CITY OF PHILADELPHIA

PHILADELPHIA WATER DEPARTMENT PRESENTATION

RATE BOARD HEARING

WEDNESDAY, APRIL 6, 2016

10:00 A.M. - 1:45 P.M.

MINUTES OF FORMAL MEETING

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LOCATION: 1515 Arch Street, 18th Floor
Philadelphia, Pennsylvania

REPORTED BY: SUSAN A. HURREY, RPR

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HELD BEFORE:

NANCY BROCKWAY - HEARING OFFICER

BERNARD BRUNWASSER - CHAIR

SONNY POPOWSKY - BOARD MEMBER

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P R O C E E D I N G S

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MS. BROCKWAY: This is a continuation of the hearing before the Philadelphia Board of Sewer and Storm Water Rate Board in the matter of the proposed increase of water and wastewater rates for fiscal years 2017 and 2018 of the Department. We have a little bit of housekeeping to start, Mr. Ballenger.

MR. BALLENGER: Yes. Thank you, Madam Hearing Officer. I just wanted to note one typographic error to our errata sheet, embarrassing as that is. And that is in the errata listed at page 19, line 15 of our errata sheet. It states the words quote, water customer revenues by 0.5 percent, parenthetical, assumption-6, close parenthetical, and sewer customer, quote, should be, quote, water customer revenues by -- and here's the typo, it should be 0.50 percent, instead of 0.05 percent.

MS. BROCKWAY: I'm sorry.

MR. BALLENGER: The decimal point is one position over to the left from where it should be. The decimal point should be 0.50.

MS. BROCKWAY: That's what I have got on my list, so I'm confused. Hold on a second. Oh, that one. I thought you were talking about the first one.

MR. BALLENGER: No. My apologies. I was on page 19. Line 15 should state water customer revenues by 0.5 percent in the last quoted passage in that errata. That's the typographic error we made.

MS. BROCKWAY: Somebody will explain to me at some point why 0.50 is different from 0.50.

MR. BALLENGER: The problem is it says 0.05 and it should be 0.50. The five and the zero are juxtaposed.

MS. BROCKWAY: The two numbers should be identical?

MR. BALLENGER: Correct. Thank you.

MS. BROCKWAY: Thank you. Mr. Dasent, I understand you have witnesses to present and they will go through your outline of the rebuttal?

MR. DASENT: Yes. But before that, a little housekeeping. We handed out earlier an errata sheet for a rebuttal outline and it indicates, I think it's self-explanatory, section five, one word changes -- prospectively changes to retroactively and it deals with some of the bond requirements.

MS. BROCKWAY: This is 5B1?

MR. DASENT: Yes. And I strike prospectively and insert retroactively. It was a typo.

MS. BROCKWAY: So it reads prospective analysis when rates are being set, tested retroactively.

MR. DASENT: Yes. And Ms. Allen will explain. Also, as part of rebuttal outline, we have a table that Black & Veatch prepared that was attached to it, table one. I have copies in the room just to make sure that everyone who perhaps didn't bring it would be supplied with a table. If you indulge me, I will hand that to the Board.

MS. BROCKWAY: Go off the record.
(Discussion held off the record.)
MS. BROCKWAY: We'll go back on the record. Mr. Dasent.
MR. DASENT: Thank you, Your Honor. We're ready to present our rebuttal case and we have identified the panel before off the record, but they are Melissa LaBuda, the Black & Veatch witnesses, Dave Jagt, Prabha Kumar, Ann Bui, Kathy Clupper of Public Financial Management, Valarie Allen from Ballard Spahr and I think I have captured everyone.
I will direct the questions to the responding witness, but it's a panel, so hopefully that will give you the answers that you need as we go.
My first question is directed to Ms. LaBuda and it's section one of our outline. Mr. Morgan's contentions that the rate model is flawed are mistaken is our heading.
Now, Ms. LaBuda, Mr. Morgan's central thesis is that the rate model is flawed. He specifically states in his testimony that the Department's financial

forecasts have historically overstated the utilities revenue requirements and that is likely to continue. Do you agree?

MS. LABUDA: No, I do not. The Department has reviewed our historical forecast. We've made the appropriate adjustments for this proceeding. While the previous forecasts appear to have been conservative, they have benefitted ratepayers by allowing us to go to fiscal year '16 with a zero percent rate increase and to mitigate the rate increases for '17 and '18 all for the benefit of ratepayers.

MR. DASENT: My second question directed to both Ms. LaBuda and Ms. Bui. Mr. Morgan claims that operating conditions in its fiscal 2018 are so far out in the future to be speculative. Do you agree?

MS. LABUDA: No. The projections for fiscal year '18 are based on well-considered estimates, consistent with current industry standards set forth in the AWWA manual, which is also referenced in the report ordinance.

MS. BUI: I would concur with Ms. LaBuda's statement there. As you know, it is really the obligation of the utility, the municipal utility in particular, to take a look at long-range financial planning. And in order to do that, we look at those -- the Department does -- the five-year forecast. That also allows us to mitigate any potential ratepayer impacts that might result due to large capital programs.

MR. DASENT: My third question to Ms. LaBuda, based upon Mr. Morgan's assessment of the rate model, he questions whether a rate increase is necessary at all because he sees no revenue shortfall. Do you agree?

MS. LABUDA: No. The Department has done everything we could to avoid a rate increase, but the rate increase is unavoidable. We have got some reasons. We have got the need to replace aging infrastructure. We must meet regulatory mandates. We lost a major contract with Bucks County Water, is the equivalent to seven to eight million revenue annually. We have growth in fixed cost such as pensions, healthcare and labor negotiations. The deductions that Mr. Morgan is making puts the Department at risk of not meeting its financial obligations.

MS. BROCKWAY: Thank you. May I interrupt for just a second? I'm trying to follow the outline and this doesn't track exactly the outline. Is that to be expected? We shouldn't worry whether it tracks the outline?

MR. DASENT: It's not going to track it precisely, but it was going to give a heads up basically that these are the subjects we would like to discuss. We will discuss most everything that we have identified in the outline. We try not to be redundant because some issues were covered yesterday.

MS. BROCKWAY: I'm making a different point, which is, for example, I couldn't find the reference in the outline that Ms. LaBuda just responded to or dealt with.

MR. DASENT: Well, we were dealing in this particular section of the outline with the fact that the rate model is flawed, and rebutting that contention that was raised by Mr. Morgan. We say it's mistaken. We say several ways which we believe it's mistaken.

MS. BROCKWAY: I understand that. So in other words, it's not me that I don't see here on the piece of paper, we do have a revenue shortfall, he's wrong that we don't. That just flows out of these other --

MR. DASENT: Yes, it does.

MS. BROCKWAY: Okay. Sorry to interrupt. Thank you.

MR. DASENT: Based upon Mr. Morgan's various criticisms of the rate model and past projections, do you agree that the rate model is flawed?

MR. BALLENGER: Can I just object? I'm not sure what you mean by various criticisms. I prefer to respond to the specific points in his testimony that you direct to us where you're responding.

MR. DASENT: Sure. The additional costs, the spend factors, the escalation factors, and the other recommendations that Mr. Morgan makes to eliminate the revenue requirement as a part of his criticisms of the rate model. Do you agree that the rate model is flawed?

MS. KUMAR: No. The financial plan model has a high degree of modelling integrity with respect to four key aspects. It meets all of the general bond ordinance and insurance covenants. It's mathematically accurate. It uses all available reliable data. And it uses reasonable and defensible projections, and it provides transparent analysis of all the mathematical analysis in the model.

MR. DASENT: Thank you. Moving to section two of our outline. I'm addressing this to Black & Veatch and Ms. LaBuda. Mr. Morgan states the Department is not at the brink of financial distress at page ten of his testimony. Based upon your review of his recommendations, do you agree?

MS. LABUDA: No, I don't. As I have stated earlier, the Department has made significant efforts over the last four years to control spending. However, in fiscal year '16, we didn't have a rate increase where we're now utilizing a withdraw from the rate stabilization trend to bridge our gap between revenues and obligations. We're also utilizing the rate stabilization fund in '17 and '18 to continue to bridge the gap between obligations and revenues.

MR. DASENT: Mr. Jagt, is there --

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

(Discussion held off the record.)

MS. BROCKWAY: Go back on.

MR. DASENT: Mr. Morgan states at page ten of his testimony that the Department is not at the brink of financial distress. As a supplement to Ms. LaBuda's answer, do you have anything more to add, Mr. Jagt?

MR. JAGT: We just want to point out the proposed changes, as proposed by the Public Advocate, have run the risk of underperforming the projection of revenues with the cuts in the volumes -- or the increases in the volumes they are proposing, we run the risk at coming in at lower volumes and the utility under recover in revenue. And also, by projecting lower expenses based on the revisions to the escalation factors, the actual budget factors, and the proposed elimination of the additional expenses to meet the additional needs of the system, we're running the risk of understating the O&M expenses as well. So the combined risk of understating revenues and overstating -- or overstating revenues, understating revenue requirements, we're at risk of not meeting the bond covenant requirements.

MR. DASENT: Is there anything more to add to that?

MS. LABUDA: Yes. In fact, one of the challenges we face with the proposed LKM-1 that was circulated yesterday is that, once again, shows a covenant default based on the Public Advocate's recommendations.

MS. BROCKWAY: Can you direct us to where that is?

MS. LABUDA: Sure. I believe this was handed out yesterday. It was in the errata sheeted. I'm looking at the combined operations revised schedule LKM-1. And I'm

looking at line -- I believe it's 26 and --
MS. BROCKWAY: Excuse me. Just for people's reference, this is the second page in. Okay. All right.
MS. LABUDA: That's okay. I'm looking at the second page in, line 26. I'm looking under the Public Advocate column for fiscal year '18. And I see senior coverage of 1.19 percent, which is lower than the required amount in the general bond ordinance.
MS. BROCKWAY: Thank you.
MR. DASENT: Now, again, referring to schedules LKM-1 through 3 and the narrative testimony that Mr. Morgan proffers. Are there any inconsistencies, other than already mentioned, between his recommendations and the schedules?
MR. JAGT: Well, first off, we want to point out -- refer back to the original submission of the schedule LKM-1, 2 and 3. As originally filed, the schedules included the additional revenues as requested by the Department and the amount per Public Advocate column. And as such, they overstated the

transfer from the revenue fund on line 34 in each of their presentations, which subsequently overstated the projection of fund balances as they originally proposed. Since the original filing, they went ahead and revised that to reflect the proper adjustments. But the original submission was mathematically incorrect.

MS. BROCKWAY: Again, when you say fund, can you be very specific? Because I'm still trying to get my head around all the different types of funds there are.

MR. JAGT: Sure. The residual fund balance that was projected in the original submittal. So in what -- the original submittal, line -- the line 34 was overstated and as well as the total on line 40, which is the projected residual fund balance.

MR. DASENT: Based upon the corrections or errata, have all these inconsistencies been eliminated, Mr. Jagt?

MR. JAGT: No. There are the consistencies between the policy objections that he makes and his testimony and what he presents in the exhibit. For example, if you look at Mr. Morgan's testimony. With regards to bond coverage, on page 43 of his testimony, Mr. Morgan suggests or states that he recommends that coverage utilized for the rate proceeding shall remain at 1.20. However, in his example in the schedules he provides, in the columns for the Public Advocate or the amount per Public Advocate for fiscal year '17, on line 26, he presents 1.31 coverage. And then again in fiscal year 2018, he presents 1.19. Both of which are inconsistent with what he presents or suggests. And in fact, in fiscal year 2018, it's below the minimum required for the utility, which would be 1.20 and represents a technical default.

MS. BROCKWAY: Can you give us a line number on page 43?

MR. JAGT: Sure.

MR. BALLENGER: Line three.

MS. BROCKWAY: Line three. Thank you.

MR. JAGT: I'm going to need the line reference for the next one and I have to look that up.

MS. BROCKWAY: Maybe we'll rely on Ballenger.

MR. JAGT: The second fact is on the cash fund to capital. On page 47 of Mr. Morgan's testimony, which --

MS. KUMAR: Line nine.

MR. JAGT: Line nine. Thank you. Mr. Morgan indicates that he does not agree with the Department's proposal to fund 20 percent of the capital. So cash funding of capital projects. However, the amounts as he presents in his exhibit or schedule one continue to reflect the Department's request, which maintains the 20 percent. And that would be presented on line 37 of schedule LKM-1. And the fact that he leaves the presentation of the proposed transfers at the Department's suggested levels just indicating -- he's reflecting the -- that we achieve the 20 percent as proposed.

MS. BROCKWAY: Line 37, I'm looking at transfer to construction fund. That's the line you're talking about?

MR. JAGT: Yes, ma'am.

MR. DASENT: Turning your attention -- have you finished your answer?

MR. JAGT: No. There's one other point. Just that the recommendation states that there were no revenue increases. But to the contrary, the analysis presented by Mr. Morgan in the cash flow table, as originally submitted, included the BMD proposed increases. And based on the inclusion, the end result was that presented an end-of-year revenue fund balance over the amount that we projected.

MR. DASENT: Does that complete your response?

MR. JAGT: Yes.

MR. DASENT: Turning your attention to table one that we handed out earlier today. And it was appended to the rebuttal outline, Mr. Jagt. Table one prepared by Black & Veatch. It was handed out earlier. Mr. Morgan eliminates PWD claims for additional costs. Do you see, with your attention turned to table one, that the analysis is premised upon a proper application of the model? Basically I'm asking to walk you through the exhibit.

MR. JAGT: Okay. On the exhibit -- sorry, I don't have the --

MR. DASENT: Looking at page one, item one. Could you just sort of walk us through the exhibit and what it means?

MR. JAGT: All right. This walks through basically how Mr. Morgan's original draft of the testimony was based on the cash flow analysis within the Black -- or the revised model, which they had provided to us after their revisions.

MS. BROCKWAY: Excuse me. The revised model? Your revised model or theirs?

MR. JAGT: It's their revised model, yes, ma'am. So in the original filed exhibit, they submitted line one. The projected revenue was pulled straight out of the model and reflect the proposed decreases in the revenue and also the adjustment for the -- removing the billing safety factor.

