BEFORE THE
PHILADELPHIA WATER, SEWER AND STORM WATER RATE BOARD

In the Matter of the Philadelphia Water Department's Proposed Change in Water, Wastewater and Stormwater Rates and Related Charges	Fiscal Years 2019-2021

EXCEPTIONS TO THE HEARING OFFICER'S REPORT SUBMITTED ON BEHALF OF THE PHILADELPHIA WATER DEPARTMENT

Hearing Officer Nancy Brockway, Presiding

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I. INTRODUCTION AND SUMMARY OF EXCEPTIONS.

The Philadelphia Water Department ("Department" or "PWD") files these Exceptions to the Hearing Officer's Report, dated June 19, 2018 including the Supplement to the Hearing Officer Report provided on June 21, 2018 (collectively, the "Report"), rendered by Hearing Officer Nancy Brockway ("Hearing Officer") in the above captioned proceeding before the Philadelphia Water, Sewer and Storm Water Rate Board ("Rate Board"). The Report – which can be adopted, modified or rejected by the Rate Board – does not provide sufficient support for the continued financial stability of PWD. Nor does it fully address (or make clear recommendations on) all issues raised by the participants. Accordingly, the Department submits its Exceptions and urges the Rate Board to reconcile the Hearing Officer's recommendations with PWD's Brief and this submission.

As explained in the record, the cost drivers for the current rate case primarily include (i) rising work force costs; (ii) fringe costs shifting from the capital budget to operating budget; and (iii) increasing costs related to regulatory requirements. In addition, the record reflects that higher debt service coverage (1.3 times) and adequate reserves (244 days cash-on-hand) are necessary to preserve the Department's "A" credit rating. The Department maintains that it needs the proposed 9.2% cumulative total increase in service revenues during FY 2019-2021 to sustain the financial status and stability of its operations.[1]

The Report essentially ignores the Department's Financial Plan and rejects or inconsistently decides other critical revenue requirement, cost allocation and rate design issues. PWD requests that the Rate Board reconsider all of the recommendations discussed below and fill the decisional voids left by inaction or inconsistency. Absent such positive action by the Rate Board (particularly concerning financial metrics), immediate placement of PWD credit ratings on "Negative Outlook" (i.e., trending to a lower rating) or "Negative Watch" (i.e., expected downgrade within 90 days absent material changes) could result, if not an immediate downgrade itself.[2]

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[1] See, Response to TR-23B (updated Table C-1).

[2] The rating agencies have expressly articulated this in their recent respective rating reports: Moody's (March 21, 2017 and July 13, 2017) "Factors that Could Lead to a Downgrade – (i) Material reductions in debt service coverage, (ii) Notable deterioration

The base rate decision now before the Board is distinct from TAP cost recovery (as base rates no longer reflect the cumulative impact of the proposed TAP Rate Rider. TAP lost revenues in the amount of $9.461 million, $13.226 million and $16.412 million (adjusted for collections) are removed from the base rate increase for FY 2019, 2020 and 2021, respectively. These lost revenues (in the aggregate amount of $39.1 million) are now proposed to be recovered via a reconcilable TAP Surcharge Rate.. In addition, the revenue requirements associated with the agreed-upon adjustments shown in Table 1 are no longer being contested.

Table 1 - Adjustments Acceptable to the Department

Adjustment	**Description of Adjustment**	**Citation to Record**
Additional Staffing Operating Labor Expense (Actual/Budget Factor)	Application of Actual to Budget Factor consistent with cost classification	PA Statement 1 at 20, Lines 6-7
Debt Interest Rate	Use of 5.25 percent interest rate for debt issuance in FY 2019 and FY 2020	PA Statement 1 at 27, Lines 15 – 16
Capacity to Pay Energy Costs	($1,493,250) - FY 2019 ($1,493,250) - FY 2020	PA Statement 1 at 31, Schedule LKM-2, line 14
Chemicals	0.0% - FY 2019	PA Statement 1 at 25-26.
Bond Issuance Costs	0.56% - FY 2019 0.56% - FY 2020 0.56% - FY 2021	PA Statement 1 at 28.

These specific adjustments reduce the revenue requirement for base rate relief by an additional $11.1 million during the PWD proposed three-year rate period of FY 2019-2021 ("Rate Period"). Taken together, the net aggregate amount of base rate relief to be decided upon is roughly $66 million.

The issue areas presented in the rate filing (net of the impact of the TAP Rate Rider and agreed-upon adjustments) can be reasonably grouped in three areas: (A) Major Policies and Financial

in cash and liquidity;" S&P (March 22, 2017) "Downside Scenario – If financial metrics deteriorate…we could lower the rating or revise the outlook to negative;" Fitch (April 3, 2017) "Rating Sensitivities – Insufficient Rate Recovery: The Stable Rating Outlook reflects Fitch's expectation that consistent rate action will be taken to support planned capital spending. However, if PWD experiences any difficulty in achieving timely and sufficient rate recovery, financial margins could decline, which would likely prompt negative rating action." PWD Statement 2 (Schedule ML-4).

Performance Metrics Issues; (B) Narrower Operational/Financial Issues; and (C) Cost Allocation and Rate Design Issues. As explained below, the Report does not allow PWD to accomplish its reasonable financial/operational objectives in any of the above areas.

II. EXCEPTIONS

A. The Hearing Officer Report Errs in Rejecting Major Policies and Financial Performance Metrics Proposed by the Department.

PWD's rates and charges are set by determining the appropriate levels of cash, debt service coverage and other financial metrics necessary to enable the Department to pay its bills and maintain efficient access to the capital markets at reasonable rates.[3] PWD's goal is to preserve its "A" credit rating. To do this, given its rapidly growing costs and capital program,[4] PWD has established certain major policies to help ensure its credit rating and financial stability. Since the Rate Board must recognize the importance of PWD's Financial Plan,[5] it is unsettling that the Hearing Officer Report errs in rejecting, deferring consideration, or making inconsistent recommendations with regard to major policies and financial performance metrics, discussed below.

1. Rate Period.

The Report errs in rejecting the three-year time horizon for rates proposed by the Department.[6] The Hearing Officer offers only a general rationale in support of this recommendation. As stated in the Report:

> It is axiomatic that the further into the future one attempts to forecast, the less certain the forecast, and the more likely reality will not match the forecast. Three years into the future is too long a period to forecast revenue requirements at a detailed and reliable enough level to warrant setting rates that far out, at least without some mechanism to true-up or adjust those out-year rates if circumstances deviate too far from the forecast.[7]

The Hearing Officer's recommendation is flawed for several reasons including that (i) it ignores common municipal rate setting practices – which permit three-year (36 month) rate periods; (ii) it lacks record

3 PWD Statement 2 at 6-7, 19-20.

4 The major cost projections that underpin the proposed rates and charges are in the following expense areas: Workforce costs; COA (hereinafter defined) costs; costs for the Capital Improvement Program. PWD Statement 2 at 32.

5 Philadelphia Code §13-101(4)(b)(i); PWD Statement 2, Financial Plan (Schedule ML-2) at p. 16.

6 Report at 26-27.

7 Report at 25.

support - given its generality; and (iii) it indirectly applies the "known and measurable" standard – after denying the applicability of same to municipal rate setting practices.

In the first instance, the recommendation is at odds with the guidelines of the American Water Works Association's Principles of Water Rates, Fees and Charges M1 Manual ("AWWA Rate Manual"). The AWWA Rate Manual explains that, if a utility is looking at revenues and expenses for a 36-month rate period, the utility may wish to use a single test year that averages the revenue requirements and revenues for the 36-month period or separate the period into three separate 12-month test periods to phase the rates in over that time.[8] There are numerous jurisdictions that utilize multiple test years, as identified in the record.[9] The Hearing Officer observes that jurisdictions cited by PWD (as utilizing future test years) employ "openers," "circuit breakers" or some other method to check the accuracy of projections for the out-years of the projection period.[10] This is not universally true, however. Many jurisdictions establish rates over successive test years without such a true-up, as was the case in the 2016 Rate Proceeding. The Report also overlooks the fact that, in past PWD rate proceedings, the rate periods have ranged from two to four years, with rate increases phased in over multiple years.

Second, the recommendation is axiomatic and overly general, as opposed to being based upon specific projections of revenues/revenue requirements for the Rate Period. The Report references the historic record of PWD out-performing projections, but does not tie the recommendation to projected revenues/revenue requirements for 2021 fully projected future test year ("FPFTY").[11] In this regard, the Report mirrors the position of the Public Advocate witness, Lafayette Morgan.[12] He makes the same mistake. That is, in examining FY 2012-2017, both Mr. Morgan and the Hearing Officer observe/opine that PWD's projections did not exactly match actual revenues and expenses. Based upon this global observation of past/historical performance, both conclude that the 2021 FPFTY cannot be accurate in its

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8 AWWA Rate Manual at 16; PWD Statement 2 at 20.
9 PWD Brief at 25; PWD Rebuttal Statement 1 at 4-5. See also, Response to TR-11.
10 Report at 26.
11 Report at 25.
12 PA Statement 1 at 11-15.

entirety. Such conclusion is without relevant empirical foundation — as there is no analysis of data actually related to the projections for the Rate Period to support such a conclusion. It is, at best, a postulation based upon historical data with no explanation of the financial/operational circumstances that occurred during that period (FY 2012-2017). It offers no basis for the Board to conclude that 2021 FPFTY is less accurate than any other FPFTY.

Third, the Report clearly states that the "known and measurable" standard does not apply in the case of a future test year.[13] The Hearing Officer reasons that this standard had applicability only with respect to historic test years. As stated in the Report:

> <u>The known and measurable concept does not apply in the case of a future test year</u>. The concept is used to adjust a historic test year, to bring it as far into the future as can be done with certainty. Aside from changes that are known to be certain beyond the test year, and whose impact on revenue requirements can be measured at the time of decision making, the historic test year is not adjusted.
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> <u>Note that the concept is generally limited to changes known to be taking place in the year following the test year. Anything beyond that period is often considered unknowable, as too susceptible to being changed in the interim</u>.[14] [Emphasis added].

