue, to line ten -- sorry, same line, line 11, total water and waste water service revenue.

And the comparison is between 731 million in fiscal year '17 to 675 million in fiscal year 2017 and the most recent projection.

MS. BROCKWAY: Say that number again, the most recent.

THE WITNESS: The most recent projection in '17 is 675,376,000.

MS. BROCKWAY: Thank you.

THE WITNESS: Sorry, that is from the 2016 hearing rate case.

MS. BROCKWAY: Which is that?

THE WITNESS: The exhibit provided, page 49 of the exhibit, the 675 million.

MS. BROCKWAY: That's from your filing in this --

THE WITNESS: The 2016 rate case.

MS. BROCKWAY: But I thought that page 49 was the 2016 filing.

THE WITNESS: Correct.

MS. BROCKWAY: Can you go over that again.

THE WITNESS: We're just pointing out that the variance between the two --

MS. BROCKWAY: Between which two?

THE WITNESS: Between page 48, which is the 2012 rate case, and page 49, which is the 2016 rate case.

MS. BROCKWAY: I see -- my problem. I see where you were. Sorry.

MR. DASENT: Does that complete your response?

THE WITNESS: Yes.

BY MR. DASENT:

Q. Ms. Kumar, Mr. Ballenger also introduced a collection factor yesterday of 97.12 percent on page 56. Do you recall that?

A. Yes.

Q. Is that the same cumulative collection of profactor what Mr. Morgan recommends in his testimony?

A. No. Actually, Mr. Morgan calculated the three year average differently than Mr. Ballenger. They used different time periods.

And so within the whole approach it is not consistent. And in their testimony Mr. Morgan recommends using more current data, and in the exhibit that Mr. Ballenger used yesterday, he was kind of using more older data.

And that is an issue, because most things that you can pick the three-year average one way or the other, and what we are saying is what we have done is use all the data available from 2012.

So again, to just reiterate here, Mr. Morgan was using only '14, '15, '16 for his three year average analysis. Mr. Ballenger was using only '12, '13, '14 in his analysis in Exhibit-7.

But what we have done is starting

from '12 we used all the data available. And there are two reasons for that. One, for the first time that much data is available for payment pattern. And second, it also makes a more consistent use of that approach in future proceedings, as well, because now going forward that kind of data will always be available.

MR. BALLENGER: Thank you. Mr. Morgan appears to have made some changes to PWD's rate following assumptions.

Has his analysis considered the interdependencies among multiple factors that influenced the financial?

MS. BROCKWAY: What are you referring to from the cross-examination yesterday?

MR. DASENT: Yesterday we were talking about the rate model and its inconsistencies, and that some of the statements made yesterday might be corrected today by Mr. Jagt in indicating.

And my question was basically if you're looking at some of the rate model assumption changes, did Mr. Morgan consider his analysis interdependencies between multiple factors that influence the financial plan outcome.

MR. BALLENGER: Objection here. I don't think this is proper redirect, for the witness to respond to Mr. Morgan's direct testimony at this point, which it doesn't arise out of cross.

MS. BROCKWAY: There was a long discussion of interdependence yesterday. I will allow it.

MR. DASENT: Thank you.

MR. JAGT: Similar to the examples we've already reviewed, as Mr. Morgan pointed out in the examples provided in the hearing Exhibit Number-7 --

MS. BROCKWAY: Which page?

MR. JAGT: And I will use -- on page 47 of 57. In this example some adjustments were made within the financial planning model to reduce or increase the revenue requirement, so they increased the capital account deposit, which was on line 27.

MS. BROCKWAY: What page are you

on?

THE WITNESS: Page 47.

MS. BROCKWAY: I've got this one as the increased Smith Garp.

MR. JAGT: Okay. It is increased to Smith Garb. I apologize. So it would have been increased on line 16.

I will back up. Page 46 shows that it's a change through the Smith Garp --

MS. BROCKWAY: Wait. Wait a minute. You are so right.

MR. JAGT: Thank you. Which shows up on the ONM line, which is line 16 on page 47. And one of the subsequent impacts, if you follow through the illustrative example that Ms. Kumar handed out, the illustration, if no transfers or subsequent adjustments are made what ends up happening is, you know, as a result of not following through with subsequent adjustments is on line 36.

We actually end up with a negative projected balance and less than 15 million, which is the targeted objective for PWD in the residual fund balance.

So any adjustments that you make to the model you should follow through, as we are showing through the steps as illustrated in the exhibit today, to make sure that you are maintaining all of the objectives and the metrics, financial metrics that you want to achieve in the financial plan.

And we have similar examples to this in Mr. Morgan's testimony.

MS. BROCKWAY: Now I think we are getting beyond redirect.

MR. DASENT: Just complete your response in terms of your re-direct -- in terms of your response from cross-examination from Mr. Ballenger. Thank you.

That is all we have.

MS. BROCKWAY: Mr. Ballenger.

MR. BALLENGER: Thank you, Madam Hearing Officer. I just have a couple of things on recross. I just like to start with Ms. Bui again.

A. Good morning, Mr. Ballenger.

Q. Good morning. Ms. Bui, you gave us some examples of some regulated water utility proceedings that set multiple-year rate increases, and I wanted to focus particularly on the three examples that you gave from Rhode Island. I think it was Pawtucket, Narraganset and possibly Newport --

A. Kenty County.

Q. Kenty County. Thank you. So for those three utilities isn't it true that they have to file annual compliance filings?

A. Yes, it is true.

Q. And do you know if that annual compliance filing can result in a change to the rate increase that was authorized?

A. To the best of my knowledge, yes. It's similar to what I mentioned that municipals go through with city council.

Q. Right. That is the parallel I had in mind.

And I would just like to turn back to section 13 dash 101 in the Philadelphia code while you will find it in Exhibit-7.

MS. BROCKWAY: Do you have a particular --

MR. BALLENGER: I'm going to find

the page for you now. Page 22.

THE WITNESS: Yes.

BY MR. BALLENGER:

Q. And I just wanted to direct your attention to paragraph one, which is titled Council Manic examination.

And in your redirect you said that Black & Veatch also relied upon the language in paragraph C that said -- that involves the reserves necessary to stabilize rates for three, four and five year periods.

As this paragraph is written, wouldn't you agree that this relates to an independent examination to be conducted by a council as compared to a rate standard?

A. I can't really comment on -- I mean, that is an interpretation. We interpret it as being -- I suppose legally you can interpret how -- how you have.

But we interpreted reading it as simply saying that if you're going to establish reserves three, four, five multiple year periods, you have to know how much revenue you need in order to do that. So that's how we read it.

Q. Okay. I think I understand how you read that.

MR. BALLENGER: Let me turn to Ms. Kumar.

BY MR. BALLENGER:

Q. I just want to make sure, Ms. Kumar -- I'm not sure if I misheard you and I just want to make sure that it's clear.

I think when we were talking about page 56 of hearing Exhibit-7 of the public advocate, and the collection factors on that table --

A. Yes.

Q. -- I thought I heard you say that this approach only used 2012, 2013 and 2014 data.

Is that what I heard you say?

A. What I'm seeing here is that if you look at the data that the time period used in coming up with that, to the shaded part or the light shading that we see, that light shading that we see in this segment is different than the three-year time period that Mr. Morgan has used in his data.

They are not one in the same, what we are seeing.

Q. Okay. I just wanted to make sure. I must have misunderstood what you were saying. Thank you.

MR. BALLENGER: We're done on recross from the public advocate. Thank you.

THE WITNESS: Thank you.

MS. BROCKWAY: Anybody else want to cross examine? I do have just a couple of questions for clarification.

BY MS. BROCKWAY:

Q. I asked Ms. Bui who the team was and she replied Black & Veatch. Before the filing was made did Black & Veatch consult with PWD about the reasonableness of the results?

A. Yes.

Q. And did Black & Veatch, when it was preparing its estimation, at that point consult with the PWD attorney?

A. I would have to check with the rest of the team, but I will tell you that as part of the process, and we are developing the rate schedules and all of that, that is a collaborative process with the department.

Q. So if the department had thought that there was a need to consult counsel it probably would have come to that, wouldn't it?

A. Yes.

Just a point of clarification, Madam Hearing Officer, both legal counsel, Mr. Dasent and Mr. Schwartz, did see the filing before it was filed.

MS. BROCKWAY: I would expect nothing less. That's what you will find in rebuttal testimony.

Well, I think you were asked questions by Mr. Ballenger that probably provided information that would have been responsive to what I would have asked you, so I am going to go along with that.

Finally, a question I have --

A. Yes.

Q. -- is we are talking about -- Mr. Jagt was talking about the problem that if you make a change in one line it may produce a result that requires you to look at other changes or to change your mind on the change that you made, if I correctly have done that.

And we were all looking at pages 45, 46 and 47, I think it was, yes, of PA Exhibit-3. I have to tell you that I took this as represented to be what would happen if I just changed the number and not as how you would want to set rates.

I didn't take the representation to be that on line 36 the negative amount was acceptable.

So what I have from your testimony is that you were looking at this as if this is the final product, and that if the adjustment were made this is what the public advocate would recommend?

MR. JAGT: No. We probably should have said and stipulated before we began the response, as Rob presented when he proffered the exhibit, he pointed out it is just an illustrative example. It wasn't carried through.

But just as a matter of an example of what could happen, it also works the same way. But I realize -- I wasn't prepared in that nature, but just illustratively providing a point that if you don't carry it through and make the adjustments, that is the type of impact that could happen.

MS. BROCKWAY: You could end up with an unacceptable impact?

MR. JAGT: Correct.

MS. BROCKWAY: Got it. Let me just check my notes. That's it. Thank you very much.

MR. DASENT: We should note that Erin Williams is in the room for Smith Garp issues today, and I don't know if it's appropriate just to bring her up if there are any questions on that subject.

MS. BROCKWAY: Let's go off the record.

(Discussion held off the record.)

MS. BROCKWAY: I take it that we are finished with the examination of the panel that has produced statement one and statement rebuttal one.

MR. DASENT: That's correct,

except Ms. Williams was a part of the rebuttal for statement one. That's why I thought it was appropriate to do it now.

MS. BROCKWAY: Right. If you would indulge me, let's turn to Ms. Williams for just a little bit.

MR. BALLENGER: Madam Hearing Officer, we still do have a couple of questions on fire prevention that I believe Ms. McCarty will --

MS. BROCKWAY: Let's go back off the record.

(Discussion held off the record.)

MS. BROCKWAY: The department has brought up Ms. Erin Williams, and I think I know what a lot of those questions were.

I didn't give you any advance notice of these questions, so I actually wouldn't be surprised if you said, I've never thought about that and I have no opinion at this time.

But I'm interested in -- and again, I understand that the process has been such that anything that we talk about now couldn't affect program design, but I want to talk about a program design, because I have a worry that grants to customers as the means of encouraging them to take certain actions that are for the benefit of the general public have a number of problems as a matter of program design.

My experience is, and almost entirely, with electricity and a little gas. A couple of things. Let's start out by -- are there customers whose properties could be benefited by an investment -- are we talking about Garp entirely?

MR. DASENT: In terms of Garp I guess Mrs. Williams can best explain the nature of the program and what progress it concerns, and even the acronym explains, sort of tells you, what its benefits are.

MS. BROCKWAY: I'm just not clear enough at the moment to know whether this applies to -- I am going to say Smith Garp.

I understand that under both, one of the incentives to persuade a customer to make an investment is to help pay for those investments by making a grant.

The theory of that is that people might want to do good, but they have reasons why they can't or won't spend their money for the whole package.

THE WITNESS: The theory behind it is two-fold, to put it simply. So when we started our parcel-based fees back in 2010 we did impact a great number of our non-residential customers.

And so Smith, the first of the grants, was originally introduced as a way to help customers implement a storm water management project, therefore making them eligible for a storm water credit or fee reduction.

What we quickly found out is that these projects were also very integral to the department's consent order and agreement for combined sewer overflows.

So really the intention of the program is to provide the department with much-needed Greened Acre projects for compliance.

MS. BROCKWAY: Greened Acre?

THE WITNESS: Greened Acres, yes. That is a metric of -- that we report to the Pennsylvania DEP.

It's acres that have been captured and treated. The storm water has been captured and treated, and the storm water management practice doesn't necessarily have to be green.