MS. BROCKWAY: Can you -- I'm going to have to take all of this later and summarize. It would be really helpful if -- so it will all be one place in the transcript, you could mention the numbers.

MR. JAGT: Sure.

MS. KUMAR: Just to give an overview in what you're seeing in table one, table one is from the model provided by Mr. Morgan. And what you are seeing on the left side, which is called LKM cash flow table, C-1 is the table in their model of how the data analysis in table C-1. And then on the right side what you see is the schedule that they presented called LKM-1. And this table, as a whole, points to the inconsistencies between these two that are inherent in the original model that they had provided.

MR. JAGT: Okay.

MR. DASENT: So line one mentioning the numbers, Mr. Jagt?

MR. JAGT: Correct. So line one, as reviewed, were straight from table one of the revised cash flow model. He pulled the exact projection of revenue as reflected, the adjustment to the usage for the reduced decrease and the elimination of the billing

safety factor.
Line two -- while -- line two, which was the -- which was from the increased revenues from proposed adjustments, from the Black & Veatch model in the cash flow, he left the cash flow -- the requested revenue increases. So we had still, in the analysis, additional revenues of 35 million in fiscal year 2017 and 72 million in fiscal year 2018. However, in the presentation table, it was presented that there were no revenue increases requested.
MR. DASENT: Just so we're clear, the presentation table or the LKM-1?
MR. JAGT: The schedule LKM-1.
MR. DASENT: That were appended to the original testimony?
MR. JAGT: That's correct. That was lines nine and ten presented no increase. However, in the supporting documentation or analysis, it did include the additional revenues.
MR. DASENT: Why is this important, Mr. Jagt?

MR. JAGT: It shows the fact that the projected cash flow overstated the revenues in the revenue fund, which subsequently overstated resulting interest earning projections and overstating fund balances.

MS. KUMAR: Based on which the recommendations that are in the testimony.

MR. DASENT: Please continue down the chart. We're at line three.

MR. JAGT: So as a result, increased other revenues, which reflected the interest earnings during the -- in the revenue fund and other operating funds of the utility, the results in the model are presented as line three. We have 23.4 million in fiscal year 2017 and 7.2 million in fiscal year 2018. However, as originally presented in the model -- well, he inaccurately stated in LKM-1, the exclusion of revenue increases. It should have been reduced and reduced the interest earnings.

MR. DASENT: So the additional revenues would have created interest earnings?

MR. JAGT: Yes. Since the analysis included the additional revenues, the fund balances were higher, and as such, the interest earnings reflected in the analysis were overstated.

MR. DASENT: Line four.

MR. JAGT: All right. Line four. As he went through the exercise and eliminated or made the proposed revisions to the O&M, to remove the additional O&M and reduce the rate case cost by normalizing, he actually reduced that FY '17 expenditures by half of the rate case expenses. And then also applied the adjusted escalation factors, the spend factors as he proposed, and adjusted liquidated encumbrances. So the results in the model as projected -- or actually from in the cash flow statement in the model are the same as he presented in the schedule testimony on line 24. There's no issues on this line item.

MR. DASENT: Dropping down. Line five.

MR. JAGT: All right. Here, as we pointed out earlier, is one of the examples of that he didn't continue to demonstrate the policies, like for debt service coverage. On line five in the Black & Veatch model, representing that he retained the proposed transfers from the rate stabilization fund from the Black -- the original Black & Veatch analysis, and then carried those transfers over into his presentation on line 25 of schedule LKM-1 of the same amount.

MS. KUMAR: This is important, because when you're adjusting the revenue on the existing rates, when all the revenue requirements and all the O&M costs and line item four are getting adjusted, then in a cash flow analysis, the transfer from -- transfer from the rate stabilization fund or money putting into the rate stabilization fund should be adjusted. But here, while they adjusted all the others, this 19.3 million and the 39 million are what was proposed by the Department through the Black & Veatch model and that has been adjusted. So that's why this line is important.

MS. BROCKWAY: Adjusted in what direction?

MS. KUMAR: Based on the revenue on

the existing rate that they increase.
Basically they increased the revenues in line one. They decreased the cost in line four. And when you do all of that, which means then you have to look at all of the other parameters, the parameters of senior debt coverage and all of that and depending on what they need, the transfer from the rate stabilization fund should be adjusted.

MS. BROCKWAY: I understand that. So in line five, let's say fiscal 2017, the 19 million, if -- my understanding, this is what the Department's -- the Black & Veatch model had and you're saying it should be different. Which direction should it be different?

MS. KUMAR: Good question. The 19.3 should have been lower and the 39 million should have been higher.

MR. DASENT: Dropping down to line six. Mr. Jagt, just walk us through the table.

MR. JAGT: Sure. As Prabha Kumar already identified, with the previous adjustments on the lines above, the net effect of the net revenues of the system were presented in the rate model analysis from table C-1 of the revised cash flow. On line 21, the result was 308 million 11,000, and in 2018 the result would be 336 million 532,000. What is presented in the testimony, original filed testimony, as 272 million 827,000 and 264 million 387,000. So it was -- even though in the presentation it's corrected to remove the additional revenues --

MS. BROCKWAY: Which presentation?

MR. JAGT: In LKM-1, it was revised to appropriately reflect the elimination of the additional revenues due to the proposed increases. This just demonstrates that the net revenues, as projected in the model and the basis of the presentation included the additional revenues and as such, like we already mentioned, ended up overstating the interest earnings.

MS. KUMAR: So here again, line item six points out the internal inconsistency in the model where in one table the revenue increases were included. The Black & Veatch proposal increases were included. But in the schedule LKM-1 that was attached to the testimony, those revenues were excluded. And so you can see in line six, the impact of including the revenue in one place and excluding the revenues in the other place.

MR. DASENT: Dropping down to the bottom of the table --

MR. JAGT: Line seven and eight, there are no inconsistencies between the two models. So we can --

MS. KUMAR: As proposed by Black & Veatch.

MR. DASENT: On line nine, is there any comment?

MR. JAGT: Again, because of the results of above the lines -- the lines above, per the projection of the -- the beginning residual fund balance, as presented in the model, due to the cumulative effect of increased revenues and decrease in the expenditures, and the fact that originally we had left the additional revenues in, the beginning fund balances presented were inaccurately carried over between the models.

MS. BROCKWAY: Presented by whom?

MR. JAGT: In the original LKM-1 analysis.

MR. DASENT: By Mr. Morgan.

MR. JAGT: By Mr. Morgan.

MR. DASENT: We're trying to illustrate --

MS. BROCKWAY: That's all right. He can do it. So let me just try to clarify this. It would be so helpful if you specified with exhausting detail which parties, which document you're talking about. So I'm looking at line nine of this exhibit and fiscal 2017 is 42 million and 2018 is 90 million. The same numbers on the right side. Can you explain, again, why that's a problem?

MR. JAGT: Okay. So he used the same numbers between the two presentations. So he pulled from the model analysis the exact values.

MS. BROCKWAY: Which model?

MR. JAGT: So from the revised Black & Veatch model with his proposed edits, but including the additional revenues which were not included in his schedule LKM-1.

MS. CLUPPER: Basically what you're saying is if you look at LKM-1 on line 30, the residual fund, what you're saying is that the beginning balance is 42 million. Mr. Morgan's testimony, Black & Veatch is 15 million. So what you're saying, Dave, is that they're overstating the beginning balance in '17 by 26 million dollars.

MR. JAGT: Correct.

MS. CLUPPER: If you make that line 30 of the residual fund beginning balance 15 million, similar to the Black & Veatch, if you don't carry over that additional 26 million and you walk that all the way through --

MS. KUMAR: Actually, that's not true. What we are trying to point out here is that there are two tables within the LKM model, which is called a revised model. There are two tables. One table is called table C-1, which is on the left side, and another table called LKM-1 on the right side. These two tables should be identical. Because LKM-1 is nothing but a summary of table C-1. Therefore, the numbers should align between LKM-1 and table C-1, because table C-1 is really the driver. However, the fundamental mistake between C-1 and LKM-1 is that table C-1 include the Black & Veatch proposed revenue increases which it should have never included. If that was the intent, they should have never included those revenue increases. But because those revenue increases were left there, all the calculations were dependent upon them being left there. And therefore, in line item nine, what it did was, because the revenue increases were left in table C-1, in line nine it overstated the beginning balance, especially if you look at column 2018. Now, in LKM-1 on the right side, the revenue increases, they removed it. And if they remove the revenue increases which we talked about in the first page, then these numbers will not be 90 million 393.

MS. BROCKWAY: I'm sorry. I don't see someplace where those numbers got lower. So explain again where you're saying that the numbers --

MS. KUMAR: We can explain that

using the new errata sheet that they have now given. Just pointing this from the original data that was provided on the errata sheet that was provided. So, for example, if you hold this side by side in the errata sheet that we have. So in LKM-1, because of the revenues being left, they are presenting 90.3 million as the residual fund balance in line item nine in this page that we all looked at, in table one. But now if you look at the errata sheet, that number has now dropped to 15 million 83.

MS. BROCKWAY: What line number?

MS. KUMAR: The line number is 31. Beginning of year, residual fund balance, line 31.

MS. BROCKWAY: Thank you.

MR. JAGT: For consistency, we'll refer to table C-1 as the model, the results within the model as revised. And then LKM-1, we'll refer to the original -- the results as presented.

MS. BROCKWAY: Again, that confuses me. Because we have several different models being talked about. We have Black & Veatch original and revised. We have Mr. Morgan's running of the model with his assumptions. So I need you to be very clear about when you say model, which one are you talking about?

MS. KUMAR: There is no Black & Veatch revised. This is really Mr. Morgan's original model, and that model is basically nothing but taking the Black & Veatch model, making all the changes. That is why we call it the LKM revised model. So they took the Black & Veatch model, made adjustments to it, revised it. The crux of the matter is that when you're taking a model and making some changes, all those calculations have to be mathematically accurate. And what this is demonstrating is that while they made adjustments to numbers, the mathematical cash flow analysis was not performed accurately. That is the bottom line that we are trying to establish through this discussion and that's what table one is trying to establish.

MR. DASENT: You mentioned also the errata sheet that was supplied by Mr. Morgan indicating there were certain inconsistencies you wanted to correct for, included in his schedules. Does that solve all the problems in terms of the inconsistencies in his presentation?

MR. JAGT: No. As we already reviewed earlier, the fact that he continues to still reflect the fact that coverage as presented is not the coverage as he suggested in the model or in his testimony. And that the transfers for construction fund are also overstated. He suggests reducing it, but still continues to present the 20 percent transfers that the City proposes.

MR. DASENT: Let's move to section three.

MS. BROCKWAY: Before we do -- actually, let me do this right now. We have not marked any of these pieces of paper coming in and I think it would be helpful. So what I would like to do is start with the -- the first piece of paper that we got was the Exhibit-1 from -- we had Exhibit-1 marked from Public Advocate. We have Exhibit-2 marked from Public Advocate. We can go off the record.

(Discussion held off the record.)

MS. BROCKWAY: I'm looking now at the errata sheet for the direct testimony of Lafayette Morgan, Jr. And my understanding is that the next exhibit number would be three. Is that correct? I see heads nodding. So that will be Exhibit-3. Say that again.

MR. BALLENGER: The first two are marked Public Advocate hearing Exhibit-1 and 2. So for consistency, I would suggest Public Advocate hearing Exhibit-3.

MS. BROCKWAY: Okay. So we're going to distinguish between Public Advocate exhibits and other people's exhibits.

MR. BALLENGER: Correct.

MS. BROCKWAY: All right. Let's then go to the errata sheet that was presented this morning from the Public Advocate and we'll make that Public Advocate Exhibit-4.

MS. LABUDA: The Department.

MR. BALLENGER: The Department's errata.

MR. DASENT: The Department's errata this morning would be our Exhibit-1, just to distinguish between the filing of this.

MS. BROCKWAY: You're jumping ahead, Mr. Dasent. Let's go off the record.

(Discussion held off the record.)

MS. BROCKWAY: So the next document that we have is an errata sheet -- actually, let's start with the rebuttal itself. Philadelphia Water Department rebuttal testimony outline. And this will be PWD exhibit --

MR. DASENT: One.

MR. DASENT: Hearing Exhibit-1.

MS. BROCKWAY: Okay. So let's keep the errata next to it. So that will be PWD hearing Exhibit-2. I would like to separately mark the page that appears in the outline but which we have been discussing called Public Advocate LKM cash flow table C-1 versus schedule LKM-1. And I would like to mark that as PWD hearing Exhibit-3. Are we up to three?

MR. DASENT: Yes.

MS. BROCKWAY: Thank you very much.

MR. DASENT: We're missing one attachment though to the rebuttal outline, and that was the summary of data responses and the responses we provided. If you will mark that, certainly it will be comprehensive and including everything.

MS. BROCKWAY: Okay. I don't have a piece of paper with that but --

MR. POPOWSKY: It's attached to the rebuttal outline?

MR. DASENT: Yes. It's the second table.

MS. BROCKWAY: We'll go off the record.

(Discussion held off the record.)

MS. BROCKWAY: Thank you very much.

MR. DASENT: Moving to section three of our outline. Assuming the implementation of Mr. Morgan's recommendations, what is the impact of eliminating all additional O&M costs, Ms. LaBuda?

MS. LABUDA: Mr. Morgan's recommendations remove nondiscretionary items from the Department's expenses, and that is problematic as we have a legal agreement with the general fund that binds us to reimburse to the SugarHouse Casino. We have legal agreements with DEP and EPA requiring us to meet our consent order and agreement. We have maintenance at our facilities which we must complete. We have to add additional chemicals for certain treatment processes in order to meet our requirements and certain regulatory mandates. So holistically, he puts the Department in a situation of not meeting its financial obligations, but also not meeting its required legal arrangements.

MS. BROCKWAY: And we're talking here PWD hearing Exhibit-1?

MR. DASENT: Yes.

MS. BROCKWAY: Okay. Did I mark on the record all the other exhibits?

MR. DASENT: Yes, I believe you did.

MS. BROCKWAY: Okay. Thanks.