The Report explains the past practice of using the known and measurable standard to adjust the historic test year (with regard to changes known to be taking place during the year following that period).[15] In that context, anything after one year following the test year was considered speculative (too susceptible to change). Here, after carefully and accurately explaining the reasons for the standard's inapplicability, the Hearing Officer inconsistently applies an almost identical standard. That is, projections (adjustments) beyond one year following the initial test period are again barred without any analysis as to whether a specific projection is reasonable. The Board should reject this recommendation. Instead, the Board

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13 Report at 24-25.

14 Report at 24-25.

15 See, *Pennsylvania Public Utility Commission, Guide to Utility Ratemaking* (2018 Edition) at 116. Changes outside the historic test year that are known and measurable may be recognized. If a future test year is employed, the focus shifts to whether the utility's proposed revenues/revenue requirements are reasonable.

should endorse the use of reasonable projections for each FPFTY (including 2021), as have been utilized by the Department throughout the Rate Period.

As stated in the PWD Brief, rate setting is prospective.[16] Rates and charges are set at a current time to recover the future cost of providing service. To do this, a study is performed using a "test year"[17] to determine if rates and charges should be adjusted. A "test year" is used for the detailed cost of service analysis and rate design.[18]

Projections must be reasonable. Financial projections cannot be based on absolute certainty in a fully-projected future test year, however. By their very nature, forward-looking projections for such test years are subject to a number of reasonable estimates and assumptions, known and unknown risks, uncertainties and other factors. So, it is reasonable to expect that actual results may vary from said projections. Nonetheless, revenues and expenses are reasonably projected within the future test period based upon reliable information that is reasonably known to the Department.

PWD's estimates of revenues and revenue requirements for the fully projected future test years in this rate filing (FPFTY 2019-2021) are reasonable. PWD provided actual data for revenues, obligations/appropriations, adjustments and balances in FY 2016 (final, audited), FY 2017 (preliminary, unaudited) and FY 2018 (as budgeted and adjusted to reflect actual-to-budget spend factors).[19] For purposes of developing projections for the future test years, adjustments were made to FY 2018 budgeted data, where necessary, to ensure that the projections were representative of revenue requirements that the Department expects to experience during the Rate Period.[20]

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16 PWD Brief at 13; PWD Rebuttal Statement 1 at 1.

17 The test year may be specific 12-month period of time or it may be a period of more or less than one year. AWWA Rate Manual at 11. There are three types of "test years" (or test periods): (1) Historic, which on based entirely on actual results in recent periods. (2) Pro-forma, which is historical based and adjusted for any "known and measurable" changes. In Pennsylvania, a pro-forma test year is sometimes called a "future" test year; and, (3) Fully-projected, which is based entirely on projections. *Id.*

18 PWD Statement 9A at 9.

19 PWD Statement 2 at 31.

20 PWD Statement 2 at 31.

In short, the proposed Rate Period with separate FPFTYs is reasonable. A three-year rate period is, in fact, optimal for this rate proceeding.[21] Specifically, inclusion of the third year of the Rate Period would allow PWD to develop a full three year collection factor cycle for TAP participants. The third year of the Rate Period is also necessary to develop new rate structure recommendations and make modifications to Basis-2 that would allow same to be implemented. Without a three-year time horizon for rates, the Rate Board cannot reasonably expect recommendations as to either of these issues in the next proceeding. In view of all of the above, the Hearing Officer's recommendation is mistaken and lacks sufficient record support and should, be rejected.

2. Debt Service Coverage.

The Report errs in not targeting adequate debt service levels consistent with PWD's Financial Plan.[22] The Hearing Officer makes no recommendation concerning debt service coverage. This outcome gives insufficient consideration to rating agency concerns. Recent rating agency reports (submitted of record) emphasize the need for the Department to improve its debt service coverage levels.[23] The Report, by not addressing this issue, proposes to do nothing to improve coverage levels. The Hearing Officer's position seems to be that debt service coverage is the by-product of whatever revenue/revenue requirements are approved – and not a targeted financial performance metric.[24] The Board should take this issue more seriously as, from both an operational and a credit rating perspective, it is essential for the Department to sustain debt service coverage levels above the minimum required levels throughout the Rate Period.[25]

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21 PWD Statement 2 at 20. As a practical matter, the impact of base rate relief occurs over a two year period (only *de minimis* impact in FY 2019). The time horizon requested by PWD also provides customers with transparency about the Department's planned expenses, revenues and rate increases over a reasonable number of years while reducing the administrative burden and expense of having to litigate base rate filings on a more frequent basis. See also, discussion *infra*.

22 Report at 31-32.

23 PWD Brief at 16-17.

24 Report at 31.

25 PWD Rebuttal Statement 2 at 12-13.

Debt service coverage is simply cash flow that is used to support the system by funding capital projects.[26] Any funds used for capital projects also allow the system to manage future leverage.[27] Adequate debt service coverage ensures that reserves are maintained at levels that can mitigate unforeseen expenses and capital needs or dips in expected revenue.[28]

The Department has targeted debt service coverage to trend to 1.3 times, which is included in its Financial Plan.[29] That level is above the minimum legal requirement for debt service coverage (which is 1.2 times coverage of senior debt, including contributions from the Rate Stabilization Fund) and will support maintaining PWD's existing credit ratings for the foreseeable future.[30] All three of the rating agencies have mentioned the PWD's increased debt service coverage of 1.3 times as a credit positive.[31] This increased coverage will result in stronger liquidity and will ultimately allow for increased pay-go funding.[32] This is critical given the reality of PWD's increasing required capital needs.[33] As with older urban systems, ongoing maintenance of assets is critical. PWD has historically had low margins and a higher debt burden.[34] Consistent reasonable rate increases will allow PWD to address capital needs without over-burdening future ratepayers.[35] The current and past debt service coverage levels for PWD are below national trends for "A" rated utilities.[36] If not allowed to improve coverage levels, PWD will face higher costs for funding its capital program (as it will have no other recourse but to issue more debt on less favorable terms).[37]

It is important that the Rate Board re-visit this issue. A potential outcome of the Report's inaction would be to allow debt service coverage to fall from the 1.30x target proposed by PWD to at or

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26 PWD Rebuttal Statement 2 at 11.
27 PWD Rebuttal Statement 2 at 11.
28 See, PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 3.
29 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 3
30 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 3.
31 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 8.
32 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 8.
33 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 8.
34 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 8.
35 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 8.
36 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 3.
37 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 3.

near minimum required levels (roughly 1.2 times) in FY 2019 (as endorsed by the Advocate). Such a drop in debt serve coverage would represent a significant shift that could adversely impact the Department's credit rating. A downgrade will make it harder for PWD to borrow and increase the cost of borrowing[38] -- which will have far reaching implications for both PWD and its customers.

Coverage in FY 2020 through FY 2021 has to be higher than minimum requirement levels to generate adequate cash funding for capital expenditures. Further, it should be maintained at the levels reflected in PWD's proposal. Such coverage will result in stronger liquidity and will ultimately allow for increased pay-go funding.[39] The foregoing is critical given the reality of PWD's increasing required capital needs.[40] In light of the above, the Report, as to this issue, should be modified consistent with these Exceptions.

3. Rate Stabilization Fund and Residual Fund.

The Report errs in not addressing the issue of adequate financial reserves.[41] The Board is required to determine minimum levels of reserves to be maintained during the Rate Period.[42] This issue is critical to the Department. As stated in the PWD Brief, days of cash-on-hand is an indicator of a system's financial resiliency and ability to swiftly address unforeseen financial requirements.[43] The number of days of cash on hand is a "key ratio" used by the rating agencies in assessing credit quality, meaning it is a highly important criteria in determining a credit rating for all three credit agencies.[44] Days of cash on

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38 See, PWD Rebuttal Statement 2 at 11.

39 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 8.

40 As with older urban systems, ongoing maintenance of assets is critical. PWD has historically had low margins and a higher debt burden. Consistent reasonable rate increases will allow PWD to address capital needs without over-burdening future ratepayers. The current and past debt service coverage for PWD are below national trends for "A" rated utilities. If not allowed to improve coverage levels, PWD will face higher costs for funding its capital program (as it will have no other recourse but to issue more debt on less favorable terms). PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 3-8.

41 Report at 27-28, 39.

42 See, Philadelphia Code, Section 13-101(4)(b)(i).

43 PWD Brief at 18-21; PWD Rebuttal Statement 2 at 6.

44 PWD Rebuttal Statement 2 at 6. A common measure to determine liquidity is "days cash on hand," which is calculated by totaling unrestricted cash and investments and any restricted cash that is available for general system purposes, divided by the result of operating expenses (minus depreciation) divided by 365. While rating agencies vary in their calculation, in particular with regards to the allowance of balances in the Rate Stabilization Fund and the Residual Fund, all mention and acknowledge the balance in their liquidity consideration. PWD Statement 2, Memorandum from Financial Advisors (Schedule ML-6) at 4.

hand is also consistent with references to terms such as “cash reserves” and “liquidity” that commonly appear in the rating agencies’ ratings reports on individual municipal utilities.[45]

Adequate cash reserves allow systems to contribute to increasing capital projects, mitigate system disruptions, and fund unexpected operating expenses.[46] The Department plans to maintain appropriate levels of financial reserves by targeting a $150 million balance in the Rate Stabilization Fund and $15 million in the Residual Fund.[47] The rating agencies give credit to the Department for balances in both funds in calculating liquidity levels.[48] It is critical that the Department be allowed to maintain these targeted levels.[49]

The Rate Stabilization Fund is vital to the Department (i) in consideration of the Department’s credit rating by all three rating agencies that rate the Department; (ii) for actual protection in the event of unforeseen emergency capital or operating requirements; and (iii) to mitigate the magnitude of future base rate increases.[50] The purpose of the Rate Stabilization Fund is to maintain liquidity in the Water and Wastewater Funds in satisfaction of financial covenants and otherwise for the financial health and operation of the water and sewer enterprise.[51] PWD aims to keep $150 million in the Rate Stabilization Fund to cover annual expenditures when the revenues are less than projected.[52] This serves as the key protection to ratepayers and bondholders.[53] A smaller level of protection is provided by the Residual Fund, which may be used to pay Operating Expenses or debt service, or for almost any other purpose in support of the System.[54] As the Water and Wastewater Funds are a closed system, the Residual Fund is

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45 PWD Rebuttal Statement 2 at 4-6. All three rating agencies view liquidity measures as a critical indicator of financial stability.