These projects that we implement through Smith and Garp are used when we report to the DEP.

BY MS. BROCKWAY:

Q. So what I want to focus on is the question of how do you incent a customer to do something that they didn't otherwise do?

A. Okay. So the storm water fee for a non-residential customer base is based on two parameters, the size of the company and the amount of impervious cover.

Those customers are eligible for a reduction in that fee via our storm water credits, which is also -- that program is summarizing rates and charges.

Q. Rates and charges?

A. Sure. So the credit available to the customer of up to 80 percent reduction is really the motivation for many of our customers to want to participates in this program.

They are highly motivated to reduce their storm water fee and monthly storm water charge, which can be very high for many of our non-residential customers.

Q. The money that they have to spend in order to accomplish what you are hoping they will accomplish is -- if you were looking at that on a net present value basis and not thinking about where does the money come from, and can you get a loan and blah, blah, does the monthly credit on a net present value, is it lower than what the customer has to spend, so they still have some to make up, is it about the same or is it higher?

A. What we saw is that the credit does not afford on a net present value basis enough -- it doesn't afford a customer return period or payback period that made sense to them financially.

So when we introduced the fee, the parcel-based fee in 2010, we were looking to see if perhaps the credit alone would be enough of an incentive for customers to implement these storm water management projects.

In fact, I think in 2011 we tried a loan, which was a precursor to our grant program, but there's very little appetite for that. There's very little appetite for our non-residential customer base to incur any more debt.

So the grant program really seemed like a nice win-win for our customers that were impacted, and also us to get storm water management.

Q.   If I understand it, the way the program operates now is that there is, you could call it a co-pay, which is an amount of money that the customer has to spend above and beyond what they can expect in bill credits.

A.   Yes. We don't -- I don't know if it's accurate to call it a co-pay, because as a result of implementing the project through our grant program the customer is obligated to maintain it, and there is an expense incurred as a result of their maintenance activities.

Q. So maybe the terminology is getting in the way, but then I see two ways in which there is still something for the customer to pay. That is the initial investment is not covered by the expectation of the credits.

And then after that there are additional expenses that have to be paid in order to maintain it.

A. That is right, but the way that we like to explain it to our customers is that the fee savings via the credits should cover the cost of maintenance activities.

Q. Are there customers that would otherwise be targets for greening or otherwise improving their properties from the Smith Garp perspective who cannot take advantage of the program as it is now defined?

That is to say they can't pay those additional amounts or they don't have disposable business income sufficient to make it attractive to make the additional investments they have to make to get those credits.

A. I'm not sure if I follow.

Q. You would think anyone would want to make investments to get the credits, but it sounds like that is not the end of it, you have to have additional expenditures.

And are there customers who can't make those additional expenditures, so they can't take advantage of the program as a whole?

A. Possibly. I am a little confused what you mean by additional expenditures.

The grant program looks to provide funding towards design and construction of a storm water management practice or project.

We do not cover any other cost that may be ancillary to the project. For example, you know, if the customer was also looking to do improvements to roof or building facade, we don't look to cover that.

Q. In energy efficiency it's windows, same thing. So let's go back, because maybe I misunderstood.

Let's say the total cost of a project that qualifies is $150. The anticipated -- the grant would bring that down by how much?

A. So we advertise our program in terms of -- we advertise a funding amount that we would like to provide to a customer in terms of the benefit to the department.

So currently we advertise that number at $150,000 per Greened Acre or less. So if a project is very competitive in the program, affording the department financially effective Greened Acres, we could theoretically cover the full cost of the storm water management project.

If the cost exceeds a certain amount, then we would tell the customer or applicant that they would need to provide their own funding for that additional cost or beyond what we would be willing to fund or they would need to find a way to bring the cost down.

Q. Do you get many customers who come in and say, we will take the 150 and spend the rest so that we get the 150?

A. No, we don't permit that through the grant program. Are you saying if the project was valued less than $150,000?

Q. No. The value is more than 150 and they have to kick in something. That is the co-pay, if you will --

A. Oh, yes. We do see applicants often submit an application with some of their own funds to make the application more competitive.

Because the program has become so competitive, applicants are looking to reduce their cost to the department as much as possible, their asking cost.

So by putting in their own funds that helps make their application more competitive.

Q. And that is without respect to whether the total cost is below 150 or above 150?

A. Yes. That is just a benchmark, really. I would say on average we are seeing applications varying anywhere between 70,000 to $190,000 per Greened Acre.

Q. I was trying to go to the method of determining the basis of the competition. Maybe you can talk a little bit about that.

A. The program is open to both. Smith and Garp grants are available to all non-residential property owners, except for properties owned by the City of Philadelphia. So that is a very wide base.

Q. Yes. Let's say you had several proposals, how would you decide which one to take?

A. So in a particular quarter -- we make decisions every quarter, at the end of each fiscal quarter.

We first evaluate applications based on their ability to maximize the amount of storm water managed on the property, and then we look at the cost per Greened Acre of that project.

Those are the two main criteria that we look to to evaluate these projects.

Q. And the cost per Greened Acre is the cost of the department?

A. The cost of the department, correct.

Q. So if you can and are willing to put in more of your own money you're more likely to succeed than the competition?

A. Absolutely.

Q. I don't think I want to take any more hearing time with this, because I have some ideas about a program design based on my electric experience, but I can't intuit sitting here talking to you whether or not they had any implication.

And in any event, like I said at the beginning, this isn't the time and place. But I am grateful to you for helping me better understand the program.

A. You are very welcome.

Q. Any questions based on what I had asked?

MR. BALLENGER: Just one, Ms. Williams.

BY MR. BALLENGER:

Q. Thank you for being here today. As you were talking about eligibility criteria it reminded me that at some point in the past I remember seeing a storm water incentives grant manual, and I wasn't sure if that had been provided at any point in discovery in this case.

Is it attached to your testimony?

A. It was attached to my testimony,

yes.

Q. Okay. So it's already on the record?

A. Yes.

Q. Okay. So I think some of what you were talking about is addressed in the manual, and I want to make sure that if there is any sort of clarification needed the manual is available.

MS. BROCKWAY: That's all the questions I have. Thank you.

THE WITNESS: Thank you.

MS. BROCKWAY: Any redirect?

MR. DASENT: Yes, very briefly.

BY MR. DASENT:

Q. Ms. Williams, has this program, Smith Garp, as you've described it today, been a successful one in meeting the department's COA obligation or consent decree obligations?

A. Absolutely. It's critical in meeting our five-year target and will be critical for your next ten year target and beyond.

Q. Is this the cheapest Greened Acre

that the department can achieve?

A. Yes. When the department is spending money this is the cheapest Greened Acre that the department can achieve.

I do want to clarify that we do have regulations that affect new development in the city, and those projects are also giving us Greened Acres.

MS. BROCKWAY: You might want to stop there, because if -- the issue in the docket is whether to spend more money on this.

The issue I was getting at is somewhat different, and as I said, really can't be raised in the docket.

I'm saying there may be cheaper program designs than this type of competitive grant, but it's way beyond the scope of what we are doing here to talk about that.

So when you say cheaper -- may I ask Ms. Williams?

MR. DASENT: Yes.

MS. BROCKWAY: What you mean is relative to direct spending on public land?

THE WITNESS: Correct, relative

to our capital program where we are implementing PWD-owned green storm water infrastructure assets. That will also incur the department very hefty operations and maintenance-related costs.

MS. BROCKWAY: Okay. Thank you for that clarification.

BY MR. DASENT:

Q. Let me say one final question. Is there a need for -- is there enough demand for Smith Garp in terms of applications submitted and applications that you haven't processed yet?

A. Yes. We have a very large backlog of applications that we are unable to award given our budget constraints.

Q. And when you spoke of the cheapest Greened Acre before, does maintenance have anything to do with that, the fact that the private land parcel owner has to maintain the equipment?

A. Yes. I mean, so there's -- the difference between PWD implementing its own capital -- capitally-funded Greened Acre versus one implemented via Smith and Garp is that the private entity is maintaining those and the department is not incurring significant underlying costs.

Q. Thank you. That's all we have.

MS. BROCKWAY: Thank you very much, Ms. Williams.

THE WITNESS: We are going to take a 15-minute break.

(A brief recess was taken.)

MS. BROCKWAY: Now, my understanding is that we are having the financial panel of witnesses who testified for the department with regard to the issues raised in Ms. Labuda's statement number two.

MR. DASENT: That's right. The rebuttal statement relates to Mr. Morgan's testimony, but we are using his testimony generally.

We are presenting our panel, which includes Ms. Labuda, Pete Nissen from Vocation Financial, Katherine Clupper from Public Financial Management, Valarie Allen from Ballard Spahr, and they are all on the cover.

And Steve. I'm sorry, I didn't look up Steve.

MS. BROCKWAY: What statement number was Mr. Morgan's testimony?

MR. DASENT: Morgan is PA statement one. I am rebutting him.

MS. BROCKWAY: Yes, I'm only talking about -- thank you. I got it. Okay. Please go ahead.

MR. DASENT: We've already authenticated the testimony and our witnesses are now proffered for cross-examination.

MS. BROCKWAY: Mr. Ballenger.

MR. BALLENGER: Thank you. As those of you who have been here for the last couple of days will probably suspect, my cross-examination is largely organized around the rebuttal statement, so if you can have your rebuttal statement number two handy, as well as Hearing Exhibit Number 7. On behalf of the public advocate we will refer to that.

If anyone needs another copy of Hearing Exhibit Number-7 -- Mr. Nissen and Ms. Clupper, I know you have been -- you were not at the table yesterday, so I do have a couple of extra copies, if you would like.

Those copies are not marked, so I just ask you to mark them Hearing Exhibit-7, and they were put on the record yesterday, May 14th.

On page three of the rebuttal statement, I'd just like to understand a little better the statement of hearing, lines four through six, where you discuss the possibility of negative cash flow due to, and this is the quote, the inherent lag in the regulatory process of adjusting rates to match costs that have been impacted by inflation or other increases over time.

I wasn't clear what you were referring to there. Are you referring to the fact that this proposed rate increase would not take effect in beginning of fiscal year 2019? Is that what you're referring to?

MS. LABUDA: That's one way to construe the sentence, is that it is only applying to those two months, but holistically, if you step back and you look at the costs that have escalated since our last filing, our pension and healthcare costs have well eclipsed any type of inflationary measure.

And, in fact, fiscal year '19 rate increase is mostly driven by workforce costs and cost related to the consent order agreement. They are not inflationary costs, those costs we are incurring today. And this is fiscal year '18, which lag the filing of the rate increase for fiscal year '19.

Q. Okay. But, of course, in this proceeding the department is asking us to look at three fully-forecasted future test years.

So in that scenario you would be talking about -- this statement would be referring to a lag that would occur at some point during the three years that you propose --

A. Again, we anticipate further pressures related to pensions, because of the significantly underfunded pension program.

So we have provided -- we have requested a three year rate increase. We have done our best to quantify, based on five-year plan projections, pension and healthcare costs.

And when you have a pension plan that is only 45 percent funded and the water fund representing 9 percent of pensions, we anticipate costs above what we've provided in our rate filing. So there will be another regulatory lag when we file again.

Q. So your projection is that your rate model doesn't actually capture all of the costs that you're anticipating?

A. And we did put that in my statement, in my direct testimony, that not only did it not -- it did not capture all the costs, because there were further policy changes that occurred citywide, such as the movement of certain vehicle costs out of the capital budget into the operating.

Black & Veatch's model did not capture that line item moved from capital to operating, and that is an additional three million in expenses that is not in the rate model.

As we discussed yesterday, we started cost of service in May of 2017 --

MS. BROCKWAY: Do you have a quick reference to the page number in your direct?

MS. LABUDA: If you give me a moment I can help you find it.

MR. BALLENGER: I believe you may be looking for page five, lines 15 to 23.

MS. LABUDA: Thank you very much.

MS. BROCKWAY: Thank you.

BY MR. BALLENGER:

Q. Turning to -- actually, just staying on page three of the rebuttal, the section starts discussing a little bit of the importance of reserves to the department's credit rating, and a lot of this discussion focuses on the rate stabilization fund.

Do you agree with that?