MR. DASENT: Mr. Jagt, Mr. Morgan also adjusts spend factors and escalation factors. Do you agree with those adjustments?

MR. JAGT: Well, no. As we reviewed yesterday, we do not agree with the adjustments to the spend factors. The adjusting actual budget factors, as proposed, run the risk of estimating O&M costs that is that the Water Department expects to occur. Second, we do not agree with the adjustments done to the escalation factors, except the one for the electric cost. As agreed yesterday, there will be no escalation of the FY 2018 electric cost. Adjusting the escalation factors on all the other O&M costs as proposed by the Public Advocate, risk underestimating the revenue requirements of the Department.

MR. DASENT: Thank you. Mr. Morgan also makes revenue adjustments, Mr. Jagt, usage factor, billing factor adjustments. Do you agree with those adjustments?

MR. JAGT: No. Again, reviewed yesterday, we do not agree with the adjustments done to the projection of the average volume per account. As discussed yesterday, the short-term usage per account shows significant year-to-year variability. And given such variability, we believe it's prudent to project revenues over the longer five-year average, which is the zero point -- or the 1.5 percent. And as an example of this, to illustrate the impact of it, it's important to note that the 1.5 percent decline, as we proposed in the model, reflects a 0.6 decrease in the overall system projected volume. That projected -- that type of reduction, 0.6 on a system basis, is consistent to what other utilities are seeing nationwide. However, if we use the .05 percent as reflected in the Public Advocate's proposed projection, the system-wide reduction reflects a 0.005 percent reduction in system volume, which is quite far below the industry average that we're seeing.

MR. DASENT: Thank you. Mr. Morgan also states there's no basis for increased issuance costs. Do you agree with that, Ms. LaBuda?

MS. LABUDA: I do not. The municipal market since the financial crisis has faced higher regulatory mandates under the Dodd-Frank Wall Street Reform Act and the Consumer Protection Act. In both of these mandates, we saw an increase requirement in disclosure. So not only does the City have disclosure council, we also have our own disclosure. Adding to that is a higher regulatory environment where we see the SEC, the Securities and Exchange Commission, paying much more attention to the municipal market and requiring us to amend our disclosures to more stringent standards. So all indications point to rising costs of issuance, not declining. Kathy.

MS. CLUPPER: I agree. I think the other thing to remember is that the cost of issue is amortized over the life of the bond issue, so it's not a significant -- it's not a significant expense on an annual basis because it's amortized over the life of the bond issue.

MR. DASENT: Moving to section four of our outline. Mr. Morgan assumes there has been no change since the last proceeding in the source of information PWD used to determine projected pension expenses and obligations. Is he correct, Ms. LaBuda?

MS. LABUDA: He is not. As I repeated both yesterday and today, the

Department has reviewed its historical projections and aligned its projections for this proceeding with the City's five-year plan, which is the State-approved plan.

MR. DASENT: Thank you. Mr. Morgan is also critical of debt service coverage analysis and peer data used by PWD in the rate filing. This is at page 42.

Are his criticisms substantiated, Ms. Clupper?

MS. CLUPPER: No, they are not. First the Board is required, as I mentioned before, to consider peer data in their deliberations. Peer data is available from the rating agencies. There's a lot of documentation -- there are quantitative organizations. They do quantitative work to come up with their medians. Mr. Morgan made the point that because the information is not available that it shouldn't be used. It is available. He also made the point that some of the coverages higher than -- the higher median coverages were driven by legal covenants. They're typically not. Most covenants are between 1.1 times and 1.2 times. That information is available. You have to do some digging going through different official statements and looking through the legal descriptions, but the medians that he cited, the 1.8 times of median coverage are more policy driven than legal driven. So it is appropriate to review peer data and the underlying information is available.

MR. DASENT: Thank you. Now, Mr. Morgan ignores, in his analysis and recommendations, Rate Stabilization Fund utilization. Certainly in the schedules. Is that the best outcome for customers, Ms. LaBuda?

MS. LABUDA: It is not. The Rate Stabilization Fund has provided the bridge for the zero percent increase in '16. It's also mitigated the rate increase in '17 and '18.

MR. BALLENGER: Can you speak up.

MS. LABUDA: Sure. Ignoring the use of the Rate Stabilization Fund is problematic, because we are using the Rate Stabilization Fund in fiscal year '16 due to zero percent rate increase and we're using it in '17 and '18 to mitigate the level of increases. So not looking at it properly is problematic for customers.

MR. DASENT: Now, Mr. Morgan also ignores the intended purpose of the Rate Stabilization Fund. It doesn't actually speak to it --

MS. BROCKWAY: Excuse me. I don't think it would be proper for you to say he ignores it, because that's a statement about his state of mind. You might say he doesn't use it or something.

MR. DASENT: Mr. Morgan's statements concerning the Rate Stabilization Fund and his testimony do not address the legal parameters or constraints associated with the Rate Stabilization Fund. Could you comment on that? Do you agree with his approach, Ms. Allen?

MS. ALLEN: I think it's important to understand why the Rate Stabilization Fund was established.

MS. BROCKWAY: You're going to have

to speak up.

MS. ALLEN: I think it's important to understand why the Rate Stabilization Fund was established and the purposes for which primarily it's used. It was established to create, you know, an operating reserve in order to mitigate the need for a city to raise rates, you know, in a precipitous way and to -- in order to do rate smoothing for the benefit of ratepayers.

MR. DASENT: Are there any limits to its use?

MS. ALLEN: Yes. The ordinance -- there's not a lot about it in the ordinance because you can't do very much with it. You can -- moneys that are in the Rate Stabilization Fund are really available for two purposes. One, primarily, is to -- at fiscal year-end, to make a transfer to the revenue fund to the extent that that money is needed to meet the revenue requirements in that fiscal year. Secondly, you can make a temporary loan from the Rate Stabilization Fund to the revenue fund or to the construction fund. But that has to be repaid when the purposes for which, you know, that money existed in that originating fund, restabilization fund, is needed again and it's going to be needed by fiscal year-end.

MS. BROCKWAY: It's going to be needed what?

MS. ALLEN: By fiscal year-end, if not sooner. But certainly by fiscal year-end.

MR. DASENT: And also, Mr. Morgan's schedule LKM-1, as revised, indicates debt service coverage of 1.19x in fiscal '18. If that is the case, would it be a covenant default?

MS. ALLEN: Yes. There are rate and insurance covenants that the City has agreed to, and as to bondholders in terms of the rate covenant, they're called in the general ordinance. And then in its insurance agreements with the bond insurer. I think we have talked about these covenants before. But with respect to the 1.19 coverage, the City has covenanted that it will generate net revenues. And net revenues are actual revenues collected within a fiscal year, less expenses. Plus, in connection with the rate covenant, any transfer that comes from the Rate Stabilization Fund, that amount has to be at least 1.2 times its debt service requirements for that fiscal year. So anything less than 1.2 would be a covenant default.

MR. DASENT: How is compliance determined?

MS. ALLEN: Well, there are a few ways. We're looking at it -- the City or the Water Department -- sorry, in the ordinance it's called the City, so -- I know yesterday we were trying to be very exact with our language. The City has many requirements. Some of them are prospective as well as retrospective in the ordinance. Obviously the easiest way to test it retrospectively is at fiscal year-end when they know exactly how much net revenue was generated in that year and they compare it to the debt service requirements paid in that year and they can see whether they met coverage. However, the ordinance requires not just there be retrospective testing. It requires at least once a year, and more often if there's a material change in circumstances under which they're operating. It requires the City to review rates and charges to ensure that the City is going to be able to comply with its covenants going forward.

Additionally, when the City is in the process of enacting an ordinance for the issuance of new debt, before it's enacted, the City has to be able to demonstrate through a feasibility report and engineering report both the ordinance and the First Class City Revenue Bond Act, which I don't know if that's been introduced into evidence. I can do that.

MR. DASENT: No, but we can refer to it.

MS. ALLEN: Requires that the City be able to demonstrate that there will be net revenue sufficient to cover debt service for the debt service proposed to be incurred under such an ordinance.

MR. DASENT: Just to get a little more specific. What happens in the event of a covenant default?

MS. ALLEN: Well, a couple things.

Under the ordinance, the fiscal agent that's been appointed, in respect to the water bonds, is required to notify bondholders within 30 days that there's been a covenant default. Even more -- even faster though, the City, through its -- let me back up. The City, in connection with every bond issuance, has entered into a continuing disclosure agreement. When it comes into the market, it has an initial disclosure, its official statement that talks about that bond issue and talks about the City and its credit, its ability to repay the sources available for repayment. And the covenant, it's made to bondholders. It also includes, you know, the City's financial -- a description of operations and financial position at that time. And then it also includes a copy of that engineering report that has demonstrated that the City reasonably believes that they'll be able to produce net revenues in the future sufficient to repay that debt service and all its debt service obligations. So that disclosure is made at the time bonds are sold.

But at the same time, the City enters into a continuing disclosure agreement for the benefit of bondholders that it will continue to update that information annually. And to the extent that there is a material event that occurs at any time during the year, it will disclose to the market that that has occurred within ten days of its occurrence. A covenant default is a material event that it would have to disclose to the market within ten days of its occurrence.

MR. DASENT: Are there any remedies available to bondholders in the event of a covenant default?

MS. ALLEN: Yes. If there's a covenant default once they have notice of it, 25 percent -- has to be at least 25 percent of the bondholders can request appointment of a trustee and direct a trustee to sue the City to require it to impose and collect rates and charges.

MR. DASENT: Thank you, Ms. Allen. Now, turning to our chief executive officer, what are some of the consequences of Mr.

Morgan's recommendations that you see as the
utility CEO commissioner?

MS. MCCARTY: Can you hear me or do
I need to move up?

MS. BROCKWAY: Why don't you --

MS. MCCARTY: I'll come up.

MS. BROCKWAY: -- come up.

MS. MCCARTY: So not seeing the
rate increase gives me a lot of stress, more
than losing my voice actually. One of the
things is the assistance to our customers. Our
program is very important. If there's a water
main break and a person's property is flooded,
that provides -- gets the property whole again
by getting -- replacing their house heater,
particularly in the winter, as well as their
hot water heater, which folks like to take warm
showers no matter what time of year. And
that's something that is fairly unpredictable.
And though we do our best to maintain our
infrastructure, we don't necessarily have as
much control over it as we would like. And
it's very important, as part of customer
service, to have our customers made whole as

quickly as possible and at least be able to live in their properties.

The other part of that of course is the claims process, it's the indemnity fund. We did discuss that yesterday. But that's to recover the losses from damages related to water main breaks, sewer cave-ins, things like that. And again, we want to make sure our customers are made whole. I should note that most of the damages are related to the residential population and the hot water heaters and the house heaters for residential properties. Commercial properties, that would be -- typically is handled through the claims process. They typically have, as commercial owners, industrial, more wherewithal to their business's back end order. Wherewithal to get that business back in order.

Also, I'm very concerned about the need to shut down capital. We lived through that back in 2004. I was deputy back then. Was not a pleasant time. And it took us a long time to recover from not doing capital jobs. Do not want to mislead you, we did have at least one emergency project during that period that we did have to use capital funds. But we did not bid any new jobs for over six months. And that really was a huge setback. Not spending capital drives up your operating cost because now we're trying to keep things operating and maintained. We have regulatory obligations day in and day out. We need to meet the Safe Drinking Water Act, the Clean Water Act, and all the other regulations that we need to comply. So the compliance is huge.

One of the things is, without a rate increase there's no cushion. Time and again things come up over the fiscal year, even where we have been fortunate to have the funds to be able to address it. There was an occurrence when we needed more activated carbon at our drinking water plants. That chemical is very expensive. And while we work very hard to get good rates for our chemicals, had we not had the ability, we were in jeopardy of violating our disinfection by-products regulation. So -- or limit. So without that cushion, without a rate increase, we would not have been able to comply.

Also note -- and we discussed yesterday, the lead. The issue with lead in service lines. That issue has come up since we filed for rates. And the Department, again, is having to address issues with lead service lines. Now, we have been adding zinc orthophosphate for years now and complying with lead and copper rules. So there's not necessarily a need for more chemicals there, but now we are being asked to do more. And, again, it's since the rate filing. Residential properties, we will be offering them to be able to replace their lead lines through our help loan program. We're also looking at, through capital, replacing the supply. So the pipe between the curb stop, the footway and the meter. That's not currently done. But it's obvious that we need to do that. It makes matters worse, basically, for our customers. And again, that's the residential population. That's the bulk of our customers. So I'm very troubled if we don't see a rate increase.

MR. DASENT: Thank you, Ms.

McCarty. Now that we're about to start a new fiscal year, 2017, is it really speculative, Ms. LaBuda, to look into the next year to figure out what we're going to do as a utility?

MS. LABUDA: It is not speculative. In fact, the AWWA manual cites best practices of looking to five-year planning period. The City completes a five-year plan that is approved by the state, and in fact, we will start our internal review of fiscal '18 budget in just a few months. It's not speculative at all. It's part of best our planning efforts to have a forward look on budgets and rates.

MR. DASENT: Thank you. That's all we have on rebuttal. We tried to keep it concise, but I think, you know, we covered the major areas that are addressed in our outline.

MS. BROCKWAY: Go off the record.

(Discussion held off the record.)

MS. BROCKWAY: We're going to break until 11:20. We're off the record.

(A break was taken.)

MS. BROCKWAY: We have cross of the panel by Mr. Ballenger.

MR. BALLENGER: Yes. Thank you, Madam Hearing Officer. I'm trying to get organized, but I think unfortunately we may skip around a little bit. I'd just like to start with a basic question. The Panel referred to the revised Black & Veatch model on a number of occasions. Is that on the record in this proceeding?

MR. DASENT: There's not --

MR. BALLENGER: I'm asking the witness panel, please. Is the revised Black & Veatch --

MR. DASENT: It's a legal question, what's on the record or not.

MR. BALLENGER: Has it been proffered as an exhibit in this case?

MR. DASENT: I don't believe it has. And, in fact, we have -- we've, through discovery, obtained the revised version of the model that Mr. Morgan sponsors. But it has not been entered as an exhibit.