46 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 4.

47 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 3. PWD aims to maintain a minimum of $15M in the Residual Fund, which is established to maintain the remaining revenues after all other payments. PWD Statement 2, Financial Plan (Schedule ML-2) at 21.

48 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 3.

49 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 4; PWD Rebuttal Statement 2 at 9.

50 PWD Rebuttal Statement 2 at 9.

51 PWD Statement 2, Memorandum from Bond Counsel (Schedule ML-3) at 6.

52 PWD Statement 2, Financial Plan (Schedule ML-2) at 21.

53 PWD Statement 2, Financial Plan (Schedule ML-2) at 21.

54 PWD Statement 2, Memorandum from Bond Counsel (Schedule ML-3) at 6-7.

the last Fund into which revenues may flow.[55] There are prudent financial reasons to maintain reserves of at least $150 million in the Rate Stabilization Fund.[56] First, a municipal utility, like any business, needs a reserve of cash-on-hand to pay current obligations as they come due.[57] Municipal water and wastewater utilities incur costs to provide the service (labor, materials, supplies, services, etc.) in advance of bills being rendered and revenue collected for providing the service. The timing of the incurrence of costs associated with running utility operations precede the timing of the receipt of revenues to cover those costs, which means a reserve of cash always must be available to handle basic day-to-day utility operations. Second, utility revenue can fall short of expenditures, causing negative cash flow due to the inherent lag in the regulatory process of adjusting rates to match costs that have been impacted by inflation and other increases over time.[58]

The Public Advocate disagrees with the targeted balance for the Rate Stabilization Fund. It recommends instead a $110 million balance in the Rate Stabilization Fund.[59] It is not opposing the $15 million balance for the Residual Fund.[60]

The Advocate's proposed target for the Rate Stabilization Fund must be rejected. Its recommended level of cash reserves would severely impede the Department's ability to mitigate any changes in revenue collections, unforeseen operating expenditures or disruptions in the ability to fund ongoing capital needs.[61] It would be irresponsible to leave a system with annual operating revenues of over $729 million and expenses of over $485 million and annual capital needs of over $300 million with cash reserves at such low levels.[62] Adopting the Advocate's recommendation ($110 million) would represent only a fraction of cash reserves necessary to meet the required medians for an "A" credit rating

55 PWD Statement 2, Memorandum from Bond Counsel (Schedule ML-3) at 6-7.
56 PWD Rebuttal Statement 2 at 2.
57 PWD Rebuttal Statement 2 at 2.
58 PWD Rebuttal Statement 2 at 2.
59 PA Statement 2 at 14, 38.
60 PA Statement 2 at 36-37.
61 PWD Rebuttal Testimony 2 at 5-6.
62 PWD Rebuttal Testimony 2 at 6.

and would be well below the required medians for an "A" rated credit on all accounts.[63] In comparison, the proposed minimum of $165 million balance in the Rate Stabilization Fund and Residual Fund would represent approximately 244 days cash on hand for FY 2018.[64] The point of the foregoing is that PWD's target of $150 million in the Rate Stabilization Fund would keep PWD on the path towards adequacy in this area, and the Public Advocate's target of $110 million would leave PWD short of the financial reserves of any comparable peer.

PWD plans to maintain appropriate levels of financial reserves by targeting a $150 million balance in the Rate Stabilization Fund and $15 million in the Residual Fund.[65] This level of cash reserves allows the utility to mitigate system disruptions, fund unexpected operating expenses, contribute to capital project and offset the burden of future rate increases.[66] As stated above, the rating agencies also give credit to the Department for balances in both funds in calculating liquidity levels.[67] It is critical that the Department be allowed to maintain these targeted levels.[68] The Report, as to this issue, should be modified consistent with these Exceptions.

4. Pay-Go Financing.

The Report errs in its indecision concerning capital funding through current revenues (pay-go financing).[69] The Board is required to determine the extent to which current revenues should fund capital expenditures.[70] The Report's inaction in this regard fails to send a clear and positive message to the rating agencies. The Hearing Officer suggests that the discussion of pay-go financing seems to be more about "optics" than "actualities" – and that PWD does not intend to fund its capital with 20% current revenues

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63 PWD Rebuttal Testimony 2 at 5.

64 PWD Rebuttal Testimony 2 at 6. The Advocate recommends an even lower RSF target in its brief. PA Brief at 53.

65 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 3. PWD aims to maintain a minimum of $15M in the Residual Fund, which is established to maintain the remaining revenues after all other payments. PWD Statement 2, Financial Plan (Schedule ML-2) at 21.

66 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 4.

67 See, PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 3; PWD Brief at 19-20.

68 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 4; PWD Rebuttal Statement 2 at 9.

69 Report at 34.

70 See, Philadelphia Code, Section 13-101(4)(b)(i).

for some years.[71] The Board should be aware, however, that PWD is incrementally trying to reach its pay-go financing objective. It will take a few years, but PWD needs to continue and build upon pay-go financing during this Rate Period – as it proposed. The fact that PWD is gradually moving towards its ultimate goal helps to minimize the size of its revenue requirement. It does not – as discussed herein and in PWD's Brief – negate the reasonableness of the interim steps or the end goal itself.[72]

To support the financial stability of the capital program, the Rate Board should clearly embrace pay-go financing. As explained in the PWD Brief, the Capital and Construction Accounts are appropriately used to provide "pay-go" financing for capital improvements.[73] Pay-go financing is simply funding capital needs with current revenues,[74] which reduces borrowing needs, thereby reducing costs that customers will have to bear over the life of the typical 30-year bond.[75] Stated differently, pay-go funding lessens PWD's dependence on borrowing money for capital improvements. Similarly situated utility systems, which have been able to fund significant portions of their capital programs with annual revenues, are able to manage their debt without significantly burdening future ratepayers.[76]

It is uncontroverted in this record that increased borrowing is anticipated to fund PWD's Capital Improvement Program and Consent Order Agreement ("COA") obligations.[77] Moreover, no one disputes the fact that more investment will be needed by PWD to maintain the system.[78] Beyond maintaining the system, PWD anticipates increasing capital and operating requirements associated with the COA during the Rate Period.[79] Despite the urgency of the foregoing, the Report demurs as to this issue.

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71 Report at 34.
72 PWD Brief at 22.
73 PWD Brief at 21-22.
74 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 4.
75 PWD Statement 2 at 5.
76 PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at p. 4; PWD Statement 2, Memorandum from Financial Advisory (Schedule ML-6) at 4-5.
77 PWD Statement 2 at 17, 21, 32.
78 PWD Statement 2, Financial Plan (Schedule ML-2) at 30.
79 PWD Statement 2 at 22.

Pay-go financing is essential to improve debt service coverage to industry standards and is just and reasonable as a principle of both public finance and ratemaking.[80] PWD has a rapidly growing capital program[81] and is working towards funding 20% of the capital program from current revenues.[82] The Department's position should be approved to allow the appropriate financial planning for a sustainable future.[83] The findings in the Report, as to this issue, should be modified consistent with these Exceptions.

5. Capital Account Deposit.

The Report errs in not fully addressing this issue.[84] The Hearing Officer opines that this issue is more theoretical (than real).[85] However, the Capital Account Deposit is a very real legal requirement dictated by the 1989 General Ordinance. As explained in PWD's Brief, the Capital Account[86] Deposit is necessary to finance water and wastewater capital improvements.[87] The 1989 General Ordinance (hereinafter defined)[88] requires an annual deposit to the Capital Account. It defines the required "Capital Account Deposit Amount" as "an amount equal to one percent (1%) of the depreciated value of property, plant and equipment of the System or such greater amount as shall be annually certified to the City in writing by a Consulting Engineer as sufficient to make renewals, replacements, and improvements in order to maintain adequate water and wastewater service to the areas served by the System."[89] One

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80 PWD Statement 2 at 17-19.

81 PWD Statement 2 at 5. The Department's rate filing (as detailed in Schedule BV-E1, Table C-7) includes capital improvements totaling $1.1 billion from FY2019 through FY2021 which supports critical improvements related to water and wastewater treatment plant upgrades, clean water storage tanks, pumping stations, water main replacements and sewer replacements. For a listing of the Top Fifteen Projects, please see Table 6 in PWD Exhibit 5.

82 PWD Statement 2, Financial Plan (Schedule ML-2) at 31

83 The PWD goal of 20% is on the weaker side and should be achieved, and even strengthened, in the future. See, PWD Brief at 22 (footnote 130).

84 Report at 34. A summary of the parties positions is missing, although basic findings are articulated.

85 Report at 34.

86 The "Capital Account" is an account within the Construction Fund. PWD Statement 2, Memorandum from Bond Counsel (Schedule ML-3 – Glossary). See, PWD Brief at 22 (footnote 135).

87 PWD Brief at 22; PWD Statement 9A at 39.

88 Restated General Water and Wastewater Revenue Bond Ordinance of 1989, approved June 24, 1993, as amended by an Ordinance approved January 23, 2007.

89 PWD Rebuttal Stat 1 at 22-23.

percent should be considered a minimum.[90] As noted in the ordinance, greater amounts are allowable based on the certification of a Consulting Engineer.[91]

The foregoing action by the Consulting Engineer is all that is legally required to effect this policy change (increasing the required Capital Account Deposit). As noted by the Hearing Officer, changing the Capital Account Deposit Amount from 1.0% to 1.5% does not increase the Department's annual revenue requirement.[92] The level of revenues needed to fund the Capital Account Deposit Amount, based on 1.5%, is less than the level of revenues necessary to meet the 1989 General Ordinance rate covenants requirements.[93] Furthermore, the increase in the Capital Account Deposit is accompanied by a corresponding decrease in the transfer to the Residual Fund.[94] In view of all of the foregoing, the findings of the Report, as to this issue, should be modified consistent with these Exceptions.