A. Yes.

Q. Okay. And as I turn to page five of your original rebuttal -- and I recognize there was an Errata Sheet. But lines 23 to -- sorry.

Lines 23 to 25, I believe you are discussing Mr. Morgan's recommendation and you say, this level cash reserves for the liquidity severely impedes the department's ability to mitigate any changes in revenue collections, unforeseen operating expenditures or disruptions in the ability to fund capital needs.

I have a question about that statement. I wanted to make sure that you are not just referring to the rate stabilization fund in that statement, are you?

A. As detailed in the financial planning, the rate stabilization fund is the bulk of the department's liquidity.

The secondary fund that we think of for liquidity purposes is also the residual fund.

Q. Okay. So you've introduced an errata where you correct line six of this page, page five, rebuttal statement on page five, and you indicate that Mr. Morgan's recommendation of 110 million dollars for the rate stabilization fund represents 176 days of cash on hand. Is that correct?

A. That's correct.

Q. Did you factor in the residual fund in performing that calculation?

A. Yes, that's correct.

Q. Did you factor in equity in the

treasurer's account in performing that calculation?

A. You can't use equity in the treasurer's account. Globally you have to think of equity in the treasurer's account current assets unrestricted.

And that is how the rating agencies measure us, on a GAP basis of accounting. And as you know, we don't separate two charges on GAP financial statements.

Q. Okay. So would it be correct, then, that when you state on page four -- I'm sorry, page six, line four of your rebuttal statement that if I were to perform a calculation and I were to take 165 million dollars and divide it by 244 days, I could determine that a day's cash on hand is a number by performing that calculation?

A. Sir, day's cash on hand, as proffered in my direct testimony as well as our financial advisor's testimony, it looks at operating expense, and then takes total cash reserves and takes -- and divides it by 365.

I'm not sure your formula quite

did that calculation. I'm not sure I --

Q. Yes, so I -- maybe we can look at page 57. It is the last page of Hearing Exhibit-7.

And I prepared this based on the original rebuttal statement. And so what I reflect in the title rows are the various components that I could tell from your testimony were included, but I wasn't sure.

But in the top row -- the second row, I have 115 million dollars in the rate stabilization fund, and then based on your original rebuttal you said that equated to 86 and a half days of cash on hand, which I was then able to calculate, and it indicated that one day's cash on hand was $1,271,676.

In the next row what I was trying to do was determine what a day's cash on hand was based on your testimony about the original level of reserves proposed, which was 150 million dollars in the rate stabilization fund, plus 15 million in the residual fund, for a combined 165 million dollars, which I then divided by the 244 day's cash on hand that you provide on lines four through five of your rebuttal testimony, and I was able to determine there that that -- that equation, that calculation would lead you to conclude that one day's cash on hand is $676,229 and change.

And I was trying to figure out what the calculations were you performed, because I couldn't -- couldn't get the same answer by doing the calculations.

A. Just for the record, I have no idea if your math is correct or not, so that would be subject to check.

Q. Sure.

A. Okay. So the way the rating agencies typically calculate day's cash on hand -- and again, this is all in my testimony, is if you would look at three components on the GAP financial statements, which would be equity in treasurer's account, current assets unrestricted plus water rate stabilization fund plus the residual fund, you would then again have to read the GAP financial statements, look at total operating expenses, subtract out depreciation and return and come up with operating expenses less depreciation and return.

You would take the sum of the reserves and divide it by operating expenses divided by 365.

And each of the rating agency's last slight variations in that formula, so what I've given you is a broad stroke. You should read the rating agency reports for how they go.

Some of them look at things like construction payable, vouchers payable, salaries payable to further --

Q. Yes, I understand there may be some differences in approaches.

I'd like to go ahead and ask for a transcript request in that you provide me with a table showing how you derived the calculation of 244 day's cash on hand, and identifying each of those components that you mentioned.

A. I'd be happy to.

MS. BROCKWAY: That's transcript request 15.

MR. BALLENGER: If we could maybe say it's part A and part B. That would be A and part B, I would like to ask you to do the same thing, to demonstrate how you arrived at 176 days of cash on hand using a 110 million dollar rate stabilization balance.

A. I'd be happy to -- we will be happy to provide the transcript request.

Q. Okay.

A. But again, these calculations are based on a GAP basis and have no bearing on what we are doing here today for rates and charges, because rates and charges are set on a cash basis, but I will be happy to supply you with the formula.

Q. Thank you. I think -- well, okay. I'm not going to argue about the importance of day's cash on hand, because I think your rebuttal statement makes the point.

And just to be clear, for the calculation, the second calculation, I'd like to make sure that you are including a residual fund balance of 15 million dollars.

A. Yes, of course.

Q. Thank you. That was 15 parts and A and B.

MR. DASENT: It's 16.

MR. BALLENGER: Is it?
MR. DASENT: Yes.
MR. BALLENGER: Thank you.
BY MR. BALLENGER:
Q. Okay. I'd like to turn to page ten of the rebuttal statement.
And in Q and A 9 on page ten, the question posed in your testimony is whether you agree with Mr. Morgan's statement that prior rate proceedings were based upon obtaining 1.20 times coverage.
And in the response to that question you state, no, we do not agree with Mr. Morgan, and you refer to the 2016 rate proceeding.
I just want to make sure that -- was that the only rate proceeding that you looked at in considering this response?
A. I didn't work for the city for the prior rate proceeding, so it's hard for me to speak of what happened in that financial plan, since I didn't set it. So the answer is no.
Q. Okay. I'm sorry, the answer is

--

A. Is no. Yes, I didn't go back to the prior rate proceedings.

Q. So maybe it would be fair for me to read your response.

A. I'm sorry, could you please --

Q. Yes. So it would be fair, then, to read your response as saying that you are not aware of prior rate proceedings being based upon obtaining 1.20 times coverage?

A. I am going to transfer to Kathy.

Q. Okay.

MS. CLUPPER: So, my understanding of prior rate proceedings in that they were slightly different than this proceeding is that prior to the rate board the commissioner set rates.

So the rating agencies and the investor community provided a pass to the city, because they knew at the end of the day that the commissioner would not set rates to violate any debt covenant.

So there was a little bit more leeway in setting rates, and they could set the rates slightly closer to the 1.2. That is not the case now.

And clearly '16 and '17 -- this rate proceeding, and when you read the testimony of the rating reports they all mention and acknowledge that the coverage is increasing and that is a credit positive.

The policy, you know, trending towards 1.3 times is mentioned throughout all the discussion, and that is the current policy. And having an independent rate board is certainly a factor that change in policy.

Q. So just to be clear, then, when the water commissioner set rates and charges there were proceedings in which the water commissioner set rates and charges based upon obtaining 1.20 times coverage, correct?

MS. CLUPPER: I mean, I was a witness to the '12, but I was not involved in the policy.

But I can tell you that the fact that the commissioner could set rates and charges did have an impact on how those rate proceedings were conducted.

Q. So you wouldn't be aware of what the targeted coverage was in any proceeding prior to 2012?

A. No. What I'm saying is that I don't know if that is relevant, because we are in a different rate-making process.

We have an independent rate board. The commissioner does not set rates. So I'm not sure you can draw a connection between the coverage policy of this current financial plan and coverage policies in the past financial situations.

Q. Well, I think relevancy is really a question for the board. I'm just trying to get a factual basis for this statement that contends that there were no prior rate proceedings that were based upon obtaining 1.20 X coverage, which is the statutory requirement for senior debt coverage in the -- in the ordinance, and I just don't -- I'm not getting an answer to the question.

MR. DASENT: It just seems like it would be in a prior financial plan or some other document that we provided in our rate case

--

MS. BROCKWAY: I think the witness can answer the question. I understand we've gotten the explanation for why the change if there is a change twice, but we haven't gotten a confirmation that there was a change.

Do you want to restate the question?

BY MR. BALLENGER:

Q. Okay. Are you aware of any prior rate proceedings that were based upon obtaining 1.20 times coverage?

MS. CLUPPER: No, I am not.

BY MR. BALLENGER:

Q. So your testimony here is based solely on the rate proceeding -- the last rate proceeding, 2016, and the 2012 rate proceeding, correct?

Is that correct?

MS. CLUPPER: I can speak to my involvement as an expert in the financial advisors to the city in helping develop financial policies for debt coverage, and that -- and I think I explained my answer to that.

MR. BALLENGER: Can anyone speak to this statement that does not agree with the factual assertion that there were prior rate proceedings that were based upon the 1.20 times coverage?

Can anyone on the panel speak to that statement?

MS. LABUDA: I don't have the records from the prior proceeding. If you would like me to go back to the office and check I can see if we ever set rates at 1.2 times coverage at a minimum level on a prior proceeding which predates the tenure of this team, I would be happy to do that.

But I don't have that document in front of me to confirm that back in 2008 or any prior proceeding that the financial plan was set at such minimum coverage levels.

I can't confirm it, because I don't have the document in front of me. As I've said before, I wasn't with the city but I would be happy to check.

Q. I offered to sort of read into the testimony here that you are simply not aware of any -- I offered that in sort of examining you to say, should read this to understand that you simply are not aware of any prior rate proceeding that was based upon obtaining 1.2 times coverage, and I didn't get a response that told me that that was the way I should read this.

But based upon what she just said, would that be a fair reading of your testimony, that you are not aware of a prior rate proceeding that was based on obtaining a 1.20 times coverage?

MR. DASENT: If Your Honor, please, we can get the information to answer the question.

In the room today we cannot respond, but we can get an answer for them.

MS. BROCKWAY: I think what Mr. Ballenger is getting at is how could the statement be so strong if the witnesses don't have that information in their memory.

So I think he's not concerned so much about getting the information as why doesn't this panel know that if they are making a blanket statement that Mr. Morgan is wrong for all prior proceedings.

And I think the problem is really with the way the question is stated here. So I think we can clear it up today, that, in fact, Mr. Morgan -- I understand the panel to be saying that Mr. Morgan is only correct with regard to 2016, or he is not correct with regard to 2016? Which of those --

MS. CLUPPER: Prior to 2016 -- 2012 --

MS. LABUDA: The last --

MS. BROCKWAY: So he is not correct with regard to 2016, and actually we should read this statement, as you don't have any statement about what happened before then?

MR. DASENT: That's correct.

MR. BALLENGER: Okay. I would like to move on. Thank you very much.

BY MR. BALLENGER:

Q. On page 11 of the rebuttal statement, and I am at lines 11 to 13, you say there that one of the key risks the department faces should the board agree with Mr. Morgan's recommendations is materially higher borrowing costs due to downward rating pressures from the lack of proper rate recovery and the lack of formulating sound financial metrics.

And below you provide a table, below that statement. And in that statement I believe these are the -- correct me if I'm wrong, but these are the Moody's score card ratings? I saw a nod.

MS. CLUPPER: Yes.

BY MR. BALLENGER:

Q. Thank you. Now, in that table it is a little bit hard to read on my copy but I just want to make sure that I'm reading it correctly.

Does it show that service area wealth is considered a 12 and a half percent of the score card factors?

A. Yes.

Q. And all of the credit rating agencies take into account service area income characteristics in some way, don't they?

A. Yes.

Q. And you've actually provided a

schedule in your rebuttal statement, schedule R2-2. And in there I found the -- the Fitch -- I believe it's the Fitch ratings criteria.

And the pages aren't numbered, so I will try and find the language I'm looking for.

MS. BROCKWAY: Before you find the language let's find the page. I'm looking at a document that says, Fitch ratings, public finance, U.S. water and sewer rating criteria sector specific criteria.

MR. BALLENGER: Yes. That is a perfect place to start. I would like to look at the next page.

MR. DASENT: Number two on the bottom of the page.

MR. BALLENGER: Thank you. That page is numbered two on the bottom.

And in the -- I believe it's the second to last paragraph in the second sentence, Fitch discovers -- I'm sorry.

Fitch describes how it considers rates for service to be financially burdensome. And it says, Fitch generally considers rates per service higher than one percent of median household income for an individual water, sewer and storm water utility financially burdensome.

And I just want to make sure you're following along where I am looking in the statement. And of course, the water department is a combined system, so it's not -- it's not subject to this particular statement that Fitch is talking about.