MR. BALLENGER: Do you have a citation to a discovery request asking for that revised model?

MR. DASENT: We requested it and received it, and I think it was an oral request and it was properly honored and we appreciate that.

MR. BALLENGER: As an accommodation, that's correct. In other words, when you refer to the revised Black & Veatch model, you're referring to Mr. Morgan's modifications to a number of assumptions in the Black & Veatch model which we provided you by electronic mail on or around March 30 --

MR. DASENT: Yes.

MR. BALLENGER: -- is that correct?

MR. DASENT: That's correct. And just so the record is clear on this, if we could, with Your Honor's indulgence, make a transcript request for that model, we would very much think it would be helpful to have a record.

MR. BALLENGER: I believe that would be a problem in the confidentiality agreement that we have entered into that pertains to that entire model.

MR. DASENT: We would ask for

confidential treatment of the revised version of the model which all the parties to the agreement have requested, and we can see the various adjustments that Mr. Morgan has made, subject to the confidentiality.

MS. BROCKWAY: Question. Do we have in the record the Black & Veatch version?

MR. DASENT: It's not in the public record because the confidentiality agreement allowed us to see it in confidence without inclusion of the record.

MS. BROCKWAY: It has not been marked as an exhibit? It's not been included or it is in the record as a confidential record?

MR. DASENT: It's not in the record, because once it's in the public record it wouldn't be confidential anymore.

MS. BROCKWAY: Go off the record.

(Discussion held off the record.)

MS. BROCKWAY: Mr. Ballenger, can you help us understand why the model itself has to be on the record? Why we couldn't proceed with your identifying issues in the model?

MR. BALLENGER: There is no -- I do not believe there is any problem proceeding without having the model on the record. That's why I believe the transcript request should not be made to have the model put on the record.

MR. DASENT: We would request the work papers. That would be a compromise. As opposed to the model itself. Black & Veatch has its work papers in the record. Mr. Morgan will have his, and then the Board can see that there is a separate revised interpretation that Mr. Morgan has presented separate from the Black & Veatch presentation.

MR. BALLENGER: Mr. Morgan's work papers were attached to his testimony and then revised in errata. They're in the record, LKM-1 through three. Those are the sum total of his work papers.

MR. DASENT: Work papers is a little more complicated than that. And Ms. Kumar is explaining to me that it includes every page in terms of the presentation. And if they exist, just print them and provide them for the Board. It will be in the record, and I think it will help us in the decision administratively and any other decision that might follow.

MS. BROCKWAY: My tendency has been to let stuff in, unless it's a real burden, even if it may or may not -- does Mr. Morgan have work papers that we're discussing that he could submit?

MR. BALLENGER: My understanding from Mr. Morgan is that he can print the model and supply it for the record.

MS. BROCKWAY: Why don't you do this, please. If you would print it, and then if Mr. Ballenger and Mr. Dasent would confer to make sure that what has been printed is not confidential or is comparable to the work papers that Ms. Kumar has been mentioning. I think if -- I would say with respect to the work papers, we were not asked for confidential treatment. So if somebody could back calculate or reengineer the model from them. Unfortunately that's already there, so I'm not going to give confidential treatment to these work papers. But you guys confer to make sure that you all have the same understanding of what these documents are.

MR. DASENT: That's fair.

MR. BALLENGER: Fine.

MS. BROCKWAY: Okay. So we will not have a transcript request -- well, no, we do. We have a transcript request for the work papers.

MR. DASENT: Number five.

MS. BROCKWAY: Yeah. So that that will be transcript number five. These are the work papers from Mr. Morgan's running of the Black & Veatch model with his assumptions?

MR. DASENT: That's correct.

MR. BALLENGER: And pursuant to the electronic exchange of information, we would just propose creating a PDF of the work papers from the model and submitting them to Mr. Dasent to check and make sure there are no problems with confidentiality. It would be voluminous actual printing and Mr. --

MS. BROCKWAY: Oh, you're talking about making a CD. Is that all right?

MR. DASENT: Yes.

MS. BROCKWAY: Fine.

MS. BROCKWAY: That will not be put into the record, unless somebody comes later and says better put this into the record.

MR. DASENT: Thank you.

MS. BROCKWAY: And then we'll talk about whether or not the record needs -- thank you very much.

MR. BALLENGER: Okay. So having reviewed off of the record the revised -- what you called the revised Black & Veatch model, which were Mr. Morgan's modification to Black & Veatch's model, am I correct that you discovered an error in how he dealt with the rate increase amounts that were embedded in the model? Is that correct?

MS. KUMAR: That is correct. The analysis in one table, table C-1, the revenue increases were included and then in LKM-1, which is another table in the same LKM model, that increases were left out.

MR. BALLENGER: And as I understand it, that -- I'll call it a data entry model, is -- or data entry error, is really the source of the majority of the issues you have identified in table one, which I think we marked for the record as a separate hearing exhibit, PWD hearing Exhibit-3, is that correct?

MS. KUMAR: Between table C-1 and LKM-1, that is correct. But there are other inconsistencies in the cash flow itself. So between these two tables, that statement is correct. But there are other inconsistencies even after the errata sheet was provided yesterday.

MR. BALLENGER: We'll discuss those. But just to be clear, the -- you have talked about a number of issues surrounding the fact that Mr. Morgan did not remove the rate increase amount from the original model in calculating his spreadsheet. Was that corrected, that particular error? Was that corrected in the errata that was submitted on the record yesterday?

MS. KUMAR: It was corrected.

MR. BALLENGER: It was corrected. And so to the extent you have identified numerical inconsistencies with fund balances, for example, those have now been corrected in this record by way of an errata which we all got yesterday.

MS. KUMAR: Line 34 -- specifically line 34, which states the NW revenue fund balance, that has been corrected.

MR. BALLENGER: What about line 40?

MS. KUMAR: That has been corrected as well.

MR. BALLENGER: What about -- continue on. What about line 32, has that been corrected?

MS. KUMAR: Just a second.

(Pause.)

MS. KUMAR: That has been corrected.

MS. BROCKWAY: It has been?

MS. KUMAR: It has been.

MR. BALLENGER: Just mathematically, are there any other line items on the revised schedule LKM-1 which are mathematically incorrect?

MS. KUMAR: Mathematically there are no inaccuracies in LKM-1.

MR. BALLENGER: Thank you. Let's talk about Rate Stabilization Fund a little bit. In both versions of LKM-1, the original and the revised, has Mr. Morgan made any change to the amounts shown on line 19, transfer to and from Rate Stabilization Fund?

MS. KUMAR: He has not.

MR. BALLENGER: And you would agree that in terms of -- back up a little bit. Isn't it true that the Department uses Rate Stabilization Fund to manage to its desired coverage levels?

MS. KUMAR: The Rate Stabilization is used as part of the cash flow to achieve the desired senior debt coverage.

MR. BALLENGER: And so under -- when I'm looking at LKM-1 as revised, fiscal year 2017, amount per Public Advocate. And you have drawn our attention to line 26 where Mr. Morgan displays a coverage of 1.31.

Having received Mr. Morgan's revised model, are you aware of whether that coverage level was generated automatically by the model or was that typed in by Mr. Morgan?

MR. JAGT: The coverage calculates and presents automatically. It's subject to the adjustments within the model for revenue increases and transfers from the Rate Stabilization Fund.

MS. KUMAR: And revenue requirements.

MR. BALLENGER: Just looking at the total senior debt service amount shown there of 207.7 million. Would you agree that one basis point of debt service coverage is approximately 2.1 million mathematically?

MS. KUMAR: Subject to check, yes.

MR. BALLENGER: Subject to check. Would you not also agree to obtain the required -- the legally required 1.2 times coverage in fiscal '17 utilizing Mr. Morgan's numbers here, that no amount be necessary to transfer from the Rate Stabilization Fund into the revenue fund for coverage purposes? The 19.3 million could be reduced to zero and the Department would still meet its 1.2 times coverage mathematically? 19.3 million is shown as a transfer from Rate Stabilization --

MS. BROCKWAY: What line, please?

MR. BALLENGER: Line 19.

MS. BROCKWAY: Thank you.

MR. BALLENGER: That could be reduced to zero and the Department would still meet its coverage requirements.

MS. LABUDA: The Department holistically disagrees with Mr. Morgan's assessment that we can remove all of the adjustments which are nondiscriminatory from the model. That is part of this discussion. So --

MR. BALLENGER: It's unresponsive to the question. I'm asking simply, can the 19.3 be reduced to zero and the model still calculate total senior debt service coverage on line 26 in excess of 1.2?

MS. KUMAR: Subject to mathematical check, from a mathematical standpoint, yes. If the goal is to get to the 1.2 total senior debt service coverage in line 26, then the rate stabilization transfer will change from 19 million 300.

MR. BALLENGER: And it could be

zero?

MS. KUMAR: Subject to check, it could be, but we have to do the math and check it.

MR. BALLENGER: I would like to ask a transfer request and report back whether utilizing these numbers in reflecting the zero dollar transfer from the Rate Stabilization Fund to the revenue fund, whether the model would in fact show 1.2 times or greater coverage on line 26.

MS. BROCKWAY: This is the model with all the other changes that Mr. Morgan has --

MR. BALLENGER: No other changes. Simply reducing the Rate Stabilization Fund transfer to zero.

MS. BROCKWAY: This is the revised Mr. Morgan model?

MR. BALLENGER: Correct.

MR. DASENT: We would object to this. If this is a mathematical adjustment, as they purport it to be, they could make that calculation and present it as their testimony, as opposed to our sponsoring somehow a calculation that has nothing to do with the policy positions the Department has taken, and math is math. If he can do it, he would submit it for the record as his exhibit.

MS. BROCKWAY: Actually, from a point of view of making decisions, it's not clear to me that it isn't already decided. It seems pretty obvious. So do you think you need more on the record as proof?

MR. BALLENGER: No. I think we can take constructive notice of math, the fact that it does, in fact, show what Mr. Morgan has testified to.

MS. BROCKWAY: Yes. And I would -- on this point, I would say math is math. And I appreciate the position of Black & Veatch not to quibble about mathematics. That makes things much easier. If you want to put a mathematical -- not an algorithm, but if you want to show mathematically how certain equations then translate to others and produce a certain result in your summaries, please feel free. I don't think they should be opposed

just because you didn't do it on the record.
Might be opposed for some other reason.

MR. DASENT: Speaking of opposed for some other reason. Based upon our records, we will indicate in our position paper our policy position which would dictate not the math would govern, but the policy behind the calculation. It's very important, in fact pivotal to the decision of the Rate Stabilization Fund or any other entry in our flow of funds.

MS. BROCKWAY: Yes, I think that your witnesses have testified to that this morning.

MR. BALLENGER: Thank you. Okay. Assuming that no transfer from the Rate Stabilization Fund remained to the revenue fund in fiscal year 2017, would line 44, the end of your balance, be increased by the amount shown on line 19, 19.3 million.

MS. KUMAR: Just for clarification, what are you proposing on line 19?

MR. BALLENGER: So if 19 is zero, the 19.3 million would not have been transferred from the Rate Stabilization Fund, and wouldn't the year-end balance on line 44 of the Rate Stabilization Fund be increased by 19.3 million?

MS. KUMAR: Mathematically, yes.

MR. BALLENGER: And then again, on line 42 under fiscal year 2018, amount per Public Advocate, where it purports the beginning of your balance in the Rate Stabilization Fund, that would also be increased by 19.3 million, would it not?

MS. KUMAR: Mathematically, yes.

MR. BALLENGER: So I think we have established that for purposes of fiscal year 2017, the coverage amount of 1.31 times total senior debt service, that was generated automatically by the Black & Veatch model, is that correct?

MS. KUMAR: The 1.31 gets calculated in the model subject to the fact that it is 19.3 million in line 19.

MR. BALLENGER: Is the same true for the coverage for fiscal 2018, a 1.19 times coverage?

MS. KUMAR: The 1.19 coverage gets calculated based on the fact that revenue -- revenues were increased in line -- the total revenue in line 14, the operating expenses adjustments that were done by Mr. Morgan, leaving the 39 million Rate Stabilization Fund transfer that Black & Veatch proposed, not Black & Veatch model, based on all of those and then the debt service, all of these line items above it, all of that mathematically translate to the 1.19.

MR. BALLENGER: Okay. And for fiscal year 2018, you showed total senior debt service, and this is from the original model, as -- I'm sorry, it is slightly revised, but it's roughly 22.3 -- I'm sorry, 223 million dollars on line 25. Is that correct?

MS. KUMAR: If you're referring to the total senior debt service on line 45, yes, in the Black & Veatch model it is 223 million 661 for fiscal year 2018.

MR. BALLENGER: Mathematically, in order to calculate what one basis point of coverage is, one would simply move the decimal over. So that would -- one basis point would equate to, correct my math, but 2.23 million in coverage, is that correct?

MS. KUMAR: If you're asking about taking the 223 million dollar 61 and adjusting it --

MR. BALLENGER: How much would one need to reflect a one basis point increase in total senior debt service coverage on line 26?

MS. KUMAR: We can calculate and let you know that.

MR. BALLENGER: For purposes of cross-examination, would you not agree that to the extent it was necessary to transfer more money from the Rate Stabilization Fund to meet legally-required coverage in fiscal year 2018, there would be sufficient funds under Mr. Morgan's model to do so?

MS. LABUDA: It depends on if you have eliminated nondiscretionary expenses. So I think it depends. If we layer in the nondiscretionary such as legal binding agreements with the general fund, I don't believe that that would be the mathematical result.

MS. BROCKWAY: Let's make clear that for now we're talking about Mr. Morgan's revised exhibit, and we take very well the point that Ms. LaBuda has just made and Mr. Dasent has made, that this does not reflect other issues that the Department must pay attention to. So we're just pretending for the moment that that's not a problem. So I want to go back though to the 1.19 issue and the 223 million issue.

To first order, could you move the decimal point in the 22.3 million and figure out how much would be needed to go from 1.19 to 1.2? I'm seeing heads nodding, but conversations --

MS. KUMAR: We need to understand what is being requested. So do we want to know what 223 million 661 would be if the coverage is supposed to be 1.2?