B. The Hearing Officer Report Errs in Rejecting or Substantially Adjusting Narrower Operational/Financial Requirements Proposed by the Department.

Once major policies and performance metrics are determined, the next step of the rate setting process is the determination and establishment of the revenue requirement.[95] This step compares the projected revenues of the utility to its projected expenses to determine the overall level of rate adjustment need in the test year. The objective is to provide revenues sufficient to recover total cash requirements for that time period.[96]

The PWD used reasonable projections for each of the test years. However, as discussed below, the Hearing Officer Report errs by rejecting, inconsistently deciding or substantially adjusting certain financial/revenue requirements for FY 2019-2021. Generally speaking, such errors fall into four categories. First, the error of trying to find a middle-ground between the parties when the evidence clearly indicates otherwise (capital program spend rate). Second, the error of deciding specific

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90 PWD Rebuttal Statement 1 at 23.
91 PWD Rebuttal Statement 1 at 23.
92 See, Report at 34; PWD Brief at 23; PWD Rebuttal Statement 1 at 24.
93 PWD Rebuttal Statement 1 at 24.
94 PWD Rebuttal Statement 1 at 24.
95 AWWA Rate Manual at 9.
96 AWWA Rate Manual at 12.

adjustments inconsistently (escalation factors for Power/Gas Costs; General Costs and Class 200 Expenses; and Chemical Costs). Third, the error of mischaracterizing certain costs as non-recurring despite clear evidence that said expenses will actually be incurred **in each** of the test years (and must be paid in the year that they are incurred). And finally, the error of not deciding a specific adjustment (FY 2021 debt interest rate).

1. Capital Program Spend Rate.

The Report errs in rejecting the Department's projected capital program spend rate.[97] The Hearing Officer adopts a spend rate of 82.12% — as the highest spend rate achieved in the recent past.[98] This recommendation is a compromise (judgment call) between the PWD (90%) and Advocate (76%) proposals. However Solomon-like this recommendation may be, the Department questions whether it gives sufficient weight to the evidence presented with regard to the uptick in capital spending. The table below depicts spending under scenarios advanced by the Department and in the Report[99] and clearly shows that the cumulative impact of 90% versus 82% capital spend rate shortens capital spending by over $116 million. In the context of revenue requirements, adoption of this recommendation would understate debt service costs and cash financing needs.

Table 2 - Capital Program Spending ($000)

Fiscal Year	**2018**	**2019**	**2020**	**2021**
PWD Proposal **(90%)**				
Total CIP Expenditures	$318,292	$328,255	$338,518	$349,342
Hearing Officer Recommendation **(82.12%)**				
Total CIP Expenditures	$290,424	$299,515	$308,879	$318,755
Difference in CIP Expenditures	**$27,868**	**$28,740**	**$29,639**	**$30,587**
			Total Difference	**$116,834**

PWD maintains that the recommendation in the Report underfunds necessary capital improvements. This will result in a potential back-log of capital projects – all related to main and sewer

97 Report at 38.
98 Report at 38.
99 Report at 38; PWD Statement 9A, Schedule BV-E1 (Table C-8, line 13).

replacements, water and wastewater treatment plant improvements or regulatory requirements, particularly for stormwater. These projects will not just go away. The delay in same can only result in increases in costs related to eventual main breaks and sewer failures, service disruptions or fines and penalties due to permit violations. The absence of recognition of these planned capital project expenditures will perforce produce increased revenue requirements in the future.

Projected Capital Improvement Program expenditures for the Rate Period are approximately $328 million, $339 million and $349 million in 2019, 2020 and 2021 FPFTYs, respectively.[100] These projected annual expenditures are estimated at 90% of the annual capital program budget to track anticipated expenditure levels during each FPFTY.[101] The capital program budget reflects an annual inflation of 2.5% based upon industry construction cost indices.[102]

As depicted in the table below, over the past six years, bidding costs related to capital projects have been steadily increasing (as demonstrated by the increase in fiscal year obligations in column 3 below). As one would expect, there is also an increase in expenditures which reached 82.12% of the budget in FY 2017 due to an increase in obligations over prior years.

Table 3 - Capital Budget Obligations/Expenditures (FY 2013-2018)[103]

Fiscal Year	Budget	Obligations	Obligations as Percent of Budget	Expenditures	Expenditures as Percent of Budget
2013	$228,573,000	$171,497,831	75.03%	$142,016,000	62.13%
2014	$235,153,000	$181,341,988	77.12%	$143,024,000	60.82%
2015	$260,353,000	$235,833,991	90.58%	$175,618,460	67.45%
2016	$284,041,000	$290,086,548	102.13%	$187,170,515	65.90%
2017	$301,629,000	$333,689,547	110.63%	$247,692,583	82.12%
2018	$353,658,000	$388,436,942	109.83%		

100 PWD Statement 9A, Schedule BV-E5 (WP-1) at 10.
101 PWD Statement 9A, Schedule BV-E5 (WP-1) at 9; PWD Rebuttal Statement 2 at 14-15.
102 PWD Statement 9A, Schedule BV-E5 (WP-1) at 9; Appendix 7.
103 PWD Rebuttal Statement 2 at 15.

Based upon the high level of obligations in FY 2016-2018, the Department reasonably anticipates expenditures in FY 2019-2021 will continue to rise, and may even surpass 90% of the capital budget.[104] In view of increasing PWD obligations (which will lead to future increases in spending), it is reasonable to reflect this trend in the Capital Program spend rate at 90% (which anticipates increased spending as depicted in the table above), as opposed to the lower spend rate endorsed in the Report (82.12%).[105] The Department's capital program spend rate is reasonable and should be adopted by the Rate Board. The findings in the Report, as to this issue, should be modified consistent with these Exceptions.

2. Specific Adjustments.

(a) Power and Gas Costs.

The Report errs in inconsistently ruling on the appropriate escalation factor for Power and Gas costs.[106] Assuming the Hearing Officer endorses the Public Advocate's position,[107] such recommendation would contradict a previous finding that the "known and measurable" standard is inapplicable in a fully projected test period.[108] The Board should note that the earlier finding is correct. As stated in the PWD Brief, financial cost estimates cannot reflect absolute certainty in a fully projected future test year.[109] All forward looking projections are subject to a number of assumptions, uncertainties and other factors. The appropriate test is whether the projection is reasonable.

With regard to both Power and Gas costs, the escalation factors used reflect the judgment of the City's Office of Sustainability, Energy Office which coordinates energy purchases across the City departments. Consistent with the Energy Office's recommendation, no escalation factors were applied in (i) FY 2019-2020 for Power costs and (ii) FY 2020 for Gas costs.[110] The Report seems to accept this part of the recommendation, but rejects the projected increase for FY 2021. However, to assume that the City

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104 PWD Rebuttal Statement 2 at 15; Response to PA-IX-20.
105 PWD Rebuttal Statement 2 at 15.
106 See, Report at 48, 62.
107 PA Statement 1 at 22-23.
108 Report at 25.
109 PA Brief at 38-39; 13.
110 PWD Rebuttal Statement 1 at 18.

will experience no increase in either power or natural gas expenses after FY 2020 is unreasonable and fails to recognize the Energy Office's expertise in coordinating purchases for the City. [111] As the Energy Office has already accounted for current hedges and its recent experience in the energy market (which has favorably impacted gas and power costs projected in FY 2019-2020), the escalation factors used in FY 2021 should be deemed reasonable projections – based upon the same reasonable judgment and experience.[112] By applying the Hearing Officer's recommendation and assuming no escalation factor in FY 2021, PWD's O&M expenses for Gas and Power Costs would be understated by some $0.57 million, in the aggregate, for the proposed Rate Period. The findings of the Report, as to this issue, should be modified consistent with these Exceptions.

(b) General Costs and Class 200 Expenses.

The Report errs in inconsistently ruling on the appropriate escalation factor for General Costs and Class 200 Expenses.[113] Assuming the Hearing Officer rejects the escalation factor proposed by PWD, the error is the upshot of the Advocate's flawed proposal.[114] Stated simply, the PA adjustment is predicated upon the assumption that PWD applied a 3.15% general escalation factor in its projections – which needed to be adjusted to remove the impact of SMIP/GARP. This assumption is factually incorrect (lacking evidentiary support). As noted in PWD Statement 9A, Schedule BV-E5 (WP-1) at Appendix 4, the overall escalation in total costs experienced by PWD is presented for FY 2014-2016 at the bottom of the table shown in that Appendix. Specific escalation factors for individual cost categories are used in projecting expenses for each FPFTY (also as shown in Appendix 4). It bears emphasis that the escalation factor utilized for Other Class 200 Costs is 3.3% – not 3.15%, as assumed by the Advocate. Moreover, the escalation factor utilized by PWD for Other Class 200 Costs did not include SMIP/GARP costs.

[111] See, PWD Rebuttal Statement 1 at 18. Also, as stated in the technical hearings, PECO has recently filed an application for rate relief with the PUC. The Rate Board should also take notice of the fact that increases in natural gas costs can be experienced independent of a new rate filing by Philadelphia Gas Works in view of its gas cost recovery mechanism.

[112] PWD Rebuttal Statement 1 at 18.

[113] Report at 52, 66. In the first instance, the Hearing Officer demurs as to this issue (not enough information available). In the second, a finding is rendered rejecting PWD's position. For purposes of these Exceptions, the Department assumes that its position was rejected and requests the Rate Board's reconsideration.

[114] Report at 66. The Advocate's proposal recommends a 1.98% escalation factor for Other Class 200 Costs. PA Statement 1 at 24.

Finally, the Board should be aware that the 3.3% escalation factor (utilized as stated above) is consistent with PWD's historical two-year average increase experience, as presented in Appendix 4 (referenced above).[115] Assuming the application of a 1.98% escalation factor in FY 2019 and 2020 and assuming no escalation factor in FY 2021, PWD O&M expenses for Other Class 200 O&M expenses would be understated by $11.43 million during the proposed Rate Period. The findings of the Report, as to this issue, should be modified consistent with these Exceptions.