Fitch is talking about one percent for an individual water utility or an individual waste water utility. Am I correct about that?

A. I'm not sure. They rate combine systems. I think this discussion is related to both water, sewer and single systems. It is a general discussion on how they do things.

Q. I think page four clears it up for us. On page four of this same exhibit there is a table that is titled attributes revenue defensibility.

And on the spectrum that it sort of shows here and -- and the first bullet next to the heading weaker it states, residential charges for individual or combined water and sewer utility in excess of one percent or two percent of median household income respectively.

The way I read that then is it's saying one percent for an individual water utility or individual sewer utility and two percent for a combined utility.

Is that a fair reading of that? I'm at -- I'm further down in the table. I'm right -- I'm in the first bullet next to the word beaker.

MS. CLUPPER: Yes.

BY MR. BALLENGER:

Q. So that is a fair way to read that statement.

So do you happen to know what the median household income is in Philadelphia according to the latest census figures?

A. I don't know offhand, but are you -- do you want me to comment on where you are leading?

MS. BROCKWAY: No.

BY MR. BALLENGER:

Q. Not particularly. I am getting

to a point, though, I promise.

A. Okay.

Q. According to the figures that I looked at, median household income in Philadelphia is approximately 40,000. It's just under 40,000.

A. Right.

Q. That sounds right to you?

A. That sounds right.

Q. If we determine what two percent of median household income would be based on that figure, we would come up with, subject to check, $66.25, or thereabouts.

And we had some discussion yesterday. I don't know if you were in the room, but we talked about what the current charges are -- a current residential bill using 5 CCF's of water per month is $66.50.

Does that sound right to you?

A. Can you just ask the question? Yes, this is math and that is correct.

Q. Okay. And I just want to make sure that when we look back at page two, when Fitch establishes these financially-burdensome

-- or financially-burdensome rates, it is actually basing its determination on 7,500 gallons of water usage and 6,000 gallons of sewer flows. 7,500 gallons of water usage is twice -- is ten CCF's, as compared to 5 CCF's, correct?

MR. DASENT: Is there a question here?

BY MR. BALLENGER:

Q. Yes.

A. I understand what you're saying. Affordability is a concern that the rate -- that it needs to look at, yes.

MS. BROCKWAY: Let's go off the record.

(Discussion held off the record.)

MR. BALLENGER: Thank you for bearing with me.

BY MR. BALLENGER:

Q. My point was just that in your rebuttal statement you spent some time focusing on the credit risk to the department based on reserves and based on coverage, but I don't see any discussion in your rebuttal statement on the issue of affordability.

And I correct in that?

MS. LABUDA: That's correct, yes.

BY MR. BALLENGER:

Q. And just so we all agree, assuming median household income doesn't increase at the same rate as the department is proposing to increase -- I'm sorry, strike that. That is a compound question.

Would you assume that if median household income doesn't increase, that the higher rates and charges would represent a higher percentage of median household income?

A. No. No, not necessarily. I think --

MS. LABUDA: As Kathy and Pete will opine, when we face the rating agencies one of the things that offsets this whole discussion is the TAP program.

As you know, TAP customers are not going to see a rate increase, because their bill is not based on usage. It is based on affordability and their income.

So, yes, the rating agency is a

factor into their overall grid service territory. And offset to that discussion here today is, in fact, the TAP program.

MS. CLUPPER: In addition, you know, coverage generates additional revenue for the department to use for several things; affordability programs, to put back into the rate stabilization fund to mitigate further rate increases, and most importantly in my mind to contribute to PAYGO, which also lowers additional debt.

Future debt burden is a critical component of affordability. If you have fixed costs like debt and pension, you know, ten, fifteen years down the road you will have a major affordability program, and you will not be able to not pay those obligations, they are fixed obligations.

So it is not, in my opinion, a correct kind of set of assumptions to talk about affordability and not talk about raising rates.

Raising rates allows you to do a lot of things to address affordability.

Q. And I was just really talking

about one aspect of the --

A. I understand.

MS. BROCKWAY: Actually, I think this is really important. And if you will allow me to understand what's being said, I think what Mr. Ballenger is asking you to agree to is that, in fact, Fitch uses the cited criteria as part of its determination of whether there is a revenue defensibility -- and it actually uses that. It doesn't -- it has other factors that it looks at to determine whether, given that factor, there is a problem.

A. In my experience in the many rating agency presentations that I've participated in, affordability is a conversation, but what drives the conversation and the ratings are the financial metrics; debt service coverage, liquidity, and that is -- runs through all three rating agencies, Moody's, Fitch and S & P.

There's no question that affordability and the wealth of an area is something that they look at.

They don't spend a lot of time

really analyzing -- you know, they look at it but they spend much more time discussing financial metrics, which is why we focused on it, frankly, in our rebuttal.

You know, maybe we should have mentioned affordability but we did -- we focused on those metrics and in those discussions that, in our experience, the rating agencies care most about.

And I would encourage you to read the rating write-ups of Philadelphia, and you will see they talk about the system and the wealth, but they mostly talk about the financial and management.

MR. BALLENGER: I wanted to turn to page 15 of the rebuttal statement.

BY MR. BALLENGER:

Q. And the question -- I was confused about the question that was posed in this part of the rebuttal statement.

It says, what are the risks to rate payers and the department if Mr. Morgan's recommendations are followed and there is an underestimation of debt service costs. And I just wanted to make sure that I understood.

Aside from an adjustment to interest rates assumptions, do you agree Mr. Morgan didn't propose any adjustments to debt service costs in his testimony?

MS. LABUDA: I do not agree with that. Mr. Morgan offered a change to the spend rate on the capital program. Inherently, he followed at assumption change on percent of capital budget from -- I don't want to misstate, so I will fact check, 90 percent down to 74 percent, he did, in fact, amend debt service cost to something lower than that we will likely need to borrow.

Q. So he didn't adjust the cost of your debt service, he adjusted the amount of your debt, is that correct?

A. Not only did Mr. Morgan change the interest rate, which we agreed to, Mr. Morgan changed the funding of the program.

So if we were -- by changing the capital program spend rate down to 74 percent, he did change the debt service.

MS. BROCKWAY: I think the answer

is yes, and I think you are not communicating.

MR. BALLENGER: That is fair.

MS. LABUDA: Thank you.

MS. BROCKWAY: In other words, you have to take on more debt in order to make up what was not PAYGO funded.

MS. LABUDA: I'm sorry?

MS. BROCKWAY: You have to take on more debt for what is not PAYGO funded under his proposal.

MS. LABUDA: I think the answer is yes. Under his method we would have less funds available for PAYGO. And the model proffered for the testimony adjusted the amount we were going to borrow.

So on both fronts we could be shy of total funding of our capital program, which is most of the debt service. So yes.

MS. BROCKWAY: If I have created a problem here, Mr. Ballenger, I hope that you can clear it up, but I will try and remember it if you don't, so I can come back to it, because I think I have created a problem.

MR. BALLENGER: I'm not sure

you've created it, Madam Hearing Officer.

BY MR. BALLENGER:

Q. Mr. Morgan, would you -- perhaps you can tell me where Mr. Morgan, in his statement, made the adjustments that you were just describing.

A. So I have Mr. Morgan's testimony in front of me. It is the direct testimony of Lafayette Morgan dated April 20th.

If you go back to what I believe is the last page of his testimony, which is schedule LKM-2, Mr. Morgan has a capital program actual to budget ratio of 76 percent. That changes debt service.

Q. And just to be clear, where Mr. Morgan describes that adjustment on page -- I believe he starts on page 28. Yes.

You see that Mr. Morgan is focused on the -- on the -- the spending factor that was projected in the actual filing, which the department projected 90 percent of its capital budget would be utilized, right?

A. I agree with that. On page 28 Mr. Morgan is discussing changing the factor from 90 percent to something less, which changes debt service.

Q. I think you said before 74 percent, but just to clarify, you can see on line 18 that Mr. Morgan says 76 percent.

A. Yes, I apologize. 76.

Q. That's okay. I know you were speaking based on your recollection.

So you would agree that this is a recommendation based purely on the anticipated spending for the budget amounts identified in the filing, correct?

A. Yes. And spending changes borrowing, which changes debt service, if you follow the steps through the model.

Q. Understood.

MS. BROCKWAY: Except I think you are making the point -- I think you were making the point that debt service would go up.

And what I'm reading here, starting lines 20, is that it wouldn't drive up debt service, because, in fact, there would be less spending.

Do I read Mr. Morgan's testimony

correctly, and if so, can you all talk now about if that is also assumed, what does that do.

MR. FURTEK: Well, funding a spend rate of 76 percent would not fully fund the capital program as envisioned and as proffered in front of counsel at this point.

MS. BROCKWAY: Can you help me out by -- do you disagree with the factual statements that were made by Mr. Morgan at the balance of paying 28 starting at lines 20?

MS. LABUDA: Just a moment, Madam Hearing Officer. Would you just state the lines again, please?

MS. BROCKWAY: Starting at line 20 I understand Mr. Morgan to say Black & Veatch projects the net funding requirement for capital funding projects to be approximately 100 million dollars less than what PWD estimated over fiscals '19 and '20.

Actually, maybe this is not having the information that I originally thought it did.

But since I have started us down this line, do you agree with that statement?

A. I'm not sure how that translates into a percent of budget, which is what we are really talking about.

MS. BROCKWAY: I'm not talking about percent of budget. I'm talking about are these numbers true.

MS. LABUDA: Let me just -- may I?

MS. BROCKWAY: You may be correct, but that's not the question.

MS. LABUDA: So in the filing we have projected total capital expenditures for fiscal years '19, '20 and '21, and the factors projected provided in the Black & Veatch model reduce capital budget by 10 percent. So assuming 90 percent.

Our assumption is that we have 328 million, 339 million and 349 million respectively for the years '19, '20 and '21 of cash capital needs that we need to meet.

Mr. Morgan's assumption factors those numbers down further to something less than 328, 339, 349, by the simple aspect of applying a different spend factor.

I can't confirm his 100 million dollar number, because I unfortunately don't have the original budget numbers in front of me.

MS. BROCKWAY: I think I am getting clear. Thank you very much.

BY MR. BALLENGER:

Q. Just, Mr. Furtek chimed in to say that this would not -- that Mr. Morgan's proposal wouldn't fully fund, I believe it's the capital budget.

Is that your statement?

MR. FURTEK: That's right.

BY MR. BALLENGER:

Q. Okay. And using a 90 percent expectation as in the model, wouldn't the same be true, that the rates as proposed wouldn't fully fund the capital budget?

MR. FURTEK: It would not fully fund but it would take care of the obligations that we have put forth so far.

Q. Maybe this is back to Ms. Labuda. Just to be clear, if the department actually borrowed less it would have a lower debt service, would it not?

A. If the department borrowed less it would have lower debt service, and we would have to do system replacements. Our capital improvement program is critical to provide the level of service that we have today.

So what I'm suggesting in this hearing is that the arbitrary application of a lower spend factor puts our critical capital budget at risk, and we could still have to borrow to do those improvements, therefore debt services is understated.

Q. Each answer seems to lead to another question. You would agree that Mr. Morgan's adjustment was based on the actual rate of expenditure over three years, right?

A. I did not say that.

Q. You said arbitrary use of 76 percent, and I just want to make sure that you would agree with me that Mr. Morgan's methodology was based on the actual figures in the rate model.

A. I don't believe 76 percent in the rate model.

Q. It is the average of the three

years of prior expenditures, as Mr. Morgan explains in his testimony.

Would you agree that that is not arbitrary?

A. I would agree that is not arbitrary.

Q. Thank you.

A. Thank you.

Q. So, just talking a little bit more about the response that's provided on pages 15 and 16 to question 14, I just want to make sure I understand.

All of these risks that you identify here, those are risks that are associated with an underestimation of debt service cost, is that right?

A. Yes.

Q. Okay. I was confused about the question, because I wasn't sure if you were referring to other recommendations Mr. Morgan had made.

And I just want to make sure that you're just focused on the recommendations that he's made regarding capital expenditures in this section of the testimony.

MS. BROCKWAY: What page again?

MR. BALLENGER: I am at Q & A 14, which starts at the bottom of page 15. And the substantive discussion takes up the full page, 16.

MS. BROCKWAY: And we're in the rebuttal?