MS. BROCKWAY: That's a way of putting it. But more it's a question of what is the difference between the -- how much would you get in coverage for 2.23 million more available for coverage? Would you get a basis point?

MS. KUMAR: So you're saying what would that 1.26 be if we add or if you take off one basis point?

MS. BROCKWAY: No. I think Ms. Clupper understands my question.

MS. CLUPPER: I think the point is you would transfer more to the Rate Stabilization Fund to comply with the 1.2 coverage.

MR. BALLENGER: 2.23 million.

MS. CLUPPER: That's all math, right? It's just math.

MR. BALLENGER: So to get to 1.2, you would need to take 2.23 million from the Rate Stabilization Fund. And under Mr. Morgan's presentation here, are there adequate funds in the Rate Stabilization Fund to transfer 2.23 million to the revenue fund for that purpose?

MS. KUMAR: There is not.

MR. BALLENGER: I'm sorry?

MS. KUMAR: There is not.

MR. BALLENGER: There are not adequate funds available in the Rate Stabilization Fund under Mr. Morgan's presentation to move 2.23 million?

MS. KUMAR: Again, this question is difficult to answer -- this question really impinges on policy. So the adequacy of whether a Rate Stabilization Fund has adequate money at the end of the year, fiscal year '18, is driven by what policies we are trying to meet. So the policy -- the policy is to meet -- the goal is to meet 110 million dollars in the Rate Stabilization Fund. As you can see in column fiscal year '18, line 44, it shows a 111 million dollars, which is what was the goal for fiscal year '18. So --

MR. BALLENGER: As we just discussed, if no transfers were made on the Rate Stabilization Fund to the revenue funds, that number would be approximately 19.3 million dollars higher?

MS. KUMAR: Which fiscal year are you asking?

MR. BALLENGER: From fiscal '17, we

discussed the fact that no transfer from the Rate Stabilization Fund to the revenue fund would be required to meet the legally-required senior debt service coverage. Do you recall that discussion?

MS. KUMAR: Mathematically the 19.3 million is not done in '17, and therefore, the '17 year-end in line 44 goes up, and that then gets translated into fiscal year '18 as a beginning balance, then yes.

MR. BALLENGER: Yes.

MS. KUMAR: But this is all mathematical, not policy driven.

MR. BALLENGER: That's correct. And I think we have talked a lot about math. We spent a lot of time focusing on your response to these numbers. So now it's our turn to talk about that response.

MS. BROCKWAY: Before we go further. At one point you said something could be supplied. Do we need a transcript request or are we -- have we covered what we need to cover? One of them was on the question of the 1.19, 1.2. We covered that.

MR. BALLENGER: I think we covered that. I think we also covered the fact that, again, if we determine that we're going to target 1.2 times coverage, that no transfer is necessary from the Rate Stabilization Fund --

MS. BROCKWAY: You know, you're fading out.

MR. BALLENGER: Sorry. I think we have also determined that mathematically there's no requirement in fiscal '17 to transfer 19.3 million under Mr. Morgan's presentations when revised --

MS. BROCKWAY: No. Yes, Mr. Ballenger, we're going over and over and over the same ground. Let's go up.

MR. BALLENGER: I don't think there's anything to supply there.

MS. BROCKWAY: Okay. Great.

MR. BALLENGER: Mr. Jagt, you talked about running the risk of underperforming. And I'd like to turn back to Public Advocate hearing Exhibit-1, if I may. I'm going to find the page as soon as possible.

MS. BROCKWAY: Go off the record.

(Discussion held off the record.)
MS. BROCKWAY: We're back on the record.
MR. BALLENGER: Thank you. So I'm on page 14 of Public Advocate hearing Exhibit-1. And I'd like to ask you, Mr. Jagt, on line 11 under the column -- the four columns for 2012, 2013, 2014 and 2015, those report amounts under the heading of difference. What do those amounts consist of? Are those amounts revenues in excess of the Department's projections?
MR. JAGT: That's correct.
MR. BALLENGER: In any of those four years, did the Department underperform on its revenues?
MR. JAGT: Fortunately, no.
MS. BROCKWAY: Say again?
MR. JAGT: No.
MR. BALLENGER: Okay. I'd like to now direct your attention to line 21. And again, under those same four column headings for total operating expense, am I correct, again, that in each of those cases, the

Department did not underperform its projections?

MR. JAGT: With the projection basis we were using back in the FY 13 analysis or the -- the analysis we used for the 2013 rate case, that's correct.

MR. BALLENGER: Okay. Thank you.

MS. LABUDA: And as we mentioned, the Department has materially changed its projection methodology, relying on the five-year plan in the areas of pension, health care and fringes. So we do not anticipate, nor expect, that performance, especially given the cited pension fund underperformance last year, to continue in the future.

MR. BALLENGER: Let me ask about the five-year plan a little bit. What do you say when -- you say that you have aligned with the five-year plan. You used the word align. I'm not sure what you mean.

MS. LABUDA: So the City provided to the Department and the Department provided to B&V specific amounts related to the minimum municipal obligation for the Department's required contribution to the pension fund based on results on fiscal year '15. It also provided our proportionate share of pension obligation block. Both those percentages reflect a prior fiscal year. So not only does it capture the pension performance for fiscal year '15, nor does it capture that we have hired more employees than were on the record as of the close of books. So there's two adjustments to those pension projections we're anticipating. One, an adjustment to capture the investment performance of fiscal year '15, and two, a second incremental adjustment higher allocating our greater share of the pension fund unfunded liability due to the fact that we now have more employees than we did when the last calculation was done.

MR. BALLENGER: Okay.

MS. LABUDA: So that is --

MR. BALLENGER: You have a line --

MS. LABUDA: That is an alignment. We have utilized those projections. If you don't like the word alignment, we have utilized the City's projection for MMO pension obligation.

MR. BALLENGER: And those are projections in your fiscal '17 budget, is that correct?

MS. LABUDA: Yes.

MR. BALLENGER: Okay. And were those projections used in your fiscal '16 budget?

MS. LABUDA: The Water Department's fiscal '16 budget, yes. But they were not used in B&Vs projections of fiscal year '16 when they completed the analysis on the prior rate case. Because, in fact, if you look at B&V's projections of fiscal year '16 to date they have in fact captured those new pension costs as of last fiscal year and you're showing a 36.9 million dollar -- I'm going to fact check that -- but we're showing a pretty significant withdraw of the RSF based on some recent projection changes.

MR. BALLENGER: You're showing a withdraw, by that you mean you're anticipating a withdraw?

MS. LABUDA: Anticipating. We're

mathematically demonstrating a withdraw from the RSF to meet all of our obligations.

MR. BALLENGER: That math is based on the assumption that you will make that withdraw, is that correct?

MS. LABUDA: I don't understand the question.

MR. BALLENGER: Have you made that withdraw?

MS. LABUDA: At the end of the year we will make an assessment and establish what the withdraw is.

MR. BALLENGER: It may or may not be that number.

MS. LABUDA: It may or may not be that number.

MR. BALLENGER: The same would be true in fiscal '17 and fiscal '18?

MS. LABUDA: Correct.

MR. BALLENGER: So the numbers shown in the model -- and, again, we refer to Mr. Morgan's LKM-1, which includes the same withdraw amounts on line 19 as are included in the Black & Veatch model, 19.3 million, 39 million, either of those amounts could change in the future?

MS. LABUDA: I expect them to be higher. And Mr. Morgan's model does not include the required additional expenses the Department faces. So my sense -- and my sense doesn't mean much because it's -- I don't have the numbers yet, but in October I will have the new pension numbers and they will be higher.

MR. BALLENGER: But you don't have them yet.

MS. LABUDA: I do not.

MR. BALLENGER: I'd like to revisit just for one or two questions, I think. The usage reduction for the 5/8" meter class, the growth rate that we have talked about. I just want to be clear. Maybe I misheard. But the loss of Bucks County Water as a wholesale customer, does that in any way affect a 5/8" meter growth rate?

MS. LABUDA: No.

MR. BALLENGER: And Mr. Jagt, you stated that the growth rate that the Department is projecting is consistent with other

utilities, is that correct?
MR. JAGT: Correct.
MR. BALLENGER: Is there any --
MS. KUMAR: Correction. The decline in usage seen system wide at 0.6 percent, based on the Black & Veatch model, is congruent with what we are seeing in the industry.
MR. BALLENGER: Is there anything on the record as to what you are seeing for other utilities and their decline in volume?
MS. KUMAR: Specifically suggesting industry statistical data in the testimony, it's not there in the testimony.
MR. BALLENGER: And when you say that's consistent with other utilities, are you saying that that's consistent with other utility projections?
MS. KUMAR: We are saying that's the kind of decline we're seeing in the industry. We're not picking any specific one utility or looking at how that one utility is affected. We're saying this is a trend. A decline in consumption system wide is something

that we are seeing in the industry.
MR. BALLENGER: Are you aware of any other utilities making a projection for fiscal year 2017 and 2018 of the decline of 0.6 percent system wide?
MS. KUMAR: If you're asking about the specific 0.6 percent?
MR. BALLENGER: Yes.
MS. KUMAR: No, not the exact six percent. But if you're asking in other utilities where projections are done for '17, a decline in consumption is seen, it depends on the circumstance of that utility. In some utilities it will go down and some utilities there's significant growth, it will go up.
MR. BALLENGER: So if you refer to an industry average, that would be an average of decreases on the one hand and increases on the other?
MS. KUMAR: The national decline is the average of the increases and decreases.
MS. BROCKWAY: Does the national average include areas that have been experiencing drought?

MS. KUMAR: Again, you're not citing the specific number as the national average. I just want to be clear on the record.

MS. BROCKWAY: No. No. You have been quite clear. We don't need to talk about that again.

MS. KUMAR: Yes. When we talk nationally, there are differences from region to region. And so, it's all kinds. It's all over the country. But the general trend that we are seeing in the nation is a decline in consumption and you may want to add something to it.

MS. BROCKWAY: Would it also include areas where there is a booming population?

MS. BUI: It includes everything. But the national trend, even if you look at just East Coast, for example, or the drought-impacted states, is that there is a decline in consumption on a per capita basis, on a per account basis, and that has been a trend that has been published in newspapers, as well as scientific journals, for example, the journal of AWWA. And it has been a trend that has been discussed for a number of years for a variety of reasons, you know, whether it's a population migration out of -- into the suburbs, or whatever the case may be. You know, energy efficient type devices. But that is a national trend. Of course on the west where we have no water, it is a much higher decline.

MS. BROCKWAY: And over what period of time are you looking at these national averages?

MS. BUI: Black & Veatch, I myself --

MS. BROCKWAY: Excuse me. I mean the 0.6 percent, does that reflect a certain year? Does it reflect a certain number of years? Does it reflect a projection as Mr. Ballenger was asking?

MS. BUI: It's not a projection. It's based upon actuals that the people are reporting, utilities are reporting as seen. That is not a projection.

MS. BROCKWAY: It's not based on one year though, it's based on --

MS. BUI: No. It's several years looking at it, the decline.

MS. BROCKWAY: Thank you.

MS. BUI: You're welcome.

MR. BALLENGER: So you spent a little bit of time on bondholder remedies, and I believe, Ms. Allen, you have provided us some information on that. Just so I'm clear, as long as the legally-required debt service coverage standards are met, none of those scary things will happen, correct?

MS. ALLEN: As long as coverage is met, as long as when -- as long as the -- as long as the City, when it is reevaluating future coverage, when it is going to issue bonds, looking at whether net revenues are going to be able to be -- yes, as long as coverage is met when they test it, as long as the City is meeting its covenant to reevaluate rates and charges to ensure that it will be able to -- that it will enable itself to continue to comply, if those obligations are met, yes, there's no covenant default.

MR. BALLENGER: We spent some time on the 1.2 coverage test in Mr. Morgan's schedule. We didn't spend any time on the point nine coverage test. I'm assuming that's because you would agree that that coverage test is satisfied using Mr. Morgan's numbers here?

MS. ALLEN: That question wasn't posed to me.

MS. BROCKWAY: Say again?

MS. ALLEN: That question wasn't posed to me. The test is that if the City generates in a fiscal year net revenues, that's cash in the door, and it does not include any transfer from the Rate Stabilization Fund, and that amount collected in a fiscal year is at least 90 percent of its debt service requirements in that fiscal year, then the test is met.

MR. BALLENGER: And that test is met in Mr. Morgan's projections here, is that correct?

MS. ALLEN: Point me to the --

MR. BALLENGER: It would be line 29

of LKM-1, which shows for fiscal year 2017 coverage of 1.18 and for fiscal year 2018 1.08.

MS. LABUDA: I'm not sure --

MS. ALLEN: There's a transfer -- that calculation wasn't made here.

MR. BALLENGER: Are we able to determine based on the net revenues being -- well, I think we can, again, take notice of math, that the point nine percent is satisfied. You didn't raise it, so I'll assume that you acknowledge that coverage test is met.

MS. ALLEN: That question wasn't asked to me. I'm not acknowledging anything.

MR. BALLENGER: No one on rebuttal raised it. You talked about --

MS. BROCKWAY: This is all argument that can go into summations.

MR. BALLENGER: That's fine. A couple more questions here. If I may just confer with my witness for one moment, please.

(Pause.)

MR. BALLENGER: I'm sorry. I'm ready.

MS. BROCKWAY: Please go ahead.

MR. BALLENGER: So we've spent a little time already talking about the City's five-year plan. To the knowledge of the witnesses, has the City's five-year plan ever been cited as an industry best practice for rate making?

MS. CLUPPER: I can speak to that as financial advisor for the City. Five-year plan is an absolutely a positive. The whole process of having an independent authority review the City budget, the process of having to submit the five-year plan, the process of having quarterly managing reports published publicly is all cited as a credit positive. All rating agencies look at an issuer's policies and ability to plan long range out to five years. So there's no question.

MR. BALLENGER: That's helpful. But I was asking whether it's ever been cited as an industry best practice for utility rate making, not for ratings, for utility rate making.

MS. CLUPPER: It is a best practice.

MR. BALLENGER: For establishing utility rates?