(c) Chemical Costs.

The Report errs in inconsistently ruling as to the appropriate escalation factor for Chemical costs.[116] Assuming that the Hearing Officer adopts the Public Advocate's position, the findings in the Report, as to this issue, are lacking in record support and fail to give sufficient consideration to the responses to PA-IV-12, PA-IV-22 and PA-IX-18. Those responses detail PWD's recent experience in procuring chemicals. The annual increases for FY 2020 are based on PWD's recent experience and unit costs provided during the procurement process.[117] By way of example, the contracted price for ferric chloride (representing 30% of the Chemical budget) significantly increased in January 2018. This increase impacts FY 2020 projections. In addition, a nominal escalation rate of 1% is applied for FY 2021, based upon a review of the overall consumer price index and PWD's recent experience.[118] The Report also fails to recognize the expertise of the PWD Operations staff in establishing reasonable cost escalation factors based upon their experience and professional judgment. Moreover, the Hearing Officer's recommendation in no way recognizes the impact that variations in river/source water quality may have on treatment costs.[119] The Department's escalation factor as to Chemical costs is reasonable and should be adopted. Assuming no escalation factor is utilized for Chemical costs in FY 2021, PWD's O&M

[115] PWD Rebuttal Statement 1 at 19.
[116] Report at 50, 64. In the first instance the Report finds the PA position reasonable. In the second, the Department's approach is deemed to be "better reasoned." For purposes of these Exceptions, the Department assumes that its position was rejected and requests the Rate Board's reconsideration.
[117] PWD Rebuttal Statement 1 at 19.
[118] PWD Rebuttal Statement 1 at 19.
[119] PWD Rebuttal Statement 1 at 20.

expenses would be understated by $0.18 million. The findings in the Report, as to this issue, should be modified consistent with these Exceptions.

(d) Normalization Adjustments.

The Report (as supplemented) errs in rejecting the Department's position concerning normalization adjustments.[120] The Hearing Officer follows the Public Advocate's lead in misidentifying costs (so called "rate case" expenses and TAP implementation costs) as non-recurring expenses. It recommends that these expenses be amortized (normalized) for ratemaking purposes. The Department disagrees for the reasons explained in its Brief and summarized below.[121]

- **Rate Case Expense**. The costs that are budgeted and projected for FY 2019 are the costs that are expected to be incurred in that year.[122] Tr. 96 (May 14, 2018). As budgeted, the category of expense characterized as "rate case" expenses by the Advocate are not limited to expenses incurred in the preparation or presentation of this rate proceeding.[123] This is self-evident by the simple fact that costs related to this rate proceeding are being incurred throughout the Rate Period. So, this category of expenses (rather than being limited to expenses incurred for this rate proceeding) is actually related to ongoing expenses for the same teams of people/consultants who are providing (and will continue to provide) other services to the Department[124] (such as bond feasibility, financial analysis and reporting). Many of the consultants have been selected (and contracted) to provide such service over multiple years. Simply put, between rate proceedings, the Department does rate-related tasks that the Department cannot do during a rate proceeding.[125] Those tasks are "captured" in the same accounting category as more traditional rate case expenses. Further, the overall level of expenses that the Department anticipates to incur from the combination of personnel and consultants are the same in years that do not include a rate case.

- **TAP Implementation Costs**. As explained in the record, the implementation costs are ongoing annual expenses and are expected to continue throughout the life of the program.[126] It should be noted that there are still parts of the program that need to be fully-implemented.[127] A major component, and specific driver, of continued "implementation" costs is the requirement to have electronic applications.[128] This requirement is ongoing and will continue in the test period. That cost alone is $3 million dollars.[129] In addition, as noted during the technical hearings, the TAP

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[120] Supplemental Hearing Officer Report (Normalization Adjustments).
[121] See, PWD Brief at 41.
[122] Tr. 96 (May 14, 2018).
[123] Tr. 254-255 (May 14, 2018). Investor-owned utilities are often required by a State Commission to separately capture rate case expenses from other studies and efforts. When that is the case, they tend to define "rate case expenses" as non-recurring expenses incurred by a utility in the preparation or presentation of a full rate case proceeding before the commission, necessary for the conduct of the rate case.
[124] Tr. 254-255 (May 14, 2018).
[125] Tr. 255 (May 14, 2018).
[126] Tr. 104 (May 14, 2018).
[127] Tr. 105-106 (May 14, 2018).
[128] Tr. 104 (May 14, 2018); Response to Transcript Request ("TR") 12.
[129] Tr. 104 (May 14, 2018).

> ordinance contains certain reporting requirements that require tracking of applications, and the way WRB obtains those tracking metrics is through bar-coded applications.[130]

To be clear, the level of these expenses in each FPFTY reflects the anticipated level of these expenses on a normal/ongoing level for that FPFTY. These expenses are annual and ongoing in nature. Each FPFTY in PWD's three-year proposal reflects the actual anticipated level of Class 200 expenses in which Rate Case and TAP Implementation costs are captured.

Normalization (as defined by Advocate and endorsed by the Hearing Officer), would only provide a portion of the funds to cover anticipated expenses: half if a two year period is adopted[131] or one-third if a three year period is adopted. This could lead to a revenue shortfall.[132] That means that there will not be adequate funds in the first FPFTY (2019) to pay for all of the costs incurred in that year and would not provide any additional funds for ongoing expenses during 2020 and 2021 FPFTYs. So, approval of this normalization adjustment would force the Department to either use funds allocated for other expenses to pay for these expenses or operate at deficit for these expenses. Neither option is a reasonable outcome. In addition, since PWD budgeted costs are adjusted by actual-to-budget factors based upon historical experience and RSF transfers are proposed to mitigate/levelize the need for additional revenues during the Rate Period –expenses are already effectively normalized. In other words, fluctuations in costs are managed by the combination of these two factors. The Hearing Officer's recommendation creates a disconnect in the revenue requirements utilized as part of a rate proceeding and those reflected in the Department's Financial Statements. Assuming the adoption of this recommendation, PWD's O&M expenses for Rate Case Expenses and TAP Implementation Costs would be understated by $3.57 million and $0.87 million, respectively during the proposed Rate Period. The findings in the Report, as to this issue, should be rejected.

[130] See, Response to TR-12.
[131] Tr. 132 (May 15, 2018).
[132] Tr. 89-90, 101-102 (May 14, 2018).

(e) Debt Interest Rate.

The Report errs in not addressing debt interest rates for FY 2021. As stated in record, PWD has projected revenue bond issuances in the projected principal amounts of $280 million, $295 million and $305 million for FY 2019, 2020 and 2021, respectively.[133] The Department has estimated debt service based upon a 30-year amortization schedule for bonds and estimated annual interest rates for each year of the Rate Period. PWD agrees to use a 5.25% interest rate for debt issuance in FY 2019 and 2020, as shown in the schedule of agreed-upon adjustments.[134] PWD maintains its original position for the projected annual interest rate of 6.00% for FY 2021.[135] The Advocate recommends that the proposed debt interest rate for FY 2021 be rejected as beyond its preferred two-year time horizon. The premise of its recommendation is that PWD projections for FY 2021 are speculative and fail to meet the known and measurable standard.[136] In the alternative (should a three-year rate period be approved), the Advocate recommends using a debt interest rate of 5.25% for each FPFTY.[137]

As stated previously, the known and measurable standard is inapplicable here. The question presented is whether the debt interest rate projection is reasonable. The projection meets that test in reasonably anticipating future market conditions (interest rates trending higher) and estimating the timing and terms of issuance, i.e., (i) bond issuance in the first quarter of the fiscal year; and (ii) interest only payments in the first year of the bond amortization.[138] The Department's debt interest rate projection should be approved for FY 2021. The Report, as to this issue, should be modified consistent with these Exceptions.

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[133] See, PWD Response to TR-23(B).
[134] See, PWD Brief at 29; PWD Response to TR-23(A).
[135] PWD Statement 9A at 39.
[136] PA Brief at 91.
[137] PA Brief at 91.
[138] PWD Statement 9A, Schedule BV-E5 (WP-1) at 8.

(f) Miscellaneous Charges.

The Report errs in its recommendation concerning Miscellaneous Charges.[139] PWD has proposed numerous changes in miscellaneous charges which are uncontroverted in this record.[140] The Advocate only contests the proposed increase in restoration charges for customers who are shut-off for non-payment.[141] The Hearing Officer's recommendation should be read as focused upon that one charge (not more expansively). The Rate Board should be aware that the proposed Miscellaneous Charges in the rate filing are based upon a detailed study which evaluated the level of effort and costs associated with each specific service for which a charge is proposed. A summary of this study was provided in response to PA-III-10, which details the actual cost of providing these service to a customer and the resulting proposed charge. The findings of the Report, as to this issue, should be modified consistent with these Exceptions.

C. The Hearing Officer Report Errs in Rejecting the Department's Cost Allocation and Rate Design Proposals.

Cost allocation and rate design are fundamental and closely related parts of the utility ratemaking process. PWD prepared a cost of service ("COS") study to equitably allocate the revenue requirements between the various customer classes of service. It also designed rates for each class of service to collect the desired level of revenues,, to reflect the way costs are incurred and to reflect the balance of policy objectives (such as bill impacts) against the desire for cost-based rates.

The PWD's cost allocation and rate design are reasonable. However, as discussed below, the Hearing Officer Report errs in rejecting certain allocation and rate design proposals advanced by the Department and overlooking other issues. These errors are based on (a) misinterpretations of the applicable law and/or industry guidance; (b) inconsistent recommendations with regard to cost allocation and rate design proposals; and (c) failing to articulate specific recommendations concerning the TAP Rate Rider.

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139 Report at 92.
140 See, PWD Exhibit 3.
141 Report at 92.

1. Fire Protection.

The Report errs in rejecting the Department's proposal concerning fire protection cost recovery.[142] The Hearing Officer appears to adopt the Public Advocate's over-arching recommendation that the *status quo* should be maintained. The Department disagrees given the evidence presented and the erroneous legal reasoning supporting this recommendation.