MR. BALLENGER: Yes.

MS. ALLEN: Is there a question?

BY MR. BALLENGER:

Q. Yes, there was a question. The question that I was asking is whether your response here solely refers to Mr. Morgan's recommendation regarding capital expenditures.

A. I said yes.

Q. Oh, you did?

A. Yes. The question, as you read it, is, are the recommendations followed and is there a reduction and does that affect service costs.

So both of those things have to hold, I think.

Q. Okay. I just -- when I read the

word recommendations I thought, well, gosh, Mr. Morgan makes a lot of recommendations. And I thought you were talking about specific recommendations and I just want to be clear that, for example, Mr. Morgan's recommendations regarding capacity to pay for energy costs would not result in all of these risks you identify on page 16.

Am I correct in reading the testimony that way?

MS. LABUDA: Yes.

MR. BALLENGER: Okay. Thank you. Let me just talk with my team, if I can just have one minute.

And with that, I am through with my cross-examination. I did promise it would be short for this panel, so I lived up to that. Thank you.

MS. BROCKWAY: Any other cross-examination? Seeing none. Questions from the bench chair?

MR. POPOWSKY: Thank you. First of all, maybe you can just refresh my memory. At the end of the last rate case that we did in

2016 my recollection is that the ratings of the department were either held the same or raised slightly, is that correct?

MS. CLUPPER: Let me just confirm. S & P -- the others were rated the same. S & P was upgraded to A-Plus.

BY MR. POPOWSKY:

Q. So the others were Moody and Fitch's, which stayed the same?

A. Yes. So now there is A-1, A-Plus and -- A-Plus, A-Plus and A-1?

Q. Okay. And which one went up?

A. Standard and Poor's.

Q. What I'm struggling with is at the top of page six of the rebuttal testimony. And you were asked questions -- I'm really trying to get a better handle on, is there a consistent definition of days on cash -- days of cash on hand that we can make valid comparisons, you know, like on page 5 you have a graph that -- where the numbers go from 89 for Indianapolis to 840 for Columbus.

So I guess -- and this isn't a question, but my underlying misunderstanding or confusion is that I'm not sure we are always talking about apples and apples.

A. So when we prepared this testimony this time we spent some time talking about it, and we made the decision to reflect Moody's comparisons and metrics.

And the reason is because, you know, they are pretty transparent. The data on other utilities is available, and we wanted to be consistent, because we appreciate the fact that they all look at it slightly different.

The result is both S & P and Fitch and Moody's both kind of say the same things. But for the purposes of providing the media, we're using the Moody's media. And we can provide you the exact definition you want.

Q. But for Philadelphia, if I'm looking at the chart on page five, it shows Philadelphia slightly over 300 days.

A. Yes. And that's because of the underestimation of how the department overperformed in the last couple of years, it did better, so they have pretty good liquidity.

Q. Okay. So if I can just turn to

page -- again, to the top of page six, the third line, you say, the proposed minimum of the 165 million dollar balance in the RSF and residual fund would only represent approximately 244 days of cash on hand for FY 2018.

Do you see that?

A. Yes.

Q. My question is, are there other dollars -- if I look at table C-1, for example, are there other sources of cash on hand?

For example, I just mentioned one of the other funds, and let me ask it a little more broadly.

If the coverage -- let's say you do achieve a coverage ratio of 1.3, and what that would mean, I think, is that for every dollar that you have to spend on interest you would collect $1.30 in revenue.

So is that 30 cents in that example counted as cash on hand or is the ten cents above the $1.20, which is the minimum, is that considered cash on hand?

MS. CLUPPER: The cash on hand looks at the balances in funds, so it includes the rate stabilization fund, the residual fund, and then what's called operating or cash -- cash on the balance sheet, which is in the financials.

That's how the rating agencies made that determination.

Q. So if I look at -- the answer to my question is no, that money is not accounted for as cash?

A. If it ends up in those funds it is, yes.

MS. LABUDA: It depends. When I think of coverage I think of coverage as the funding of our capital program from internally-generated funds.

So in an ideal scenario, we've talked about that $1.30, that additional 30 cents flows through the waterfall, it is available in net revenues available for debt service, repair debt service.

And that additional funding, that 30 cents, goes to the capital account in some way, shape or form.

That is how we typically utilize

coverage. And since I've joined the department I view coverage as the tool or the faucet that you lever in order to get money to pay for capital from internally-generated funds, or in other words, cash.

Q. Okay. So if I go to table C-1 on the current case, let's say, which is schedule BVE-1 of table C-1, which is also included in the public advocate's Exhibit-7, but I have the color copy here, can you tell me, are there any other sources -- if I just go through this entire -- all these lines, I see the rate stabilization fund at lines 37 to 39. I see the residual fund, lines 29 to -- well, are there any other funds in here, the construction fund, the capital account deposit, are there any other lines here that I can go to and say, ah-ha, here is money that would be added by Moody's or S & P or Fitch to the calculation of cash on hand over and above the 165 million --

A. Unfortunately, you can't. The rating agencies measure us from like a peer comparison perspective. They are looking for a global way to analyze us versus Benchmark's.

They use a different set of financial statements. They use the government-accepted accounting principles, and that is represented in the certified annual percentage report.

So there is a third bucket that the rating agencies count that is not part of the presentation for the rate filing, because we set rates and charges on a cash basis, not on the GAP financial statements.

Q. So can you tell me what that bucket is?

A. Sure. Of course. I have my financial statements with me. Give me one second.

So if you were to look at the PWD financial statements, which are part of the record, and I don't know what exhibit they are, you would look under the statement of net position. You would look under assets.

You would look under current assets, and it's going to say cash on deposit and on hand. And in fiscal year '17 on the GAP financial basis there was 95 million dollars in that account.

Q. So from a GAP -- for this fiscal year '95, your cash on hand, at least according to the folks who look at that, would add the rate stabilization fund, the residual fund and the 95 million cash on hand?

A. Yes. And may I transfer this over to my counsel, please?

Q. Sure.

MS. ALLEN: I just wanted to add for general fund during its purposes that the only funds that can be used -- that hold liquidity or cash on hand are the residual fund and the rate stabilization fund.

Monies in all the other funds are restricted to the use of those funds, except in emergencies. There can be temporary loans but those monies need to be restored at the end of the fiscal year, so that doesn't help on a long-term basis.

The one exception is the capital account. Money can be used to pay the debt service if there is a deficiency, if there is an emergency and there is no other source of funds to pay that.

But for cash and liquidity purposes for operations of the water department there is no other source of liquidity other than the funds we discussed.

Q. Okay. But I was actually focusing on the comparison --

A. Sure.

Q. -- because it is a major point in your testimony. You are comparing cash on hand and I think all other utilities are -- they all have restrictive funds that would meet the same -- you know, as a --

MS. ALLEN: Listing the names of the funds --

Q. So there would be -- do you know what it was prior -- is 95 million -- is that about where it ends --

MS. CLUPPER: 79 last year. 79 million in the last rate proceeding --

MR. POPOWSKY: In 2016?

MS. CLUPPER: 2017. The last rating was 79.

MS. LABUDA: And again, the

rating agencies count that when they are rating us, but from a rates and charges perspective and from a cash basis, that money is already spent.

MR. POPOWSKY: Like I said, I was really just trying to see if I understand these comparisons here.

MS. LABUDA: And the comparisons are also attached to my testimony in a PowerPoint, which will be easier to see than the rebuttal.

MR. POPOWSKY: Could you just give me one minute? Dollars of -- when you are -- when you're looking at your coverage ratio, let's say you have a target of 1.3, am I correct that you cannot use dollars that are currently in the rate stabilization fund?

There's no double counting there. Ms. Clupper said that is correct.

MS. CLUPPER: Because we transferred -- that would be transferred over. So if you have 100 million and you say, I need 20 million of that to meet my coverage, I have to transfer it out, and that's no longer in the rate stabilization.

MR. POPOWSKY: Right. Money in the rate stabilization fund does not count toward. It has to be over and above that --

MS. CLUPPER: Right.

MR. POPOWSKY: Thank you very much. I appreciate that.

MS. BROCKWAY: I've only got a couple of questions.

BY MS. BROCKWAY:

Q. When we were having the discussion about rating characteristics, I'm talking about Fitch and the median household income, Mr. Ballenger started down a route of putting to you a number of facts, and I don't think we ever finished the list or got an answer with respect to those facts.

And this may not be of any implication in the case, but I don't like the loose end.

So my only note here -- and I can go back and start, but probably the easiest thing is to get a list of these facts that Mr. Ballenger wanted to put to you.

The only one I can think of is

the difference in the assumed usage between the department customers and what Fitch was assuming.

One of them was 7,500 gallons and the other one was half. Does that ring a bell?

MS. LABUDA: That does, Madam Hearing Officer. Fitch is an organization, if I may, that rates systems holistically across the county and the demographics of a system on an average basis from a -- if you think of the United States broadly, are going to have different characteristics than the City of Philadelphia with your typical row home without a yard.

And Fitch's consumption would pick up some of the nuances of someone with a yard that's watering and using a little bit more water than a typical row home in Philadelphia. So there will be some demographical issues in Fitch's numbers.

MS. BROCKWAY: May I ask, Mr. Ballenger, were there any other facts of that kind that you had been intending to put to the witnesses?

MR. BALLENGER: I don't think so, Madam Hearing Officer. We've re-visited some facts from the record from yesterday, and I think that was -- we talked about median household income and consumption, and I think that is all that was necessary.

MS. BROCKWAY: Okay. One last area to gild the lily. We are talking about before the rate board.

I have a confusion about why Dubon covenants set requirements below the levels that would support robust ratings.

MS. ALLEN: The bond ordinance that we're talking about was drafted in the late eighties, early nineties when the City of Philadelphia was going through terrible fiscal pressures and the water fund was getting rated for general fund purposes, the aviation fund was getting rated for general fund purposes --

MS. BROCKWAY: The what fund?

MS. ALLEN: The aviation fund. The enterprise funds were getting rated. And in order to make sure the bonds were at minimum marketable and salable in the public markets, minimum thresholds were set, and that's what the 1.2 was based on.

So it wasn't a matter of what your cost of funds were at that time. It was, are you going to be able to borrow it all, and what do we need to establish in order to even be able to get into the market.

The ordinance hasn't been amended since then. But the city has rebounded and turned around financially and has been able to, over time, improve its credit ratings and lower its cost of borrowing to something more affordable. At that point it was an emergency.

MS. CLUPPER: I think you're correct, though, in that most systems have bond covenants lower than their financial policies, and that is pretty common.

And the reason is because you don't want to set bond covenants at a level that if there is an emergency or some kind of economic downturn, which happens quickly in the world of municipal -- I mean, things go bad quickly, that you've now violated a covenant.

So we have done a lot of work on

trying to look to see where kind of nationally covenants are and where their policies are, and there is a difference. And the reason is because the rate agencies understand that mostly the bond covenants are a minimum and financial policies are developed, you know, to create liquidity and financial sustainability. So you are correct. There is a difference.

MS. BROCKWAY: Thank you. Those are all the questions I have. Any more questions based on the questions from the bench?

Seeing none, I'm going to thank the panel very much.

It's quarter to one. I suggest that we take a break until quarter of two.

(A lunch recess was taken until 1:54 p.m.)

MS. BROCKWAY: We will go on the record. We are continuing this afternoon with questions of Ms. McCarty by Mr. Ballenger on fire prevention.

MR. BALLENGER: Yes. Thank you.

BY MR. BALLENGER:

Q. I really just wanted to talk to you for a minute about the system of hydrants in the city. And I included in hearing Exhibit-6 on behalf of the public advocate, I read a recent article from our local news media titled Think You Can't Park There, question mark, Take a Closer Look At That Philly Fire Hydrant, and I was just interested in looking at this article that the author identifies them on page two of the article in that exhibit.

It identifies that certain hydrants were part of the city's now defunct high-pressure fire system and that those --

A. Can you tell me like what part of the page?

Q. I'm sorry, there is a paragraph that begins, the hydrants.

A. Yes, thank you.

Q. I was just curious about this, because I hadn't been aware that there were two sets of fire systems in the city.

To your knowledge, is this correct, that there was an older high -- not older, perhaps that there was a high-pressure fire system in place for many years?