MS. CLUPPER: Are you asking the question, has the rating agency specifically --

MR. BALLENGER: I'm not asking about the rating agencies at all. I'm talking about industry rate-making practices and whether or not the City's five-year plan has ever been cited as an industry best practice for establishing rates and charges.

MS. BUI: AWWA is one manual which is like the bible.

MS. BROCKWAY: Louder.

MS. BUI: AWWA's M1 manual, which is the bible within rate-making world and provides all the guidelines of things, does cite five-year planning -- financial plans as being the best management practice. Does it call out specific utilities practices? No. Because I sit as one of the editors on that manual and we try not to do that. In addition, if you look at other AWWA published books, for example the Financial Management for Water Utilities, it also cites that as a best management practice for the financial world to use for rate making.

MR. BALLENGER: And I think we would like to ask a transcript request that the manual be placed on the record.

MS. BUI: The entire manual?

MS. BROCKWAY: Go off the record.

(Discussion held off the record.)

MS. BROCKWAY: Back on the record.

MR. BALLENGER: And the City's five-year plan, that's -- just circling back a little. That has to do with a lot of different departments in the City, correct, not just the Water Department?

MS. BUI: Correct.

MR. BALLENGER: So the City's five-year plan comprises a lot of factors which -- or includes within it a lot of calculations, I assume, and estimates for the future that have nothing to do with the Water Department?

MS. BUI: I can't speak to that.

MS. LABUDA: What's interesting is that you're raising a unique point, is that we're one tax I.D. with the City of

Philadelphia. We're the City of Philadelphia. We're a department of the City, and so when you talk about the cost of our lease, it's a City-wide approach. So the lease assumption using the five-year plan directly correlates with our lease cost. When you speak about fleet management costs, we have one fleet management department. So the cost for fleet management directly correlate to our costs, except that where we may have higher expenses related to the number of vehicles we have. When you cite to the cost of procurement, we use City-wide procurement roles so the cost of City-wide procurement directly relate. We have one pension system. We're all paying into pension system so the cost of pensions, health care, other fringes and salaries, all directly correlate to the City of Philadelphia. I am sure I am missing a few areas where, you know, debt services based on the Water Department's credit rating versus the City's general obligation bond rating. So that would be an area where our costs might differ.

MR. BALLENGER: And does the

five-year plan -- well, strike that.

MR. DASENT: Did you finish your response?

MS. LABUDA: I believe I'm missing a few areas that also correlate, but I just don't have the plan within reach, so I apologize for the areas that I missed.

MR. BALLENGER: Quite all right. It's a helpful overview.

What is the consequence to the Department of the projections in the five-year plan being slightly inaccurate or even grossly inaccurate? Is the Department placed in breach of any covenants if the five-year plan is inaccurate?

MS. LABUDA: The key is that the Department must maintain its Rate Stabilization Fund balance to make sure it has its minimum balance to ensure that it has ample capacity to cover unforeseen expenses. And those unforeseen expenses can relate to higher cost in pension, salaries, fringes, or the fact that we need more chemicals to ensure we're meeting water quality standards. So the key to our financial civility is maintaining the minimum balance.

MR. BALLENGER: I want to ask one question. Ms. Clupper, when I heard you talking about Mr. Morgan's testimony concerning the hearing date, I thought I heard you -- perhaps you were paraphrasing Mr. Morgan say that he said the information is not available? Do you recall what you said?

MS. CLUPPER: So you're asking me to comment on that comment?

MR. BALLENGER: I heard you say it so I wrote down the words quoting you as saying information is not available and Mr. Morgan said information is not available. I don't see that in his testimony.

MS. CLUPPER: So his -- and I apologize if I misspoke, but just to be clear, the question that he -- that he responded to was do you agree with the Department's proposed change in the debt service coverage. He discusses the Department's proposal to increase debt service coverage to 1.2 to 1.35 times, supposedly supported by a comparative sector summary produced by rating agencies. That's not entirely correct, but I'll get to that in a minute. The summaries are essentially general medians of various factors. They do not provide any details of entities that are included and derive in the medians. Summaries don't -- the information -- the information -- the summary is a median. The information is available. You can see what's in the median. He's making the point that it's inappropriate to establish policy based on summary data.

He further makes the point that it is possible, for whatever reason, that most of the utilities that make up the median have bond covenants that require those utilities to maintain higher debt service coverage. The point that I'm making is that critical information is unknown with regards to the published summary, and it would be inappropriate to authorize policies based on such lack of information. My rebuttal, my comment is that that information is available. It takes some digging and it takes some subscription to certain, you know, rating agencies. The rating agencies are -- I mean, they're not small organizations. They're huge organizations that have a lot of database, they're qualitatively driven and they don't publish medians lightly. There are information that's underneath those summaries. So I don't think that it's accurate to say that critical information is unknown. I also don't think it's accurate to make the -- to assume that the median, for instance, of Boodie (ph.) of 1.81 is legally driven. It's not typical. Most legal covenants are the 1.1, 1.2 times range, in my experience anyway. And that information is also available. You can go and look at the official statements through the MO, which is a portal site that MSRB provides to investors.

MS. BROCKWAY: Can you -- what was the acronym?

MS. CLUPPER: EMMA. Just type MA and it will pop right up. And then you can search for whatever official statement you want and you can look and see what the legal coverages are. But the bigger point of the -- the policy is not just based on sector summary.

The policy -- you know, we spent a lot of time working with the Department over years looking at summaries so it's an important part of the deliberation. But the reason why coverage needs to be increased again is to generate resources all to the bottom line so there's money available to make the system stronger, and that's the reason why the policy is important. It's supported by ratio medians because you look at other utilities, best practices that are considered healthy by investors and rating agencies. That's all important to do. But the bottom line is, the reason why you want the coverage is to go back into the system. It doesn't go to investors or other private people like an investor-owned utility. It's a municipally-owned utility. The money goes back into the system to address critical infrastructure needs that are going to face the Department for years and the City and the ratepayers.

MR. BALLENGER: And in this statement that you're talking about, about Mr. Morgan's statement, that it may be inappropriate to use that median. Am I correct that you did cite in your testimony to the agency ratings summary at the median?

MS. CLUPPER: Yes, I did. We included the summaries. We did include summaries, yes.

MR. BALLENGER: I have another question. I just wanted to talk a little bit about the use of the Rate Stabilization Fund, if I can. And I think, Ms. Allen, you talked about Rate Stabilization Funds being available for two purposes. And the first purpose you mentioned was to transfer into the revenue fund? And once transferred into the revenue fund, is there any restriction on the use of those funds for any purpose?

MS. ALLEN: No. Once moneys are in the revenue fund, then it goes through the waterfall and it --

MS. BROCKWAY: Say again?

MS. ALLEN: Once moneys are in the revenue fund, there is a prioritization in the general ordinance about how revenues are used. And once each step is -- first operating expenses. If operating expenses are met, then you pay debt services. Debt services are provided for, then you top off the debt service reserve and you go down and through the prioritization that is in the general ordinance. But there's not a specific -- anything more specific than that. To the extent that the other purposes have been provided for, it can go to -- it goes -- it can go all the way through --

MR. BALLENGER: I think in discovery we asked a question about that, and Ms. LaBuda directed us to this page of the official statement, page nine that depicts that flow of funds. So once transferred into the revenue fund, basically the amounts could go to operating expenses, they could also go to capital expenditures, is that correct?

MR. JAGT: I want to clarify one thing. The initial question, as you stated -- which transfer are you referring to?

MR. BALLENGER: I'm not referring to any specific transfer. I'm referring to the Department's transfer of money from the Rate

Stabilization Fund to the revenue fund.

MR. JAGT: Okay. Thank you.

MR. BALLENGER: So the moneys transferred from the Rate Stabilization Fund to the revenue fund could be used to pay operating expenses, they could be used to make --

MS. ALLEN: That transfer happens at the end of the year. So whatever the revenue requirements are necessary for the Water Department at the end of the year, that's -- it settles the fiscal year.

MR. BALLENGER: They could be used, for example, as part of a capital account deposit?

MS. CLUPPER: I think the timing is critical to understand that it happens at the end of the year. So stuff already happened. You have already extended your operating to plug a hole. I think that's a very critical point to remember in this waterfall discussion. So you couldn't use it that year because that year has already passed to.

MS. LABUDA: And that's an important point which I tried to discuss yesterday with one of the questions that came my way on what happens when -- can you make retroactive adjustments and reduce an operating-level expense. And the answer is, we pay expenses as they come throughout the fiscal year and we receive invoices, we pay for chemicals, we pay for electricity, we pay for ongoing expenses throughout the year month by month by month. And then we get to year-end and we figure out if we have overspent or if revenues were sufficient, and then a transfer is made in October. And how that money flows will depend on what expenses we had through the year.

MR. BALLENGER: Okay. I understand your position. I think we'll probably address that in a brief.

MS. BROCKWAY: Are you trying to ask whether they can intentionally under budget a capital account so that --

MR. BALLENGER: No, Madam Hearing Officer.

MS. LABUDA: In our general bond ordinance, there's a requirement that we must, not choose to, we must set aside one percent of net property plans and equipment towards our capital trust. Most people would better understand it as renewal and replacement. We must do that as part of our obligations. There is a required one percent transfer for renewal and replacement.

MR. BALLENGER: Right. And that's part of the definition of the capital account deposit amount, is that correct? Is that right? The one percent, it's in the ordinance?

MS. ALLEN: Yes.

MR. BALLENGER: By definition, that also includes -- it includes -- as I said, we can address this in the briefs, but it states or such greater amount as shall be annually certified to the City. So it is not limited to one percent, is all I'm saying. But we can address it in the brief.

I think I am done and would pass cross-examination to Mr. Delaney or Mr. Helbing, if either of them have any questions.

MR. DELANEY: I don't have any questions to ask. I'll pass.

MR. HELBING: Neither do I.

MS. BROCKWAY: Any other questions from anybody else?

MR. DASENT: On redirect, we'll have a brief redirect.

MS. BROCKWAY: Are you ready to go now?

MR. DASENT: If you give me just a moment.

MR. POPOWSKY: I have a question, if you don't mind. I have been struggling with this back and forth on the interest -- the coverage ratios versus the Rate Stabilization Fund. So what I noticed on -- this is an exhibit that was handed out yesterday, the Public Advocate exhibit -- hearing Exhibit-1, page 14 which you talked about today, which is the bringdown from the last case. I think it was prepared by Black & Veatch. On page 14, if you look at the first few lines, there's a lot -- several lines. There's a lot of differences between the rate case projection versus the actual results. But when you get to the coverage ratios, particularly the senior debt coverage ratio, lo and behold, the actual is identical to the projection. So my assumption is that you're actually solving for that number. That's a plug number.

MS. LABUDA: It is. And it's based on legal counsel's advice that we had to -- while the Department did experience outperformance, we were advised legally that we had to meet the exact coverage metrics that were portrayed in the settlement. So the additional funds went to the RSF.

MR. POPOWSKY: So when you were concerned that the numbers were going to go to 1.9, that's not really a concern. The real concern is how much are you going to have to take from the Rate Stabilization Fund to keep it at the 1.2, is that correct, or whatever you choose?

MS. LABUDA: Actually, I was more concerned that the position of the Public Advocate grossly understated our expenses.

MR. POPOWSKY: I understand that.

MS. LABUDA: We would be in severe jeopardy of managing the utility --

MR. BALLENGER: I would object to the statement that grossly understate or overstated anything.

MS. BROCKWAY: I'll overrule the objection and let's just let the Board member have --

MR. POPOWSKY: I'm just trying to determine -- so to me, the issue is not whether you're going to go to 1.2, 1.9. How much do you to keep in the Rate Stabilization Fund?

MS. LABUDA: I mean, there's multiple factors. The first factor is that we can't have coverage -- manage to have something less than 1.2. And we don't set rates to cover a hundred percent of budget. So how much is the minimum amount we can functionally have in the RSF. And then there's the fact that we're severely leveraged. You don't want to continue 1.2 times coverage and rely on the Rate Stabilization Fund. You want to start to de-leverage the utility or Department, or by incrementally increasing, as we did during the prior settlement, that coverage amount.

MR. POPOWSKY: But you're going to

start off on the number based on how much you put in from the Rate Stabilization Fund. Is there a minimum? I can't recall. I apologize. Is there a minimum you must keep in the Rate Stabilization Fund or is there a target or --

MS. LABUDA: Legally, the general bond ordinance requires 45 million in RSF. Do I have that number correct? The Rate Stabilization Fund must have 45 million in it?

MS. ALLEN: Subject to check.

MS. LABUDA: There's some minimum amount in the Rate Stabilization Fund under the general bond ordinance. Then there's the philosophical question is if you aren't setting rates to cover a hundred percent of your budget, how do you balance your budget if your Rate Stabilization Fund is something less than that minimum ten percent of your original budget. Then there is the third part of this equation, which is how much does the Department need on an ongoing basis in the RSF, since we have no other account that can flow to revenue to meet ongoing operations in an emergency. And in the financial plan, I said that's 110 million in fiscal year '18. And we would use the RSF in '16, '17, and '18 to get to the 110 million, provided assumptions that we provided are accepted and also are within the range of what we experience.

MR. POPOWSKY: Okay. Thank you.

MR. BALLENGER: Hearing Officer, if I may ask one more question.

MS. BROCKWAY: Uh-huh.

MR. BALLENGER: Ms. LaBuda, you stated that the Public Advocate's position is to grossly underestimate your expenses. Could you please direct me to where in Mr. Morgan's testimony he states that our position is to, quote, grossly underestimate expenses?

MS. LABUDA: Mr. Morgan states that he wants to remove all adjustments because they're not reasonable. So by --

MS. BROCKWAY: I'm going to interrupt. This is argument obviously and I think we're, you know, making too much of a semantic difference. I think we can understand it on the Board. I do have a question -- do you have other questions?

MR. BALLENGER: No.

MS. BROCKWAY: You can put that into your summary.

MR. BALLENGER: Not at this time. Thank you.

MS. BROCKWAY: But, you know, we don't need to have a lot of time on the record about something which is pretty clear.

I wanted to ask about the five-year plan requirement. Did that come about initially as part of the PICA bonds?