Stated plainly, this recommendation (as originally articulated by the Advocate and adopted by the Hearing Officer) is based on the wholly incorrect conclusion that PWD is actually prohibited from allocating the costs of public fire protection to any customer other than the City itself.[143] As stated in the PWD Brief, such conclusion is drawn from a misapplication of cost causation principles[144] and is wholly contradictory to the guidelines in the AWWA Rate Manual as well as the experience of other municipal utilities whose regulators have sanctioned analogous cost allocation approaches. This recommendation is also premised upon a misreading of the Philadelphia Code – in suggesting that there is a prohibition to cost recovery in the circumstances presented.[145] That is, Section 13-101(4) contains two key provisions that must be read in context. Section 13-101(4)(a) establishes the minimum amount of revenues that rates and charges shall yield to the City.[146] Section 13-101(4)(b) establishes the maximum amount of revenues that rates and charges shall yield to the City.[147] By its plain language, Section 13-101(4)(b) compares the revenues that rates and charges yield to appropriations <u>from the Water Fund</u> to the PWD. That

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[142] Report at 107.

[143] Such arguments implicitly contradict the Public Advocate's position that allocation of public fire protection costs is policy position being advanced by the PWD. See, PA Statement 3 at 90-92.

[144] PWD Brief at 51.

[145] PA Statement 3 at 91-92.

[146] "The rates and charges shall be such as shall **<u>yield to the City</u>** **<u>at least an amount</u>** equal to operating expenses and debt service, on all obligations of the City in respect of the water, sewer, storm water systems and, in respect of water, sewer and storm water revenue obligations of the City, such additional amounts as shall be required to comply with any rate covenant and sinking fund reserve requirements approved by ordinance of Council in connection with the authorization or issuance of water, sewer and storm water revenue bonds, and proportionate charges for all services performed for the Water Department by all officers, departments, boards or commissions of the City." Philadelphia Code § 13-101(4)(a) (emphasis added).

[147] "The rates and charges **<u>shall yield not more than</u>** the total appropriation from the Water Fund to the Water Department and to all other departments, boards or commissions, plus a reasonable sum to cover unforeseeable or unusual expenses, reasonably anticipated cost increases or diminutions in expected revenue, less the cost of supplying water to City facilities and fire systems and, in addition, such amounts as, together with additional amounts charged in respect of the City's sewer system, shall be required to comply with any rate covenant and sinking fund reserve requirements approved by ordinance of Council in connection with the authorization or issuance of water and sewer revenue bonds. Such rates and charges may provide for sufficient revenue to stabilize them over a reasonable number of years." Philadelphia Code § 13-101(4)(b) (emphasis added).

comparison excludes the "cost of supplying water to City facilities and fire systems" because such costs have been historically appropriated from other parts of the General Fund. That being said, it is not reasonable (as the Report recommends) to read that exclusion as prohibiting rates and charges for public fire protection. Such an interpretation would mean that the PWD could not directly allocate the cost of public fire protection to anyone, including the Fire Department. In view of the foregoing, the findings of the Report, as to this issue, should be rejected.

2. Cost Allocation/Rate Design.

The Report errs in inconsistently ruling on cost allocation and rate design issues.[148] That is, the Hearing Officer, in the first instance, finds that the PWD capacity factors used in the cost of service ("COS") study are appropriate, but then inexplicably rejects the Department's proposed rate design (premised upon the PWD cost of service analysis) and adopts the Advocate's proposal instead.[149] As explained below, the Hearing Officer clearly adopts the use of capacity factors proposed by the Department. The inconsistency arises in the rate design recommendation. See, discussion *infra* — Section C (2)(d) below.

(a) Capacity Factors Used in the Cost of Service Study Are Appropriate and Reflect PWD's Historical Experience.

As explained in the PWD Brief, for the water COS Study, Black & Veatch used the Base/Extra-Capacity cost allocation method outlined in AWWA's Rate Manual. This approach reflects the fact that engineers size and design the water source of supply, treatment, pumping and transmission and distribution facilities to handle the annual usage and potential maximum day and maximum hour demands of the PWD's water customer base. Accordingly, in sizing the PWD water system, the design criteria recognize the "anticipated" annual usage and maximum demands placed on the water system.

To determine the appropriate extra-capacity system factors for cost allocation, the Department's COS Study uses the methodology outlined in AWWA's Rate Manual. Following this methodology, the

148 Report at 104-105.
149 Report at 105.

COS Study recognizes the highest ratios of maximum day to average day demand and maximum hour to average day demand. The highest recent ratio of maximum day to average day demand is <u>1.41</u> based on the FY 2012 system raw water pumping data. The proposed system-wide maximum day capacity factor of <u>1.40</u> is consistent and supported by recent data.[150]

Similarly, the highest recent ratio of maximum hour to average day demand is <u>1.92</u> based on the FY 2016 system treated water delivery data. The Department's use of a <u>1.90</u> system-wide maximum hour capacity factor is consistent and supported by the recent data.[151]

The utilization of (i) system raw water pumping data as the basis for the maximum day capacity factor and (ii) system treated water delivery data as the basis for the maximum hour capacity factor to reflect PWD's system characteristics, is consistent with the methodology used in prior rate proceedings and aligns with the AWWA Rate Manual guidelines.

The Rate Board should be aware that the Philadelphia Large Users Group ("PLUG") agrees with the Department's methodology and capacity factors. Richard A. Baudino submitted rebuttal testimony on behalf of PLUG, which states that "the system-wide maximum day and maximum hour extra-capacity factors used in the COS Study are based on the PWD's actual historical experience, are reasonable, and should be adopted for purposes of the COS Study used in this proceeding."[152]

(b) Capacity Factors Used by the Advocate Reflect Illustrative Examples, Not PWD-Specific Data.

It should be noted that there are variations between customer-class specific extra-capacity factors in the COS Study and those that are calculated based on the methodology outlined in Appendix A of the AWWA Rate Manual. In the first instance, extra capacity factors used in the COS study are specific to the utility and will reflect demands associated with PWD customers. More generic data (as shown in the above referenced Appendix) is proffered for illustrative purposes and has no empirical relationship with PWD. More specifically, generic data will vary from utility specific data. These variations are primarily

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[150] PWD Rebuttal Statement 3 at 3.

[151] PWD Rebuttal Statement 3 at 5.

[152] PLUG Rebuttal Statement 1 at 2, lines 18 to 21.

due to the use of typical weekly and hourly usage factor assumptions as presented in the example calculations included in Appendix A of the above manual. These weekly and hourly usage factors used in the AWWA Rate Manual are illustrative assumptions that do not represent unique circumstances of each system. The factors Black & Veatch has uses in the COS study reflect PWD-specific considerations, which include:

- PWD does not experience seasonal peaking to the same extent as some utilities since urban customers do not have summer use peaks reflecting irrigation.

- PWD has a lower system-wide maximum day peaking factor when compared with other utilities, and hence experiences more diversity in hourly use adjustments than those presented in the AWWA Rate Manual.[153]

(c) The Advocate's Proposal Does Not Follow Accepted Industry Guidelines nor Does It Reflect PWD-Specific Adjustments.

The PWD COS study relies upon recent data and follows the industry-accepted methodology for determining system-wide and customer-specific extra-capacity factors. As summarized in the table below, the Public Advocate's expert witness, Mr. Mierzwa, proposes customer-class specific extra-capacity factors that do not follow accepted industry practices nor account for PWD's specific characteristics.

The table below summarizes how the Advocate's analyses departs from industry norms with regard to each calculation component in his analysis (i.e., shown by comparing AWWA Guidelines and analysis used in Mr. Mierzwa's testimony (Schedule JDM-1). [154]

[153] PWD Rebuttal Statement 3 at 7.
[154] PWD Rebuttal Statement 3 at 7.

Table 4 – Comparison of Advocate Cost Allocation Recommendations and AWWA Guidelines

Calculation Component	AWWA Guidelines	Schedule JDM-1
Customer Class Maximum Monthly Demand	Maximum monthly demand during the year of system historical peak day demand. PWD's system historical peak day demand occurred in FY 2012.	Average monthly demand based on FY 2014 to FY 2016.
Maximum Day Factor	Maximum Day to Maximum Month	Maximum Day to Annual Average Day.
Weekly Usage and Hourly Usage Adjustments	"Care must be taken to recognize the usage characteristics of each utility's customers; the assumptions in this appendix are for illustrative purposes only."	Utilized illustrative calculations presented in AWWA's Appendix A – with no material changes to address PWD service characteristics.

PLUG witness Richard Baudino also reviewed Mr. Mierzwa's class cost of service study and found that he did not use the appropriate customer demand factors[155] and was inconsistent with industry norms. The Report's findings are consistent with the PWD and PLUG positions to this point. The puzzling inconsistency between the cost allocation and rate design recommendations is discussed below.

(d) The Rate Board Should Approve the Department's Proposed Rate Design.

After endorsing the Department's proposed cost allocation framework, the Hearing Officer inexplicably adopts the Advocate's rate design proposal which is premised upon a different cost allocation analysis.[156] This is obviously inconsistent. PWD's allocation approach (as endorsed by the Hearing Officer) is the basis of the proposed rate design. The Department's rate structure is reasonable and should be approved. Both the current and proposed rate structures utilize a single schedule of rates.[157] This rate design/structure provides reasonable cost recovery[158] as evidenced by the fact that 82% of retail

155 PLUG Rebuttal Statement 1 at 6, lines 5 to 7.
156 Report at 105.
157 PWD Statement 8 at 8; PWD Exhibit 6 at 791 to 795.
158 The basic underlying principle in developing cost of service rates is the determination of what causes the cost, or what elements in a water or wastewater system are causing the level of revenue requirements. As stated above, the Department's capacity and customer peaking factors rely upon recent data, reflect PWD's historical experience for the appropriate facilities, follow industry accepted methodology, and require no adjustments. Thus, the COS Study is appropriate, and the proposed rates, which Black & Veatch designed to recover the cost of service do not require the revisions proposed by Mr. Mierzwa.

billings are within 1.5% of the calculated cost of service.[159] Under this structure, the same usage (MCF) rates are applicable for all metered usage for all customer types,[160] vary based on monthly consumption, and decline with increasing consumption. The design of the declining tier blocks reasonably captures the inherent diversity of water usage among PWD's customer types. In addition, PWD's water service rate structure, which includes fixed charges by meter size and a volumetric rate that reflects declining block rates, is a well-accepted rate structure that many utilities use across the United States.[161] That being said, the Department recognizes that there is a need for a holistic evaluation of its existing water, sewer, and stormwater rate structure and is considering a conducting a comprehensive rate structure review before the next rate proceeding.[162] Consequently, the Department plans to present any potential changes to the rate structure as part of the next rate proceeding, for the Rate Board's consideration.