A. Yes.

Q. And it says here it's dated to the early 1900's. Is that approximately correct, to your knowledge and information?

A. To my knowledge.

Q. Sure. And further down the page in the next paragraph it states that the city decommissioned the fleet in 2015.

And I guess what I wanted to just check with you is that am I correct that then there is a low pressure fire system?

A. Correct.

Q. Okay. And so for a period of time there were, in fact, two fire systems that were operational in the city?

A. Correct. The high pressure system was fed by both rivers when it was originally conceived, and then more recently, before it was decommissioned, it was supplied with potable water and there were two high pressure pumping stations, one at 2nd and Race, now known as -- excuse me, Delaware Avenue and Race Street.

But that was the gist of the high-pressure fire system. It was built to handle -- when we had a lot of industry and to handle those fires.

Q. The article talks about that a little bit, but I think for my purpose, and I just kind of wanted to understand, because I was never aware that we had two totally different systems for a period of time.

Approximately when was the low pressure system installed, do you know?

A. I couldn't tell you off the top of my head. I can check if you want.

Q. Well, has it been in place for many, many years?

A. Yes, for several years. In fact, before the high pressure system could be decommissioned the water department worked very closely with the fire department, because again, they dictate where hydrants are placed, to ensure that the high pressure system could be decommissioned and you would still have the coverage you needed with the low pressure system.

The other rule -- point, probably, that will be helpful or maybe not, is that the reason the high pressure system could be decommissioned was not only because of the coverage of the low pressure system, but the pumpers that the fire department uses had more capacity to pump that water, so they didn't need that high pressure system.

Q. So they were able to draw sufficient water from the low pressure system?

A. Yes, exactly.

Q. I was able to get through some of the questions I had on fire protection earlier, and I promise I will be brief, and I meant it.

That is all I have on fire protection.

MS. BROCKWAY: I've got a couple of questions. You have to help me out, because I neglected to print it out, but I was reading -- and I don't have access to wifi on anything but my phone, but I was reading your budget statement to the counsel for the most recent years, the one that you gave in this March.

A. Um-hum.

Q. And there is something in there about fire services. I only remember what it was. I don't remember being confused.

So maybe this is a transcript request to find the statements in the budget statement to counsel that mention fire services in any way, and to relate those as to what they were talking about, relate those to the types of fire service costs that we've been talking about on the rate case.

I don't think that that question will make any sense until you look at it?

A. Right. My recollection, and it is subject to check for sure, and we will definitely provide what you are asking for, but I believe that the reference was that the transfer of costs from the general fund to the water fund for the fire costs, so it was an issue today for the fire cost. I believe that was mentioned, because we would have to budget for it, if it were approved by the rate board as opposed to the general fund budgeting for it.

Q. So that's probably where I read it. It was only one phrase or one line.

A. Right. And we had to defend why there were differences in our budget at the --

to city council, so that was an eight million dollar change or about.

Q. So could you take another look at that line and see whether or not it discusses anything in addition to or less than what's been discussed in the rate case?

If that's not completely clear by Thursday I will have brought it up again. Actually, why don't we do that.

I will go back and I will look at it, and if I still have a question after your testimony here now I will pose it again, but we don't need a transcript request.

Any questions? Any further questions? Commissioner McCarty, thank you very much.

A. My pleasure.

MS. BROCKWAY: I believe we are ready for the presentation of Mr. Morgan's testimony and examination of the same.

MR. BALLENGER: Yes, Madam Hearing Officer. If my recollection is correct, you moved Mr. Morgan's testimony onto the record yesterday with one errata, a typographical error corrected on the transcript, and I believe that the parties stipulated to its authenticity.

MR. DASENT: That's correct.

MR. BALLENGER: So I present Mr. Morgan for cross-examination at this time.

MS. BROCKWAY: We will go off the record.

(Discussion held off the record.)

MS. BROCKWAY: We have cross-examination from Mr. Morgan.

MR. DASENT: Just brief questions for your today. It's good to see you again, Mr. Morgan.

BY MR. DASENT:

Q. In preparation for today I reviewed your resume and was reminded of your last testimony in the last case. And I went over some of the data submissions you gave me in the last case in the transcript.

When we were last in the hearing room, I found out, you indicated that you've testified in Rhode Island proceedings involving municipal utilities, so I was reminded of that. That's true, right?

A. That's correct.

Q. And based upon the record from the last proceeding, Pawtucket Water Supply Board, and there again a commission, were two of the municipal utilities that you were testifying on behalf of?

A. Yes.

Q. And it's my recollection from the formal discovery that some of these Rhode Island utilities and municipal utilities use multiple test years, is that true?

A. That's true.

Q. And the period of years that they use is two or three or more?

A. I've done cases where it's been two and it's been three.

Q. And is that an accepted practice for municipal utilities in Rhode Island?

A. Yes.

Q. Let me skip ahead a little bit and talk about some of your other testimony.

If the board accepted your recommendation to deny any increase in fiscal 2019 and 2020, your own calculations show that if everything goes as projected the water department would only be able to satisfy its bare minimum coverage.

Is that true from looking at your exhibit, LKM-2 or one?

A. It is LKM-1, and when you say bare coverage what are you referring to?

Q. The 1.2 times coverage for senior debt.

A. I show that in 2019 the department will achieve a 1.3 percent -- 1.3 times, rather, and in 2020 I show 1.2.

However, there's an aspect that's missing, which is the TAP revenues not accounted for in that presentation.

So essentially we are not looking at just the bare-minimum. The utility will earn more than that.

Furthermore, I'm showing that when you look at the residual fund we are reflecting that the utility will earn or will have a balance, rather, that exceeds what they are seeking in their filing, as well as the rate stabilization fund?

Q. Staying on the subject of coverage, for 2021 have you made any calculation of debt service coverage, assuming all of your adjustments are adopted?

A. Not for 2121.

Q. Did you look at the impact of your recommendations in 2021 on any future year or any other future year in the projection?

A. No, we did not. And the reason why we didn't go beyond 2020 is that because I looked at the information I was provided, and as best as I could determine, going beyond 2020 the numbers would be uncertain.

And so we were trying to stay within the period where we could rely upon the numbers that were presented.

Q. Okay. Again, talking about your resume a little bit, in your work you indicated you worked for Pepco for a while.

Have you developed any water utility revenue projections based upon historical customer data as a part of your work experience there or elsewhere?

A. Would you help me in

understanding when you say water customer data?

Q. You haven't worked for a water utility, so I guess that is a little unfair. Utility revenue projections based upon historical customer data, have you had experience in making those projections?

A. At Pepco we used -- at the time we had where you have partial and projected test years, so I have had some experience with that, yes, but it wasn't fully projected.

Q. It wasn't fully projected, so mostly historical experiences --

A. Correct.

Q. And that is obviously not a water utility.

A. Correct.

Q. Do you believe that the 110 million dollar rate stabilization fund is an appropriate level for the fund in the future? Your testimony speaks to that.

A. I believe based on the information that I have reviewed that the 110 was what the utility was seeking in the last rate case, and there hasn't been anything to change my mind.

However, as we've presented our findings in this proceeding, we are not suggesting that rates be set to limit the utility to 110 million.

Q. So do you have a specific rationale for that 110 million, other than that's what it is now?

A. Well, you know, generally in an instance where the utility is changing from one standard to the next and one principal to the next, there's usually testimony with supporting information that supports that change. In this proceeding I did not see that.

Q. And you have no separate independent basis of your own for determining whether that is sufficient or not?

A. That's primarily my position, as I stated.

Q. You stated in your last testimony, or when we last met each other in the hearing room, that you were not a financial advisor and no background in municipal bonds. Is that true?

A. That's correct.

Q. And you also indicated that you didn't have a legal background and that you were not a licensed lawyer?

A. I am not a licensed lawyer.

Q. So you would -- I take it you can see that your testimony deals with legal issues -- has dealt with the cooperation of counsel?

A. My counsel did review my testimony. I don't recall that I got into interpreting the law or what I think to that sort.

Q. You have not been involved developing a financial plan, if I remember that from your last testimony?

A. Financial plan for a municipal --

Q. Like for a bond issue or --

A. No, I have not.

Q. If I might have a minute.

MS. BROCKWAY: While we are at a pause, let me remark that board member Ewing has joined us and has heard most of Mr. Morgan's cross.

MR. DASENT: Just one follow-up,

Mr. Morgan.

BY MR. DASENT:

Q. Am I correct that in looking at LKM-1 the revenues that you show do not include TAP revenues?

A. That is correct. The TAP revenues, it's my understanding, as presented by the utility is not included.

Those revenues were -- are being developed separately, and so they are not reflected in here.

That is an adjustment that I recall seeing, revenues being reduced to reflect the fact that there is going to be a TAP revenue.

MS. BROCKWAY: Before we go further, can you finish the sentence, they were not included in --

MR. DASENT: Looking at LKM-1, in the cost of service.

MS. BROCKWAY: No, I think he was talking about it wasn't included in the departments --

MR. DASENT: No. The question

was mine and I asked him whether it was included in his LKM-1.

MS. BROCKWAY: Yes, and he answered based on some -- could you say that again?

I got the impression that you said that the department -- that essentially your statement that without TAP revenues was apples to apples with the department's total revenue requirement. Is that correct?

I just want to see what lines up with what.

THE WITNESS: Okay. As I understand it, the cost of service as provided supports the base revenue. And the TAP revenue is going to be in the form of a rider, so it has not separately been identified in the cost of services.

MS. BROCKWAY: I think we need to stop also here, because I think you and I use cost of service in a similar way, but I have learned that it's not how it's used here in the water department. Here it refers to allocations to classes.

So total revenue requirement is, I think, would you also agree, is what you meant to say.

A. In the revenue requirement, yes.

MR. DASENT: Just so I'm clear, Mr. Morgan -- Mr. Morgan, referring you back to schedule LKM-1 on your testimony of public advocate statement one, specifically line 12, does that particular line include TAP revenues?

A. As I recall, the proposal for the rider is not reflected in it, so this is just total revenue of the utility.

Q. Thank you.

MR. DASENT: Nothing further for us.

MS. BROCKWAY: Cross by any other participant? Seeing no questions from the board.

MR. POPOWSKY: I just have a couple of questions about your schedules so we understand them when we go back.

If I look at LKM-1 in the first year, 2019, you show on line 30 a total senior debt coverage ratio of 1.30, and then in year two it's 1.20, is that correct?

A. That's correct.

Q. Now if I want to go in year two, if the board would accept 1.30 as the appropriate number, I would have to get, I guess, ten or 20 million dollars from somewhere else, is that correct, either the rate stabilization fund or the revenue to bring that up.

How would you go about --

A. I -- as I indicated in my testimony, there's 13 million dollars or so that's been reduced that's going to be recovered as part of TAP revenues. And so you have to account for that in order to actually do a calculation.

So essentially you will bring in additional revenue, yes.

Q. So under your view, 13 million could come from the TAP revenue, and then any additional money would then come from where?

A. Well, as I see it, if you want to achieve something higher than the 1.2 and you've accounted for the TAP revenues and you're still under, you will have to generate additional -- have to reflect an additional revenue.

Q. Using your -- if I go to line 30 -- I was looking at the residual fund. Your residual fund is much higher than the department's request.

Can you just explain why?

Is that because of not taking -- did that have anything to do with the deposit into the capital account?

Is that why that is?

A. It's -- that takes into consideration -- as we spoke yesterday about the dashboard, and in that dashboard assumptions are made, changes are made.

What my testimony -- I did not go in and change any of those assumptions as far as what is going to be transferred to the capital fund or the general fund.

What I did was to simply show that without a rate increase the utility will be in a position where, keeping all their other plans constant, they will be in a situation where at the end of the year in the residual fund they will exceed the 15 million which they state as being required, and they will exceed the 150 million in which they indicated will be required for the rate stabilization fund.

So all those other things that they were projecting to do has still been reflected.

Q. Okay. And then just one other question. Looking at schedule LKM two, these show your adjustments for 2019 and 2020, and I believe a couple of those adjustments have been adopted now by the department, but for those -- if the board did choose to look at 2021, is there a way to go from this schedule to -- what was your -- is there a way to look at these numbers and say, okay, here is the adjustment for the year 2021?