MS. LABUDA: Yes.

MS. BROCKWAY: Will that requirement sunset when those bonds are paid off?

MS. ALLEN: Yes.

MS. BROCKWAY: How long will that be?

MS. CLUPPER: We have to check.

MS. BROCKWAY: So several years. And has the Department considered what it would do if it no longer has that covenant obligation?

MS. LABUDA: I'm sorry, if the City

no longer produced a five-year plan? There's no indication that the City, based on discussions to date, has any intention of not doing a five-year plan. We would need to continue to have discussions with the City's finance director on just obtaining projections on a five-year basis if the official plan were not to be produced in 2023 or 2024, whatever the correct year is. But there's no indication that that's going to happen.

MS. BROCKWAY: Thank you. Did you have more?

MR. BALLENGER: No.

MS. BROCKWAY: Does anybody else have any questions?

MR. DASENT: We have redirect briefly after a brief break.

MS. BROCKWAY: All right. Let's see. We'll go off the record.

(A break was taken.)

MS. BROCKWAY: During the break, I had discussions with Mr. Dasent and Mr. Ballenger about the question of responses to the various stages that have come in. So the last stage we have is the rebuttal accompanied with cross-examination. It seems to me, and I think at least these parties agree, that it is -- that we have time, given how quickly things are going, to give Mr. Ballenger the opportunity to put on some surrebuttal tomorrow. I understand that you would like to do that only after cross on the direct?

MR. BALLENGER: I think it depends on how cross goes, but we may be able to avoid surrebuttal and just handle anything on direct. But I can't anticipate -- I can't forecast.

MR. DASENT: That's what I anticipated, but I think our flexibility indicates we will let tomorrow start with a very short cross of Mr. Morgan of those areas we haven't already discussed. And we have stormwater management witnesses and other things to do.

MS. BROCKWAY: Okay. And just to this step off. If there is surrebuttal, and if you want to rejoin to it, you can, but it will be limited to the surrebuttal, not to anything else.

MR. DASENT: Fair enough.

MS. BROCKWAY: And tell me again, who are the stormwater witnesses?

MR. DASENT: We have Erin Williams tomorrow, David Katz, and of course in the future it's David Russell for Penn Future.

MS. BROCKWAY: Okay. Thank you. I think we should keep plowing through. So we were ready for redirect.

MR. DASENT: Yes. Just very brief redirect. I'll direct the question to Ms. Clupper.

Assuming Mr. Morgan's adjustments are okay mathematically, just sort of the focus of much of the discussion today. What's the big picture?

MS. CLUPPER: When I look at this kind of bottom line, so I always look at the bottom line year-end fund balance after, you know, the balance completed. As the Water Department's municipal advisor, I'm extremely concerned that we're creating and focusing on a situation where that we're managing exactly to a required coverage and we're using the resources. I think it's important to remember, historically the water commissioner sets the rates. And so there was an internal process that CLS was involved with and the rating agencies, and the investor community gave the City a break because they knew at the end of the day the water commissioner would raise rates in an amount that would maintain 1.2 times the coverage. There was this sort of understanding that that was going to happen. And they also understood that the Water Department consistently outperformed.

In fact, you know in the Standard & Poor's recent write-up, they specifically mentioned that the financial performance meets and exceeds current projections. I mean, it's sort of a Philadelphia thing that they say the sky is falling and they outperform, and that's a good thing as far as investors are concerned and as far as the credit agency. So I think that that -- so I think that's generally a credit positive. But now that there's an independent rate-making board, all three rating agencies have specifically mentioned in their write-ups the concern it could be, you know, positive, but they are concerned that that sort of, you know, reality that the commissioner set the rate doesn't exist. And they are looking very carefully at what happens here. They're expecting the Water Department's coverage trends have been on the -- you know, slowly going from 1.2 higher, and they understand that the policy of the Department is to increase the coverage. They understand the policy of the Department is to increase PAYGO -- use the capital, the internally-generated funds. They understand that and they're giving them, you know, kudos in all their write-ups.

So there is a focus, they don't want to say a concern because they're not going to do a judgement, but they are looking at this Board, the process and they're, you know, expecting and hoping to continue the positive trend. So when I see this bottom line, you know, number, it causes me concern, because I'm concerned that we're kind of going backwards and not continuing with the trend that will ensure some positive sustainability of a system. You know, the Department has almost a two-billion-dollar capital project and it's okay to look at things in two years, but the Department can't. It's got a huge CIP program, as most utilities do. Very, you know, asset intensive and, you know, you have to -- they're looking for this trajectory. And so that's why I'm concerned when I see this, you know, mathematically-corrected bottom line, it still causes me concern.

MS. BROCKWAY: When you say bottom line, is that a line on one of these exhibits or is that a general term?

MS. CLUPPER: I actually looked at the bottom line of the year-end balance -- not to get back into the model, but I have to say this. So if you look at LKM-1, setting aside all the other conversation about -- that went on, what I do is I look at the residual fund because that's the fund now, that's the bottom line for the Department, that's line 30. And I see that the beginning balance of the Black & Veatch is 15 million and the beginning balance for Mr. Morgan's is 42 million. And I think well, that doesn't make sense. You have to start with the same beginning balance. So I adjust the beginning balance in 2017 at 15 million and if you kind of do the math, at the end of 18 the fund balance, which is the year-end residual fund balance, is a negative two million dollars. That just means that we're -- you know, there's no juice there, there's no coverage. So, yeah, that causes me a concern.

MR. DASENT: Is utility planning month to month or year to year?

MS. CLUPPER: No, I think the utility plans far out. Their rate increase is only two years. They have to plan out, you know, five years and even, you know, longer. I mean, the capital plan passed by the City is six years. But I'm certain that Black & Veatch and engineering projections go out 20 years, 25 years because projects take years to complete. I mean, it would be irresponsible not to have a long-range plan on the capital side of the utility.

MR. DASENT: Based upon your

listening today to various questions and our presentation, are we capturing sort of the long-term view or are we sort of stuck in the weeds?

MS. CLUPPER: I think this is a very short -- no, it's not long term.

MS. BROCKWAY: You're referring to LKM-1?

MR. DASENT: Yes.

MS. CLUPPER: Yes.

MS. BROCKWAY: Which has come in as part of your Exhibit-3.

MS. CLUPPER: Yes. Two-year picture.

MR. DASENT: Do you have anything else?

MS. LABUDA: I think the other point that Kathy and I experienced when we were recently with the rating agencies is that they're watching our coverage. They're looking for incremental improvements to continue, they're watching our balances and the Rate Stabilization Fund. We're using those balances for projecting to use those balances. So the combination and the big-picture risk to the Department is that if rates aren't adequate to meet our obligations and we continue to rely on the RSF, you're putting the Department in jeopardy of rating triggers. And ultimately what it comes down to is that any type of downgrade in ratings results in higher costs. And that is the big-picture concern when we take a narrow focus and aren't thinking long-range planning or five years out and incrementally de-leveraging the Department.

MR. DASENT: Thank you. That's all we have.

MS. BROCKWAY: Cross?

MR. BALLENGER: No, not from me.

MS. BROCKWAY: Any other party cross? I have a question. Early on in this proceeding, there was a kerfuffle about costs for advanced metering infrastructure. And the particular dispute had to do with discovery having to do with the business case and other information about why would the Department want to do this, what are the benefits, costs, so forth. That was resolved by taking out of this two-year period AMI-related costs. You have said several times -- this is to the Department. You have said several times in your testimony that you need to go out longer, that you need to go out five years.

Is there -- in your projections, do you still have any AMI in the third through the fifth years?

MR. DASENT: It's in the planning period. But the witnesses need to speak to that.

MS. BROCKWAY: Yes.

MR. JAGT: As filed, it's in the planning period that we have reflected in our filing.

MR. DASENT: Beyond the rate period?

MR. JAGT: Right. Correct.

MS. BROCKWAY: Do you know how much would be in the plan if you were to remove the AMI? I understand there are some offsetting adjustments that you might want to make.

MS. LABUDA: May I read the -- so in the assumptions document, which was PWD

Exhibit-5, I'm on page number eight -- I apologize. So on page one, it reads that the implementation of AMI is anticipated to provide the following conditional revenue in fiscal year '19. And I'm just citing what's on the record, which is point four million in fiscal year '19, 1.25 million in fiscal year '20, and 2.1 million in fiscal year '21. If you give me a moment, I'll go through and cite the page if there's any other assumptions on the expense side.

MS. BROCKWAY: You're saying that that is a net benefit at this time to the Department from putting in AMI?

MS. LABUDA: The financial plan contemplates that benefit. But I also want to point out that beyond fiscal year '18, it also contemplates -- and this is on page eight of PWD Exhibit-5, B&V page number eight, I'm looking at class 100 and 200, fiscal year '19 to 2021 projected cost savings of the result of the anticipate implementation AMI range from point two million to 1.9 million from 2019 to 2021.

MS. BROCKWAY: Perhaps using this as an example. What is the importance to the Board of the years beyond the two-year period?

MS. LABUDA: So from my perspective as a financial person, I worry that any delays in implementation or various implementation -- I'll look to our CEO, any delays could change the net benefit of the potential program to our bottom line. So the risk of course is that the savings don't materialize.

MS. BROCKWAY: And if somebody said au contraire, not only will there be no savings, you will have a net loss, would that be a fair discussion to have?

MR. DASENT: For the rate period?

MS. BROCKWAY: Well, we seem not to be having it now, but what I'm worried about is that we have a record which is at least qualitatively based on a period beyond this rate period and makes some assumptions about the health of the Department. And part of that is based on the AMI, which might -- those assumptions about the impact of AMI might be, as they have been in the electric industry, subject to a great deal of dispute. And so I'm trying to figure out how the Board can, without getting into what the Board thinks about AMI and your savings, the Board can contemplate the period of time after the rate period. What do we do with your statement that you're worried about losing the net benefits and so forth if we don't get into the question of are there net benefits?

MS. LABUDA: And Prabha Kumar corrected me that I wasn't summing up all the parts in the assumptions document and during the planning period the net benefit. So it's zero.

MS. KUMAR: May I answer?

MS. LABUDA: Yes, please.

MS. KUMAR: So after the AMI implementation and the savings coming from the AMI predicated upon timing. So there was a timing that was assumed for the AMI implementation.

MS. BROCKWAY: There was a timing what?

MS. KUMAR: There was a timing of

implementation that was assumed, which was the '18 times -- that the project will be completed by '19 and the net savings start coming in starting '20. So if the project is not done at all, when the project cost happens during this time frame, the 19/20 time frame that we're talking about, the savings are -- continue as annual savings beyond that period. So if your question is is there a potential loss by not doing this at all in a certain time frame, in the very long-term, yes, there could be, because the savings are going to continue to accrue on a year-by-year basis.

MS. BROCKWAY: I understand that and I understand that's the position of the Department. But because of my experience in the electric industry where AMI has been very fiercely debated and there are multiple points of view, it raises to me the question of how does AMI work in the water situation and can the Board rely on these projections of savings. And what would be great would be if somebody could explain to me why we don't even need to care about that. But I'm having trouble getting there.

MR. DASENT: The proposal is not ripe, that's why we have not stipulated to remove the operating expenses from the rate period. In the planning period, it will come into focus because it has to go to city council. It has to be fully vetted, and within those parameters we will know and you will know because we will share that information with you. As of right now, it's not ripe for any determination.

MS. BROCKWAY: But does that mean that the Department has pushed back its plan to start AMI implementation?

MR. DASENT: Ms. LaBuda will have to speak to that or our CEO.

MS. BROCKWAY: That kind of process was already built into the original assumptions?

MS. MCCARTY: Well, I think it's important to remember that the current contract ends in 2019 if we take the two one-year option to renew for the meter reading. So during -- you know, outside this rate case. But we're going to have to figure something out. So are we planning? Of course we are, because we have to. We don't just look at tomorrow, we have to look out. I'm not saying you're disputing that. But we have to figure something out. What it is, we don't know right now. And as Andre pointed out, we need to go to city council if we're going to go with the long-term control plan. I think there's too many variables right now to say whether we will or will not go to AMI. We would do our due diligence and does it make sense. And I would suggest that I think there are differences in the water industry versus the electric industry in that regard. Things that AMI can bring you is, you know, if a customer is -- their toilet is running, they can be alerted within, you know, whatever that time frame might be, three days, 24 hours, and reduce that additional consumption and then potentially adjustments in their bill, disputes in their bill and things like that and high bills and creating delinquencies. But that is one of the many factors that we would evaluate in looking at

AMI. Does that answer your question?

MS. BROCKWAY: Yeah, it goes very far towards it. I want to clarify a little bit the timing issue. When you first filed your advanced notice and your notice, AMI was there and there was some funds for these next two years and they have been by agreement taken out. Does that mean that you are changing in any way the planning activities that you would have done had those $400,000 still been in the budget? In other words, are you going ahead with the planning and is that not related? Can that be separated and is it not tied to this $400,000?

MS. MCCARTY: We needed those funds -- we're basically playing that -- you know, what we need those funds for, which is not to say we're not still continuing to look at AMI. But those funds were allocated for activities that we are not currently doing. Does that make sense?

MS. BROCKWAY: Yes. So there is -- the impact of this is whether you would have done it anyway. So some delay from the

original assumption about what your path would
be? I think that's all I need to know. Any
questions?
            MR. BALLENGER: No. I just -- if I
could just make one statement. I think that's
an important clarification because I think, you
know, this -- unlike the costs for --
            MS. BROCKWAY: Actually, we don't
need you to make a statement.
            MR. BALLENGER: Okay.
            MS. BROCKWAY: The Board wants to
hear it.
            MR. BALLENGER: The kerfuffle that
you referenced arose out of a discovery
dispute. What I was getting around to was that
we would view the record as being sort of
inadequate at this point, which is why I'm
encouraged to hear that there has to be some
more discussion and development for this issue
to go to the Board in this case. In our view,
we would think we would need a chance to do
more discovery and maybe this issue would have
to be taken up in a later decision if the Board
wanted to make a decision on it. I was going

to contrast that with the electric expense, which I think we have had an opportunity to have discussions about and is an adjustment that's been agreed to after having built a record and had discussions.