While the specific components of the rate structure review and the detailed scope of work are yet to be finalized, at the current time, the Department envisions the following activities as part of the rate structure evaluation:

- Determination of the strengths and key issues about the existing rate structure.
- Definition of rate structure evaluation objectives and desired key outcomes.
- Evaluation of select rate structure alternatives and an analysis of the pros and cons of each alternative. Examples of rate structure alternatives that the Department may evaluate include uniform volumetric rate, inclining block rates, customer type based fixed and volumetric rates, specific cost recovery riders and/or charges, stormwater rate structure and magnitude of stormwater credits.
- Evaluation of bill impact and impact mitigation strategies.
- Recommendation of a proposed alternative rate structure that takes into consideration multiple factors including data availability, ease of administration, customer bill impact and outreach, and billing system modifications.

159 PWD Statement 8 at 8; PWD Exhibit 6at 791 to 795.
160 PA Statement 2 at 17.
161 PWD Statement 8 at 8.
162 PWD Statement 8 at 9.

The Department notes that such a holistic rate structure review study would require substantial time and effort (between 24 to 36 months). Therefore, it is imperative that the Rate Board consider approving rates for a three-year rate period in this proceeding as that would provide the Department reasonable and adequate time to perform a comprehensive rate structure re-evaluation.[163]

It would not be reasonable to mandate the adoption of rate design changes in this proceeding. Such changes should not be contemplated without thorough planning and interaction with customer groups before making such a major change.[164] Revenue stability could be significantly impacted due to unforeseen changes to various customers and customer types; this could cause disruptions in revenue collections or materially impact revenues.[165] As a matter of best practice to facilitate customer acceptance, the rate design changes recommended by the Hearing Officer should not be decided in this proceeding, but should only be decided after undertaking the activities and practices discussed above.

3. TAP Rate Rider.

The Report errs in not articulating recommendations concerning the TAP Rate Rider.[166] The Rate Board should be aware that the Department developed a revised proposal for both the TAP cost recovery mechanism and the reconcilable TAP Rider -- moving closer to the Public Advocate's proposal – after extensive deliberations with the Public Advocate.[167] The salient aspects of the PWD revised proposal are as follows:

- TAP costs will be recovered via a distinct and reconcilable TAP Surcharge ("TAP-R") defined in terms of dollars per thousand cubic feet ($/MCF);
- TAP-R will <u>only</u> recover the TAP bill discount amounts provided (adjusted for collections);
- TAP surcharge rates will be expressed as two sub-components: 1) a "Water TAP-R" added to each declining block rate of the water quantity "base rate" ($/MCF); and 2) a "Sewer TAP-R" that is added to the uniform sewer quantity "base rate" ($/MCF);

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163 PWD Statement 8 at 9.
164 PWD Statement 8 at 8-9.
165 PWD Statement 8 at 9.
166 Report at 75-89.
167 PWD Brief at 52.

- TAP-R will be subject to an annual reconciliation process in accordance with the proposed Rate Rider framework;
- The determination of net over or under collection of TAP costs will be based on an examination of both the actual TAP costs experienced, and the actual TAP rider revenues recovered from non-TAP customers; and
- All other TAP related costs including program administration and LiCAP costs will be recovered via "base rates" (i.e. PWD's existing rates and charges).[168]

This revised approach addresses key concerns of the Public Advocate identified in a dialogue that began during the pre-discovery phase of the proceeding and continued throughout most of the proceeding. As noted in PWD's Brief, the Department and Advocate have reached general agreement as to numerous areas related to the TAP Rider framework.[169] The areas agreed to are as follows:

i. The TAP Rider and associated surcharge will only recover lost revenues associated with TAP discounts provided to TAP customers.

ii. All other TAP related costs including program administration and LiCAP costs will be recovered via "base rates".

iii. The TAP Rider Surcharge will be defined in terms of dollars per thousand cubic feet ($/MCF).

iv. The TAP Rate Rider Surcharge will be apportioned between the water and sewer services as follows:

    A portion of the reconcilable TAP costs will be allocated to the water service and the resulting Water TAP-R surcharge rate ($/MCF) will be added to each declining block rate of the water quantity "base rate" ($/MCF); and

    A portion of the reconcilable TAP costs will be allocated to the sewer service, and the resulting Sewer TAP-R surcharge rate will be added to the uniform sewer quantity "base rate" ($/MCF).

v. Both the Water and Sewer TAP-R surcharge rate will be computed based upon the Non-TAP Customer sales (in MCF) for the Projected Rate Period.

vi. The Water and Sewer TAP surcharge rate will be reconcilable on an annual basis.

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168 PWD Rebuttal Statement 5, Schedule R5-1.
169 PWD Brief at 54-56.

> The actual discounts provided to TAP Customers (i.e. revenue loss) will be reconciled against the TAP-R surcharge revenues collected from Non-TAP Customers.

vii. Interest on over and under recovery of TAP-R revenues will be included in the reconciliation of the TAP-R. The interest amount for the reconciliation period will be computed based on the following interest rate:

> The yield to maturity 52-week interest rate of United States Treasury Securities with constant maturities as compiled and published in the Federal Reserve Statistical Release H.15 (519); and
>
> The above referenced interest rate will be the rate that exists each year as of the first day of the month, preceding the month of the annual reconciliation submission to the Rate Board.

viii. PWD will use a combination of actual and estimated data to determine both the TAP discounts provided and the TAP-R surcharge revenues received for the reconcilable (current) period, and perform the annual surcharge rate reconciliation.[170]

ix. PWD will not include an emergency adjustment clause as a part of the proposed TAP Rider.

The above areas of agreement reflect the significant progress PWD and the Public Advocate have made in addressing mutual concerns and finding common ground.[171] There are three areas of disagreement remaining that are discussed below (i) low-income collection factor; (ii) arrearage forgiveness; and (iii) apportionment of TAP Revenue Loss.

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[170] Note the use of estimated data is necessitated by: (1) the need to reconcile TAP discounts provided during the reconciliation period with TAP surcharge revenues collected during that same period; (2) at least 60 days of lead time for filing the rate rider request to the Rate Board; and (3) providing customers with notification of the Board approved changes to PWD's TAP Surcharge rate.

[171] Under both approaches, the TAP Rate Rider would go into effect beginning in FY 2019. Specifically, with the implementation of the rider, all revenue losses associated with TAP would be recovered via the associated surcharge rates which would become effective beginning in September 1, 2018. The reconciliation component would begin with the filing of the FY 2020 surcharge rates, which will include a projection for FY 2020 TAP revenue loss and reconcile actual discounts provided to TAP participants with revenue recovered via the TAP-R surcharge from Non-TAP customers.

(a) Low-Income Collection Factor.

The Department disagrees with the use of a low-income collection factor as proposed by the Advocate. PWD proposes that its system-wide cumulative collection factor of 96.54% should be used in determining the TAP revenue loss and the surcharge revenues recovered from Non-TAP customers.[172] This collection factor is based on PWD-specific historical data of billings and receipts.[173] The collection data represents the effect of multiple factors including the nature of integrated services PWD provides (water, sewer, and stormwater); the magnitude of PWD's monthly water, sewer, and stormwater charges; and PWD's customer base. Use of the system-wide collection factor also demonstrates that TAP participants should be expected to achieve a collection factor commensurate with the system average once they are given an affordable bill and protected from any enforcement action on arrears. Further, based on Black & Veatch's research there are other rate case proceedings where utilities have used system-wide collection factor specifically in the context of low income customer assistance program cost recovery.[174]

The Public Advocate has a different approach. It recommends instead that a low-income uncollectible factor be applied to the annual TAP discount amount to determine the TAP revenue loss.[175] In the absence of PWD-specific data for low-income customers, Public Advocate witness, Roger Colton, suggests that PWD utilize an average of PECO and Philadelphia Gas Works ("PGW") low-income gross write-off ratios.[176] Based upon the foregoing, Mr. Colton estimates that an average low-income uncollectibility rate should be 13.1%. In other words, applying this low-income uncollectibility rate, the Advocate proposes that an 86.9% collection factor be used to calculate the TAP revenue loss. The

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172 PWD Statement 9A, Schedule BV-E5 (WP-1) at 2, 15, and PWD Rebuttal Schedule R5-1 at 3.

173 PWD Statement 9A, Schedule BV-E5 (WP-1) at 2.

174 As noted in the response to TR-1, based on Black & Veatch's research and to the best of their knowledge, in other municipally-owned water utilities, there are currently no water/sewer rate rider mechanisms that have been implemented to solely recover the cost of "low-income" assistance programs. Of particular note, even among electric utility low income rate riders, a system wide collection factor is used in determining revenue loss. For example, the Public Utilities Commission of Ohio allows a collection factor allowance in determining the revenue loss associated with an electric utility's Percentage of Income Payment Plan (PIPP) Plus program. Therefore, Ohio Development Services Agency's (ODSA) Universal Service Fund (USF) Rate Ride, utilizes collection factors, based upon each utility's specific system wide collection experience, for the purposes of determining the actual rate rider revenues collected.

175 PA Statement 3at 62, line 15.

176 PA Statement 3: at 62, lines 16 through 19.

Department is critical of this recommendation for a variety of reasons including, that the data is not specific to PWD, its derivation is not clearly documented in the record, and it relates to non-water sector utilities.[177] The record is also silent as to whether PECO or PGW use such low-income write-off data in their respective cost recovery riders for their universal services programs. Mr. Colton offered no confirmation on this point except to indicate that terms related to the respective rate riders may have been the outcome of settlement agreements.[178] The point of the foregoing is that the collection factor recommended by the Advocate has an uncertain empirical foundation.