A. What I was attempting to do with this schedule was to look at -- first of all, we -- I showed that -- we showed yesterday that if you go into the model and you make changes to the expenses, you change assumptions, it doesn't automatically change the revenue requirements.

So at this point, if the board

decides to accept my adjustment say to the Smith and Garp, the way to have that reflected in the revenue requirement is to instruct the utility that the rates should be reduced by the size of the adjustment.

So if you are looking towards 2021 you would have to make a similar instruction to the water utility, that these adjustments which we have reflected should be reflected as reduction to the increase in the revenue requirement.

Q. So I have to wait until the end, I guess.

A. Well, the reason it's done that way is because, as we have explained, it does not automatically recalculate the revenue requirement.

You have to go in and decide how much revenue requirement you want to reflect, and then you make those changes. So I hope I'm answering your question.

Q. Okay. I was just -- there's just no easy way for us to just go down and write in numbers for 2021 based on the information we have.

We would have to go back to the -- well, first one would be easy, I guess Smith and Garp.

A. Essentially these numbers would be reflective of 2021. So you are speaking of -- they -- for example, the Smith and Garp, if you're looking at 2021 you would be moving the ten million dollars at -- and there are the power costs and gas costs, there were some amounts which I removed which are not presented here.

I will be happy to provide it if it's a request, but it's -- we did not show that, because we were not recommending that we use a three year rate period.

MS. BROCKWAY: Give us a second.

MR. POPOWSKY: Perhaps we could make a transcript request then to give us a schedule based on your estimates of the impacts of your adjustments in fiscal year 2021 if the board were to look at fiscal year 2021 in this case, and that would be transcript request 17.

THE WITNESS: Can I ask a

clarifying question?

MS. BROCKWAY: Sure.

THE WITNESS: So in the case of rate case expense, I've amortized that over two years, because we were looking at just a two year rate period.

So if we were to reflect a three year rate period, 2021, I would spread that out over three years so that it's recovered over the ratio.

Q. Yes, I think that's right. In other words, if you're going to change the adjustment to include 2021, in that particular case you would have to go back and recalculate 2019 and 2020.

I don't know if there are any other adjustments that have that same effect, but if you could --

A. The implementation of TAP --

Q. Imitation of TAP -- those are the of your amortization adjustments. So in those two cases please show us what the effect would be across the board.

A. Okay.

Q. So in effect, it is a new schedule, LKM-2, which would include numbers for all three fiscal years, just for the benefit of the board if we choose to look at that year.

MR. DASENT: If the board pleases, I would ask that once you identify a certain scenario that you want to rerun the model, that you look at both the department's view of it, as well as Mr. Morgan's.

In other words, we can plug in the assumptions in the testimony and run an alternate scenario so that you can see all the adjustments made.

MR. POPOWSKY: Sure, but my question was just limited to this particular schedule. I certainly understand that we have to -- at the end we know we have to rely on the department to make the final calculations.

MR. DASENT: And that is like a compliance filing, but even before that, when you are dealing with your final determination you haven't made quite yet, I would like you to have the numbers in front of you rerun with some of the assumptions you would like to see.

MR. POPOWSKY: Well, from my perspective I can say that was helpful in the last case you presented that to us.

And I think the advocate and the other parties had access to that so that they could disagree, and I think that was very helpful in the last case.

MR. DASENT: And we just wanted you to know the consequences or the impact.

MR. POPOWSKY: Sure.

MS. BROCKWAY: Just to clarify that, the difference between what you're doing in transcript request 1 and what you talk about doing, which is a fuller examination, is let's say, for example, you would go into the dashboard and change some of the things there if you could, because of changes that were made in the expenses or revenues otherwise.

MR. DASENT: I was saying basically based upon our assumptions you can run a scenario. Based on their assumptions we can run the scenario and give you a point of comparison so you see the full consequences of the adjustment.

MS. BROCKWAY: I think you're answering by saying yes.

MR. DASENT: I think I am, but I'm trying to be as definitive as I can.

MS. BROCKWAY: I just want to follow onto this line. I want to go to your statement, Mr. Morgan.

BY MS. BROCKWAY:

Q. I think I am starting with your Roman six, starting on page 15. These are the specific adjustments based on your analysis.

The material discussed here is what you picked up and put in a chart form, LKM-2?

A. That is correct.

Q. I want to go through it, because it seems to me that you had in some cases given the board a sense of what you would do if the board wanted three years, and in other cases it wasn't clear to me. Let's see.

I am not sure that you talked specifically about fiscal '21 for spend factors. On page 17 you discuss this generally with respect to your criticism of the way the department has gone about that, but before we get to Smith Garp on that page, did you recommend any specific adjustments with regard to the material you discussed there?

I don't see any here, but I just want to make sure I'm picking up everything.

A. And I'm trying to make sure I understand where you are going, but let me try and answer it the best way, and we can see if I addressed it.

The way the spend factors work, the utility begins with the 2018, and the costs are escalated to determine the future years, but then the amounts for each of those future years as far as the expenses are concerned, the spend factors are -- you multiply those amounts by the spend factor.

So essentially what you end up with is a lower, or I would say revised, amount because of the spend factors. So if you look at 2021, if I were reflecting 2021 I would be picking up -- I did not disagree with the company's spend factors, so the numbers I will be picking up would be their 2021 numbers, which should already have the spend factors applied.

Q. So if I -- let's go to Smith Garp.

A. Okay.

Q. Starting on page 17, and this goes over to page 19 -- actually, this is probably not the best one, because you're saying don't add expenditures in the first two years at all, is that right?

A. I'm sorry, could you repeat that?

Q. You're saying don't add any Smith Garp expenditures in the first two years of this three year period?

A. Right.

Q. Okay. Do you discuss anything for fiscal '21?

A. No. Essentially what I'm saying is that the Smith Garp should be removed as an adjustment to the cost of service. And because we are not reflecting 2021 I did not address that.

But -- so if you're looking at a three year period, I will be consistent and take out the Smith Garp in all three years.

Q. So let's turn to page 19, which is where you discuss reasons why you believe that no additional revenue is required for it.

And I see -- let's see, outperformed budget to free up cash. The same topic, ability to control costs and incentive to control costs. Those are the two basic arguments that you are making for fiscal '19 and '20, am I correct?

A. Correct.

Q. And are you saying those two factors would apply equally in 2021?

A. Yes.

Q. Is there an escalator applied to Smith Garp as opposed to these additional revenues?

A. No, not as presented by the utility. There is no escalation. That number is a number which was predetermined by them.

And so essentially what they are looking at is reflecting that increase in each of the years, so it's not escalated.

Q. That increase meaning the additional adjustments we're talking about in this case?

A. Right.

Q. And if that is incorrect or gives me the wrong impression, I'm sure the department will clarify for me.

Let's go to additional staffing operating leave or expense. Here you recommend an adjustment to apply the appropriate actual budget factor.

What would you do for 2021 if you were asked to propose something for that year for this category?

A. So 2021 I show the amount that they present, I would apply the spend factor to that.

Q. It doesn't show up on LKM-1 or two, but we have -- you're saying that we have in the record evidence on which, if we agreed with you, we could make that -- we could specify a formula for getting to 2021?

A. The spend factors are provided in PWD Exhibit-6, and I'm not sure if that's part of the record. I am assuming it is.

Q. Yes, it is.

A. So the spend factor is in there.

Q. Now we are getting to collection factors. This is the same question. What would you do for 2021 if the board decided it wanted to go that far?

A. The collection factor affects the revenue, so you would apply whatever collection factor you've determined to be appropriate, you would apply that to the revenue for 2021.

Q. My understanding is that the department is proposing a collection factor that's made up of three components that takes into account the experience and collections of earlier bills in later years, and that you are suggesting, and I am looking at page 21 at the top, a three year average to derive collection factors.

Do I understand that correctly?

A. Right. And yesterday we presented a recalculation. When I did this initially I attempted to reflect what the company -- what the utility did in the last rate case.

Q. If we did 2021 on your system do

we have the information to apply your recommended driver or derivation --

A. It is presented --

Q. The three year average, do -- would we have -- I take it this is a rolling three year average. We will start there.

A. Yes.

Q. Would we have enough information to extend -- to do a comparable three year average for 2021 based on your method?

A. We have to use the most recent three years that we have.

Q. Yes. Would we have it?

A. Yes. It is Hearing Exhibit-7.

Q. Well, I'm -- my recollection of Hearing Exhibit-7, and we can get to it, is that it goes to 2015 or maybe '16.

A. It goes through 2016. That is the most recent year we have.

Q. So the collection factor that you derived which shows up in the results on LKM-1 and two is based on '14, '15, '16?

A. No. It's -- yes. Yes.

Q. Okay. Because you only had

information up to '16.

A. Yes.

Q. And you would do the same for 2021?

A. Correct.

Q. All right. I am going to the chart escalators. And here -- and starting on page 22 you recommend, for a number of these cost classes and line items, some differences.

So I want to turn to 2023, and starting at lane seven -- line seven. And here you directly discuss what you think the board ought to do if it decides it wanted to go ahead with the three year plan, is that correct?

A. What page are you on, I'm sorry?

Q. 23.

MR. BALLENGER: We are having just a pagination issue with the print version.

THE WITNESS: Okay, yes. Your question is did I have specific recommendations for the board with regard to these?

BY MS. BROCKWAY:

Q. Yes. And on this one I see that you do.

A. Okay.

Q. Which is to take out the 2021 escalator on the grounds that it's not known and measurable?

A. Right.

Q. Would it meet the standard of a reasonable estimate of future costs?

Known and measurable is a very specific standard. Something has to be known now will happen in the future, and it has to be mensurable now based on information about what will happen in the future.

Do you agree with that?

A. Yes, that would be a reasonable estimate. The -- the hesitation I have is that when we look at historically what the utility has projected, the farther out you go in time the less accurate those costs are.

And so that's primarily why we would want to stay with the two-year period, because when you start to go far out those numbers become uncertain.

Q. What I'm trying to get at here is whether or not if we said known and measurable is not the standard, but we will look at whether or not a forecast is reasonable based on information, would you say that the department's three percent increase for 2021 is not even reasonable?

A. It depends on the specific item. What, when you look at, for example, labor costs --

Q. Actually, let me interrupt you, because you are going ahead of me. So let's go back.

I am going cost by cost through your testimony, and I am still on power costs.

A. Okay. Yes, I would -- I believe they were projecting a four percent for power cost.

Q. I see three percent.

A. Three, okay. That three percent was a number that was -- was selected based on what was going to be used for budget, and it was not based on historical activity. It was not based upon an analytical process.

So for power costs I would say yes, the three percent, there is no basis for projecting that three percent.

Q. Okay. Let's move to gas costs. Same page.

A. Gas costs, same recommendation. The three percent that they used was based on the same memo that -- basically the memo said three percent is being used for -- for the five year plan, and so it's -- it's a good number to use for budgeting -- or for the rate case, rather.

Q. For the rate case, if we did not take into account your argument that that escalator in the third year is not known and measurable, but if we only applied some form of reasonableness to this would you still say, as you did in the case of power costs, that for the other reasons you state in your testimony about planning as opposed to rate making, this is not -- would not even meet that test, not even meet reasonableness?

A. Right, for the gas cost. And again, it's because it is a number that was chosen almost as if it -- they wanted a proxy for a cost increase.

It wasn't based upon reviewing previous cost or potential increase in the cost of gas. So that's --

Q. Basically -- okay. Let's turn to page 24, general costs and other class 200 expenses. And you start with general costs where you note that the department uses a three percent escalator.

Now, ten to 11, you say three percent is not supported, but let's go on to see what you say is supported.

A. Okay.

Q. When you get down to line 16, therefore I believe it is appropriate to remove Smith, Garp, and that results on line 21 with a general expense, the escalator of 1.98 percent, is that how you did this?

A. Yes. When we requested information to support the three percent we were referred to an exhibit on the table and appendix to Black & Veatch's testimony.

And it essentially said what was done, for us to look at the historical changes in these costs. And it listed the costs that I show on the categories, the cost classifications that I presented on that table on page 22.

So what I did was to go back and look at the cost increases. And I noticed that because of the increase in Smith and Garp it drove the -- basically it skewed the growth and expenses up to three percent.