In this rate proceeding and prior proceedings, PWD has always projected water, sewer and stormwater revenue receipts based on customer payment patterns and not based on income level distinctions among its customer base.[179] Based upon actual historical trends, PWD has determined a cumulative system-wide collection factor of 96.54% is appropriate. This collection factor is data driven and provides a factor that is robust and reliable to be used for TAP revenue loss determination. The collection factor that the Public Advocate recommends is wholly unrelated to PWD and inappropriate on its face.

(b) Arrearage Forgiveness.

PWD disagrees with the inclusion of any reconcilable arrearage forgiveness in the determination of the reconcilable TAP surcharge rate at the current time, but has noted its willingness to consider the inclusion of arrearage forgiveness in the future pending changes to City policies and after consideration of other implications.[180] The Advocate's position to the contrary is aspirational at this point in time,[181] as the

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[177] As detailed in the 2016, 2015 and 2014 *Universal Service Programs & Collections Performance Reports of the Pennsylvania Electric Distribution Companies & Natural Gas Distribution Companies* referenced in the Public Advocates' Hearing Exhibit No. 1, the "Gross Write-off Ratios" are based on information for "residential billings". Further the "Gross Write-Offs Ratio" is calculated by dividing the annual total gross dollars written off for residential accounts by the annual total dollars of residential billings." This approach differs from how PWD derives the system-wide collection factors, which reflects payments and collections over multiple years. As noted above, the TAP-R will be billed to all Non-TAP customers, not just residential customers. Beyond that, the write-off policies for PECO and PGW are not the same as PWD as they are governed by the requirements of the Pennsylvania PUC while PWD is subject to the City's write-off policies. See, Response to TR-3.

[178] Tr. 114 (May 11, 2018).

[179] PWD Rebuttal Statement 5 at 7.

[180] PWD Rebuttal Statement 5 at 8.

[181] The Public Advocate proposes that arrearage forgiveness should be included in the development of the TAP-R in

Rate Board, WRB or PWD lack the authority to change the City's arrearage forgiveness policies. Pursuant to the Charter, that authority lies with the Law Department.[182] In any event, inclusion of arrearage forgiveness as part of the TAP-R surcharge at this time, without any additional consideration to its implications on the revenue projection approach and cost of service analysis that are already used in the determination of the base rates, could risk a potential overstatement of the impact of arrearage forgiveness.[183]

(c) Apportionment of TAP Revenue Loss.

PWD proposes to apportion the TAP revenue loss based on the proportion of the water and sewer annual revenue requirements respectively, to the total combined water and sewer revenue requirements.[184] This approach is appropriate because the TAP revenue loss is essentially a "cost" or "revenue requirement" for the Non-TAP customers.[185] Consistent with the foregoing, it is only appropriate and reasonable to apportion the TAP costs between water and sewer services based on the proportion of water and sewer revenue requirements to the total water and sewer revenue requirements. In addition, PWD revenues reflect payments (for a given year of billings) received over multiple years. Therefore, using revenue requirements as the basis for apportioning costs better aligns with the timing of when TAP costs are incurred. For consistency and certainty, PWD in its Alternative TAP Proposal, recommends using the FY 2019 Water and Sewer revenue requirement distribution percentages to apportion the FY 2019, FY 2020, and FY 2021 TAP costs between water and sewer services.

The Public Advocate disagrees with the above approach. It proposes instead to apportion TAP revenue losses to water and sewer services based on the proportion of annual revenues of those respective services to total system revenues. Their approach is premised upon the assumption that the TAP bill

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conjunction with a potential change in the arrearage forgiveness policy.

182 See, Charter §§1-102(1), 4-100, 6-201, 4-400(b) and 8-410.

183 As stated in the record, the cumulative collection factor of 96.54% which PWD uses in determining revenue receipts, already reflects the remaining 3.46%, which PWD deems as not collectible and hence that is akin to money that is forgiven. See, PWD Statement 9A, Schedule BV-E5 (WP-1) at 2, 15.

184 PWD Rebuttal Statement 5 at 9.

185 PWD Rebuttal Statement 5 at 6.

discount is a revenue loss to those two services. This approach was reasonable when, in the original filing, TAP costs were embedded as lost revenue and were to be recovered via all of the existing rate structure components.[186] That is no longer the case with the Department's revised proposal. No portion of the TAP revenue loss will be recovered via base rates and therefore TAP participants will not aid in the recovery of costs assigned to the TAP Rider. The revenue loss is a cost solely to be recovered from non-TAP customers. There is no longer any foundation for this area of disagreement.

The foregoing suggests that the two major remaining disagreements relate to the application of a low-income collectability rate and inclusion of arrearage forgiveness. The Department suggests that the Rate Board resolve both remaining issues consistent with the evidence presented and its limited legal authority to set rates and charges.[187] The Report, as to this issue, should be modified consistent with these Exceptions.

D. The Hearing Officer Report Errs in Denying the Department's Motion in Limine.

The Report errs in denying the Department's Motion in Limine.[188] The Motion specifically addressed issues raised by the Public Advocate concerning the structure and operation of TAP; and shut-off notices — both of which are beyond the scope of the instant proceeding. The Hearing Officer's recommendation denying the Motion in Limine runs counter to the City Solicitor's opinion and advice provided in the 2016 Rate Proceeding. In 2016, the Rate Board asked the Law Department for its advice regarding the scope of Board authority to direct the Department (and by extension Water Revenue Bureau) to take specific actions to improve the customer service experience.[189] The Law Department advised that (a) the Rate Board has the authority to fix and regulate rates and charges, which includes the power to deny any rate increase above the baseline required by the Philadelphia Home Rule Charter and Philadelphia Code on any reasonable basis, and the power to grant a rate increase for a shorter period that

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186 PWD Statement 9B, Schedule BV-S1 at 4.

187 The Department does not mean to minimize the procedural issues raised by the Advocate related to annual reconciliation. The Rate Board must establish its own procedures to review the TAP Rider which, PWD believes should track analogous reconciliation proceedings which are uniformly carried out without a hearing.

188 Report at 12.

189 See, 2016 Determination of Water Department Rates and Charges for FY 2017-2018 at 39-40 and Appendix B.

the Department has requested; and (b) the Rate Board does not have the power to direct how the Department provides service. In the last rate proceeding, the Rate Board was guided by this advice. PWD submits that the City Solicitor's opinion and advice should also guide the Rate Board in the instant case.

By way of background, on April 20, 2018, the Public Advocate filed, *inter alia*, the prepared written testimony of Roger Colton (Public Advocate Statement 3). Mr. Colton's testimony is divided into four parts:

- Part 1 – Structure and Operation of TAP;
- Part 2 – TAP Cost Recovery;
- Part 3 – Public Fire Costs; and
- Part 4 – Barring Unfair and Deceptive Shutoff Notices

On May 7, 2018, the PWD submitted a Motion in Limine ("Motion") [190] to request that the scope of the technical hearing exclude the customer service issues raised by Parts 1 and 4 of Mr. Colton's testimony as beyond the scope of a rate proceeding before the Rate Board. The Motion did not address Parts 2 and 3 of Mr. Colton's testimony.

Issues and proposals on (a) the structure and operation of TAP and (b) shutoff notices are customer service issues. This rate proceeding is related to the Department's proposed rates and charges for Fiscal Years 2019 through 2021. Mr. Colton's testimony includes recommendations regarding both the structure and operation of TAP (Part 1)[191] and shutoff notices (Part 4);[192] such testimony is **not** related to granting or denying (in whole or in part) the proposed rate increase; and is **not** reasonably part of the Advocate's case regarding the proposed rate increase. The only reason for Mr. Colton's testimony on said issues and proposals is to direct how the Department (and by extension the WRB) provides service.

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190 A motion *in limine* is a motion made to determine a matter affecting the conduct of the hearing, such as preclusion of testimony or evidence. See, e.g., *Commonwealth v. Pikur*, 596 A.2d 1253, 1259 (Pa. Cmwlth. 1991) (defining an *in limine* motion as a motion or petition submitted to the court in a pending matter either pretrial or during trial whereby exclusion is sought of anticipated prejudicial evidence, keeping extraneous issues out of the underlying proceeding, precluding reference to prejudicial matters, or preventing encumbering the record with immaterial matter.).

191 PA Statement 3 at 7-58.

192 PA Statement 3 at 103-108.

Mr. Colton seeks to have the Rate Board require the PWD to modify particular programs. First, in Part 1 of his testimony, Mr. Colton argues that modifications should be required for TAP to comply with legislation.[193] With regards to TAP, Mr. Colton recommends (a) modifications to the TAP application;[194] (b) the removal of any time constraints on the return of any TAP application;[195] (c) that arrearage forgiveness for TAP participants be "improved;"[196] (d) that PWD enter into certain agreements and contracts with others;[197] and (e) modifications to PWD's outreach to Limited English customers.[198] Second, in Part 4 of his testimony, Mr. Colton recommends[199] that additional conditions/restrictions be placed on PWD's ability to issue shutoff notice(s) to delinquent customer(s).

The issues and proposals in Parts 1 and 4 of Mr. Colton's testimony are beyond the scope of the subject rate proceeding and are, therefore, legally irrelevant. The findings of the Report, with regard to both issues should be rejected, as beyond the Rate Board's jurisdiction. Alternatively, the findings should be rejected for the substantive reasons stated in PWD's Brief.[200]

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193 PA Statement 3 at 17-18, 24, 31-32, 32-35, 45.
194 PA Statement 3 at 23, 27-28.
195 PA Statement 3 at 23.
196 PA Statement 3 at 36-45.
197 PA Statement 3 at 55.
198 PA Statement 3 at 57.
199 PA Statement 3 at 108.
200 PWD Brief at 64-74.

III. CONCLUSION

For all of the foregoing reasons and arguments raised in the PWD Brief, the Department requests that the recommendations in Hearing Officer's Report be modified consistent with these Exceptions.

Respectfully submitted,

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