Q. Let me stop you right there to understand. So what you're saying is that in the calculation the department made, based on historic data from 2014 through 2016, they reflected an actual historic increase in Smith Garp?

A. Right. And part of that is reflected in the increase in Smith and Garp expenses.

Q. So if you say we should plateau them at this point, that's what you did here, you took them out and --

A. Yes, I took Smith Garp out, because those are not costs that are driven by inflationary pressures.

The -- those are costs that if you want to expand a program you decide that you want to increase it by five million or ten million, that's more discretionary.

So that's why I took it out, so that the costs that remained in calculating that 1.98 were all costs that changed because of inflationary pressure.

Q. You wouldn't apply your own 1.98 to the Smith Garp?

A. No. Again, it's -- the program is decided -- the expansion of the program is decided independent of inflation. It's decided based on how they want to expand the program.

And so the costs that I were applying an escalation or inflation factor to were costs that are an un-discretionary that the utility really doesn't have a control over what the supplier charges, the price that the supplier offers is the price, and so the utility then bears that price.

So applying this escalation of factor was simply to reflect a cost that is beyond their control.

Q. If we take out Smith Garp is it clear what other line items would get this change based on -- what other line items or general costs and what are other class 200 expenses?

I know that you have a summary of the result of that in your schedules, but I'm trying to find out, if the board fiddled with the escalation factor for general costs and other class 200 expenses, and it did not approve what the department wanted but did approve something for three years, putting Smith Garp to the side, are you using terminology that they would understand when they wanted to run a rate model and know exactly what costs to apply your adjusted figure to?

A. They should, because in the model in the assumption section all those costs are separately identified and it lists the cost by the class, and so that's where I wanted to make that change.

Q. Are there any -- these are -- we are talking about class 200 expenses, right?

A. Right.

Q. And are you talking about the entirety of class 200 expenses?

A. That's how I supplied it, yes. The class 200 is presented as a line item, and that's where you make that escalation factor change.

Q. The reason I'm confused is because your heading there says, general costs and other class 200 expenses.

And so what I'm trying to do is figure out if we wanted to apply your theories of how costs behave in the future, but we wanted to go to 2021, how could we do it and do we have enough information in the records.

So what I'm trying to find out -- let me put it this way. Let's say we go to a 1.98 escalation factor, hypothetically, is it clear exactly what line items would get that treatment if we told the department to run that model?

In other words, could we just say to the department, all class 200 expenses and nothing else?

A. As presented in the assumptions chart in the model, it should be clearly identified what those class 200 costs are.

Q. Let me do it this way. I want to ask you a record request, and now we are up to 18. And that is for any of these situations where you have proposed an adjustment.

Please provide the most discrete line item available in the record associated with that and -- so that we would have a blueprint of every place in the record where a change would have to be made to accommodate a change that we make based on your testimony.

MR. BALLENGER: Just for clarification, Madam Hearing Officer, is that for the specific percentage in this that we've been discussing, the 3.15 to 1.98?

MS. BROCKWAY: Well, I actually want to do it for all of these costs that are discussed. Let's see. Up until the top of page 32, those I understand to be the adjustments or the types of areas where you would have adjustment, and what I -- this is another version of Mr. Popowsky's question, but here I'm asking for what would be the assumptions line items that would be changed for each of these.

That is sufficient to identify

and bound what the board's decision would mean based on its consideration of these expense adjustments.

A. Yes. Essentially what I'll do is I will be able to point to the tab and the line item on that tab where it would be changed.

Q. That may be all. Just let me take a look.

MS. BROCKWAY: Thank you. Those are all the questions I have. Do we have any redirect?

MR. BALLENGER: If I can just have one minute to just discuss with Mr. Morgan.

MS. BROCKWAY: Let's go off the record.

(Discussion held off the record.)

MS. BROCKWAY: Are actually going to have further questions of the witness based on questions posted after the cross.

BY MR. DASENT:

Q. Let me direct your attention, Mr. Morgan, to your schedule LKM-1, and specifically line 21, total operating expenses.

Are you there?

A. Yes.

Q. Does this line show any increase in Smith Garp expenditures in fiscal '19 and '20 according to your schedule?

A. No.

Q. Mr. Morgan, I wanted to refer you to schedule BBEBWP-1. It's appendix four to the Black and Veatch testimony.

A. BEV --

Q. BBE5 -- WP1. It is the assumption stuff --

A. Okay.

Q. Now, we spoke earlier about how you used escalation factors. If you look at the top of that page you see separately class 200 services.

MR. BALLENGER: Do you have a page number?

MR. DASENT: 23.

MS. BROCKWAY: Does it matter if we follow along?

MR. DASENT: Yes. It really helps.

MR. BALLENGER: Is this the page

for water fund --

MS. BROCKWAY: Ms. Bui --

(Discussion held off the record.)

MS. BROCKWAY: Black & Veatch has kindly provided a one-page document entitled schedule, BBE-ES:WP1.

BY MR. DASENT:

Q. At the top of the page, Mr. Morgan, do you see where it says class 200 services?

A. Yes.

Q. Now drop down two lines, three lines, actually three --

MS. BROCKWAY: I don't see them.

MR. DASENT: Class 200 services.

MS. BROCKWAY: Okay. As opposed to class 220 and 221.

MR. DASENT: That's correct.

MS. BROCKWAY: Okay.

BY MR. DASENT:

Q. Now drop down one more to Smith Garp. Just below that they are listed separately?

A. Yes.

Q. Drop down to the second part of the chart where it shows the two year average increases. Do you see services again, class 200?

A. Yes.

Q. And beside that is 3.30 percent.

A. Yes.

Q. And then drop down to Smith Garp, about three or four lines down. Smith Garp is listed at a much higher increase, 72.86 percent.

A. Yes.

Q. And it's separated.

A. Yes.

Q. Now drop all the way down to the bottom of the page and you see on the right side 3.2 percent.

A. Correct.

Q. Is that a two year increase?

A. Yes.

Q. That's separate and apart from these individualized lines. We are seeing the same information for two year increases segregated by services, Smith Garp and others, isn't that true, subject to change?

A. It is a composite growth. When the question was asked specifically how did you come up with the growth factors, I was -- I was referred to this chart.

So what I did was to come up with -- the 1.98 is applied across the board to the various categories of expenses.

So rather than choosing some expenses where you reflect a higher rate or lower rate, I applied one escalation factor to all the expenses that -- for example, the Smith and Garp is not one, the chemicals is -- I believe is not reflected. Salaries and wages, those are costs that are separately calculated, so, I came up with a composite gross number and that is what I used.

Q. Okay. I am assuming you didn't look at appendix four, then, for benefit and your protection?

A. I used appendix four.

MS. BROCKWAY: Say that again.

THE WITNESS: I used appendix four.

MS. BROCKWAY: Can you be clear

about how you used it? I think the question, for example, there are totals on WP-1 which include line items for Smith Garp.

I'm hearing two things, one, that you took each of these line items and where appropriate applied your escalator, or two, you took the sum at the bottom of any group and applied your escalator.

BY MR. DASENT:

Q. The number you used, Mr. Morgan, is 3.15 percent, isn't that true?

A. Am I answering her or --

MS. BROCKWAY: Please let me have this and you can come back.

THE WITNESS: Okay. The way I used the schedule was to come up with -- to try to calculate one general growth factor.

So I went through the costs that are at the bottom that are coming up with the composite of 3.2 five. I took out the Smith and Garp to arrive at 1.98. The 1.98 is then applied, for example, to class 200 for services, 300 for materials and supplies, indemnity -- no, and transfers.

So that is how I used the numbers of this page.

BY MR. DASENT:

Q. Now, Mr. Morgan, in that they are separately stated above, services of 203.3 percent and Smith Garp separately stated again at 72.86 percent, why did you have to do any calculation?

A. What I was attempting to do was to come up with a general factor that you could apply to the various categories of expenses, because when I asked for the specific factor, when I was referred to this chart I assumed you were using the normal 3.15 composite factor to calculate, so I simply was revising that composite factor to remove the Smith and Garp.

Q. Does the water department use a composite as an escalation factor, the 3.25?

A. It uses -- they were instances that some of the factors -- one of the factors, I should say, that they use is not even tied to this chart, so that's part of the problem.

Part of the problem was to be able to tie back the growth factors that were

applied as I was referred to this chart.
MS. BROCKWAY: We will go off the record.
(Discussion held off the record.)
MS. BROCKWAY: Certain background information hadn't been provided to me. I hope Mr. Dasent will continue with his cross.
BY MR. DASENT:
Q. Since the rate filing, Mr. Morgan, are you aware that Philadelphia Electric Company has filed for an increase of 2.2 percent?
A. Yes, I am.
Q. Are you aware, also, that PJM pricing can increase by 2.5 percent again next year?
A. I wasn't aware of that. Again, but that's -- that's -- the PECO case was just filed. We don't know what that increase is at this point, so, you know, it has to be adjudicated and determined to be able to calculate what that rate is.
Q. I certainly understand that, but I'm saying at the horizon of 2021 we are still

showing increased rates coming, and at what level we don't know with precision, but we know they are coming.

So for planning purposes and reasonable projection purposes we try to capture some of that uncertainty. Do you agree with that?

A. In general terms, yes. But again, I guess the important point to clarify here is since we filed the rate case that -- PECO's filing occurred.

MR. DASENT: Based upon the scope of your questions, Madam Hearing Officer, that's where I stop. If you have additional questions maybe I can help.

MS. BROCKWAY: No. I would only ask the parties to be extremely clear in your briefs about what the dispute is here and why you think the other side is wrong.

I would like to ask the department to make copies of this one excerpt from the work papers, and we will mark it as an exhibit. It is very helpful to have it. I am going to give you the one that you kindly supplied to the bench back.

We don't have any other witnesses this afternoon, do we?

MR. DASENT: No, that's it.

MS. BROCKWAY: Off the record.

MR. DASENT: I think we are up to four.

MS. BROCKWAY: Off the record.

(Discussion held off the record.)

MS. BROCKWAY: We're going to take a 15-minute break.

(A brief recess was taken.)

MS. BROCKWAY: During the off the record discussion the bench had a transcript request that might help in sorting out some of these issues.

MR. POPOWSKY: Thank you. I just wanted to apologize for added transcript requests, which I guess would be number 19. And it goes to the questions that I was asking earlier about the calculation of cash on hand. And Ms. Labuda, I think, referenced an amount of, I think it was 95 million dollars that is reflected as in some type of cash act by GAAP, but generally accepted accounting purposes and, what we are requesting is for you to provide, first of all, that page where that appears, and to the extent it's not clear, a description of what's included in that account and what, if any, restrictions are placed on that account that would prevent that cash from being available to the department.

MR. DASENT: We've got that.

MS. BROCKWAY: I would also like to add to that how does cash get into it, into those.

MR. DASENT: We also want to formulate a transcript request based upon Mr. Jagt's suggestion, and we are writing it up right now.

MS. BROCKWAY: We had an agreement about that. I think the thing to do is if you can circulate that by e-mail, and then on Thursday if there are any differences of opinion about the language in the transcript request, sort it out and then bring copies of what is sorted out to put in the record on Thursday.

It will probably be 20, but let's wait until then. Did you have anything further?

MR. DASENT: Nothing further today. It doesn't look like we have any business on Wednesday, but Thursday we will be back.

MS. BROCKWAY: For this witness. Mr. Ballenger.

MR. BALLENGER: Yes, I actually do not have any redirect for Mr. Morgan. And accordingly, I believe we won't be seeing him again in the hearing room, so going once, going twice, Mr. Morgan --

MS. BROCKWAY: Mr. Morgan is excused with the thanks of the board.

MR. BALLENGER: Thank you so much.

MS. BROCKWAY: So that concludes the business for today. We will not have hearings tomorrow. We will resume again at ten o'clock on Thursday. There will be a discussion of whether there's any cross of the Land Bank witness. We don't expect it.

And there may be some cross of

the Penn Environment witness, although not much, and once those two witnesses have gone on and they are off, we will turn to the presentation and examination -- presentation by and examination by Mr. Skiendzielewski.

If there's nothing else, thank you very much. We are adjourned for the day.

(The proceedings were concluded at 3:32 p.m.)

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