MS. BROCKWAY: Yes. And I wasn't contemplating that we would reopen that issue here. I was trying to understand, given that that issue is in flux, to what extent do the third through the fifth years, to the extent they are affected by it, that issue, matter or can we basically set that aside completely and think about the third toward the fifth years as if as if it hadn't and didn't need to be decided.

MR. DASENT: I thought that's just basically what the commissioner informed us.

MR. POPOWSKY: I'm sorry, I did have one other question. I apologize. You referenced the residual fund. I apologize and I haven't been able to get all these funds clarified. But the residual of what?

MS. CLUPPER: The residual fund, in my mind anyway, is like the ultimate fund balance. So in the waterfall, we have things -- everything starts up here and it falls to the residual fund. In my mind, if I'm thinking about how much money do they have kind of left over, whatever, it's the residual fund. That's how I view it.

MS. ALLEN: If there's any excess revenue at the end -- revenue comes into the revenue fund and they meet all the revenue departments. At the end of fiscal year, if there's anything that's excess, there's a last bucket.

MR. POPOWSKY: And that's after the Rate Stabilization Fund as well?

MS. ALLEN: Yes.

MS. BROCKWAY: Actually, may I follow up on that. My understanding is that the testimony is that the 110 million dollars is a target. A couple of questions. To the extent you haven't had a chance already to explain why that particular target is important, I would be very interested. And as part of answering that, I don't know what number to pick but somewhere between 45 million and 110 million. Would another number be tolerable or is this the number it has to be?

MS. LABUDA: So in PWD Exhibit-2, we have a document called the Philadelphia Water Department Financial Fund. It's a PowerPoint summary of the financial goals and objectives the Department has set. Many of them mirror the goals and objectives of what was set in the prior proceeding, such as 20 percent pay-as-you-go capital and maintaining the Rate Stabilization Fund at a hundred million, plus some sort of inflationary assumption. And it is my distinct opinion that 110 million by fiscal year '18 is the minimum amount the Department needs to ensure that we have adequate funding to cover the differential between budgets and what rates cover. It's also an amount that we'll need in order to manage to our day's cash-on-hand metric.

As I cited earlier, one of my concerns with spending down the RSF and not improving coverage is the rating agency implications. So if coverage continues to not -- if we don't have the ability to improve coverage incrementally and we're spending down Rate Stabilization Fund, we're going to be in a position where we're going to have cash defined as days cash on hand in the rating agency's view, which is much lower than our peers, and that is a rating challenge for the Department. So we needed to balance the original budget because we don't set rates to cover a hundred percent of budget. We need it to maintain adequate fund balance. Fund balance is important for emergencies. And we also need it to ensure that we don't see rating agency declines.

But I would point to PWD Exhibit-2, the PowerPoint, that steps through more of the Department's goals and objectives from a financial planning perspective, which are also prepared, of course, in the cost-of-service analysis.

MS. BROCKWAY: So you say the 110 is the minimum of --

MS. LABUDA: Yes.

MS. BROCKWAY: And if the Department were to choose something like 100 or

90 million and say this is going to be our target for the next four or five years, would that have the same impact on the rating agencies as well. We're going to draw down the fund now because we don't want to raise rates?

MS. LABUDA: Well, there's two problems. We already went through a year without a rate increase and so we have nondiscretionary expenses we're facing. And any type of shift lower than rates, as we have requested, puts pressure on all years on the outgoing plan, right? Because you still have those expenses. They're not going away. And you're just putting pressure on outgoing year's rates if we don't have sufficient revenues. And I would challenge you that I won't change the plan below 110 million because I feel very strongly that we will be in a very bad spot financially with anything less than 110 million by fiscal year '18 because budgets are going to grow, they're not going to shrink.

And also from the rating agency perspective, I don't think I want to be in a position where I'm recommending the Department

to face negative outlooks and potential
downgrades from a rating agency perspective.
Most of our peers keep 280 to 350 days cash on
hand. I would say subject to fact check,
because I don't have the peer medians right in
front of my hand, but that's what I'm
recalling. So we're going to take our 113 --
our 110 million is going to drive us to
something much lower than that.

MS. BROCKWAY: Lower than 280?

MS. LABUDA: Absolutely, yeah.
What we're going to end up with is about 175
cash on hand if we end up with 110 million in
fiscal year '18. And, again, this is all in
the financial plan.

MS. CLUPPER: Just to add. The
rating agencies aren't going to look at one
fund. They're going to look at debt service
coverage. They're going to look at residual
fund. They're going to look at total cash on
hand. But because the residual fund is
targeted so low, the liquidity really resides
in the Rate Stabilization Fund.

MS. BROCKWAY: I was trying to

stumble towards a scenario in which we take the worry of the rating agencies that this Board is going to slash rates or keep rates so low that your revenues are in great danger. So that's a risk. I was trying to think of how much of the 110 is essential to that issue. In other words, if the Board were to say well, we think this is a -- we think it's very important that the Department have a comfortable RSF, but we think that a hundred million is going to be enough. And even as that flows through to, I don't know, 160 days, I don't know what it would mean, this would be a communication from the Board to the rating agency saying yeah, you were worried that we were going to cut, we're going to cut a little, but we're certainly not going to cut drastically and we don't tend to cut further as we go along.

MS. CLUPPER: So they're going to look at the action of this Board. They're going to look at the action, and so if you make a statement, frankly the board may not be the next board that does the rate increase, right? So if you lower the target of the Rate

Stabilization Fund, that means you're using it to bolster operations. And when you use the Rate Stabilization Fund to bolster operations, you're creating a structural deficit that at one point will catch up with you. So if you're using money to help operating and you need that to maintain the coverage, what that means is that here's the end of the rate period, and then the next year, as Missy said, those expenses don't go away and now you have created a structural deficit. That's what they're looking at. They're looking at okay, we have a situation where they use the Rate Stabilization Fund and they say they're not going to do it anymore but could be a different Board, and now we have this structural deficit so it will be a credit negative.

MS. BROCKWAY: I will admit that I don't understand this fully, and I think it's something that could be briefed because I am -- I'm falling off the logic train when you get to using the RSF for operating. It seems to me that that wouldn't be the case. It would be say no, you don't need 110, you only need a hundred or whatever, which is a different calculation.

MS. CLUPPER: Yeah. Yeah. You would make -- you're making that statement because you intend to not raise your rates and so --

MS. BROCKWAY: Well, by the 10 million dollars, yes.

MS. CLUPPER: So that's the next logic, well, you're not going to raise rates and the question is why. I mean, ideally the Rate Stabilization Fund never gets touched. If I have my way, it would 110 million and you would have coverage that was enough that you would never need the Rate Stabilization Fund to maintain 1.2 because you have coverage of 1.3 and 1.4 and that money would fall to the Residual Fund, be taken into the construction fund, and the Rate Stabilization Fund would sit there as a rainy day fund, you know, for emergencies that, you know, you need to maintain that, you know, because something happened and you need that money to maintain coverage. Or there's an economic disaster in the City and there really is rate concerns and you need to use that to stabilize rate increases. So that would be the ideal.

So I think, you know, the rating agencies are not going to make a credit decision on a hundred or 110. They're going to look at the bigger picture. They're going to look at trends and they're going to ask the question, what happens next and they'll do their own kind of, you know, projection and they'll see that if you have used it and you haven't raised rates, there will be a deficit in your operating.

MS. BROCKWAY: I think under my assumption for this hypothetical, the rate increase to the extent of ten million dollars would not be awarded and that would continue through the future, at ten million dollars presumably, unless you have inflation -- unless the 110 should be going up as we go further.

MS. CLUPPER: Let me just sort of -- if you're saying that a Board would say to the Department, your Rate Stabilization Fund has to be maintained at a hundred million and then the next sentence is well, we're going to raise the rates so you don't need to use it, so it's always going to be at --

MS. BROCKWAY: No. No. It would not be that. We're going to make sure that rates are enough that it will always be at a hundred, at least.

MS. KUMAR: Just one other point to make here. When you are saying that the 110 million, we will have it at a hundred million. The only way that happens is really, from what you're suggesting, is to use the level of revenue increases needed in '17, let's say. It's important to remember when you're making that change in '17, it has that compounding effect on each succeeding year. So that revenue -- that five percent -- say it's four-and-a-half percent. The next year '18 that we are projecting is off of '17. So when you cut down half a percent on '17, it's going to have a compounding effect on '18 and each year is a compounding effect on each year.

MS. BROCKWAY: Why would it not be in each year a ten million dollar difference from what the plan was? What is it -- what's the word?

MS. KUMAR: Compound.

MS. BROCKWAY: Yeah, why does the 10 million compound?

MS. KUMAR: So for example -- all hypothetical, so please don't quote all these numbers. So let's say the five million dollars -- five percent rate increase and that you have to change it to a 4.8 percent and that's how you get the 10 million dollar reduction, let's say. Then the next year that what we are projecting and we have projected that we need to build on the five percent that we have projected. But now you're going to be building only on the 4.8 percent but you still want the same 10 million dollar reduction the next year, which means what we are projecting in the next year now, you have to increase that. So each year you have to keep increasing -- because what is happening is the very first year, revenue increases, let's say, from five percent to 4.8 percent. That point two percent is affecting every succeeding year. But what you're doing in the denominator, you're saying every year you want to reduce ten million. So the only way -- what we have projected, the revenue increases that we are trying to project to mitigate rate impact and the only way that can happen is in the first year you want to reduce 10 million, the next year you have to say I'll reduce it even more, from 10 to 12 and then 14 and 16. So you constantly have to change the Rate Stabilization balance. The two go in tandem.

It's not that I'm just -- keep the 10 million reduction every year, but the very first year you say I'm going to reduce the revenue increases for the first year, that's compounding effect every year. Which means at some point down the road, the level of revenue increases you need has to start going up more than what we have been projecting.

MS. BROCKWAY: I'm absolutely not following this because it sounds as if it's -- what's being driven -- what's driving this calculation of the need for the increase is some pre-thought percentage difference between this year and next year. I still don't understand why you just don't take 10 million dollars off going forward.

MS. BUI: Let me see if I can restate what your intent is. Correct me if my understanding is incorrect. What you are proposing is that instead of in year one -- hypothetical, instead of providing a revenue increase such that it allows us to have 110-million-dollar target, you're proposing a one-time time change so it drops it to a hundred.

MS. BROCKWAY: One-time change?

MS. BUI: Well, I mean, instead of five percent, it would be four and a quarter or something. Whatever the number is. So at the end of the waterfall, you have a Rate Stabilization Fund that's at 100 million dollars. And you are suggesting that in your future years, that 100 million dollars would be maintained.

MS. BROCKWAY: Other than we have had some discussion about the need for inflation on the fund, but -- assuming no inflation on the fund.

MS. BUI: Yeah, let's not complicate. What Prabha is pointing out is that in order to make sure, okay, that you're at -- let's forget inflation, that you're at that 100 million every single year, that would mean that you needed to have sufficient revenues coming in the door to meet your expenses so that you do not have to draw upon your Rate Stabilization and also make coverage.

MS. BROCKWAY: But why would you have to draw more than -- why would you have to have revenues more than ten million dollars more?

MS. BUI: It would be slightly more than the ten because you would have to make sure that you need -- that you're meeting coverage. The ten million that you have right now, that you want to decrease, it's probably not ten because that assumes already that -- your balance to start with, right?

MS. CLUPPER: Because you're using 19 and 30 million already for the draw. So there's already a structural deficit in the operating currently. They bake that in. So there's 19 this year, 30 million the next year. And if you don't use the Rate Stabilization Fund, now you could have a 40-million-dollar structural deficit. Now you can't touch your Rate Stabilization Fund. So the idea is to get out of this structural deficit situation so that the Department charges rates sufficient to cover operating and the debt. And that when that debt increases, that's only going to increase, which is another reason you want to increase the amount of debt that you're borrowing, so that in 20 years from now you don't have a situation where you have to charge 1.2 times coverage -- well, I don't want to do the math, but it doesn't work.

MS. BUI: I think Kathy's point is right on. If we do not have a situation where the Department was in a structural deficit every year, then what you're proposing could theoretically work out. But unfortunately we do have a structural deficit, so there are drawdowns on the Rate Stabilization Fund.

MS. BROCKWAY: I'm not getting the

math, other than the observation that costs will go up in the future.

MS. CLUPPER: If you're using 19 million as in the model to -- from the Rate Stabilization Fund, that means you have -- you don't have 19 million dollars in your operating. That's where you're using it. So that's a structural deficit.

MS. BROCKWAY: I understand and I understand that structural deficits are bad. But what I don't understand is why the structural deficit explodes if you start ten million dollars lower.

MR. JAGT: You're setting rates in the one year -- to achieve revenues to reduce Rate Stabilization by 10 million. So in order to do that, your revenues don't meet your revenue requirements by that 10 million dollars. So the next year it's the same situation, the rates you set will come up 10 million dollars short. So the only way to counter that and leave the, you know -- you know, end up not using it anymore is you would have to push up the rates to have that 10 million dollars back in.

MS. BROCKWAY: Yeah. And that's what I was assuming that -- and that's because costs go up.

MR. JAGT: Yeah. I mean, it's compounded by the fact. So if you're making large withdraws from Rate Stabilization already and you add more to it, that just of -- you either need big reductions in cost or the increases in the revenues -- to, like, neutralize it to stop the draws.

MR. BRUNWASSER: If you had no inflation though, you know, if you had zero inflation for the next two years, if that was the projection, you know, your thing would work out. Drop --

MR. JAGT: Well, you would still have --

MS. CLUPPER: Every year you have 200 some million dollars --

MR. BRUNWASSER: Yeah. Yeah. Yeah. But I'm saying as far as --

MR. JAGT: But even if you had no inflation because you set up the first year to under recover 10 million dollars, you would still have to bump up the rates the next year and year two to make sure you capture that 10 million, otherwise the Rate Stabilization will continue to decrease by 10 million dollars a year.

MS. BROCKWAY: Yeah. And I agree. I just don't understand -- I think we're talking at cross purposes. Because -- you may want to brief this.

MS. BUI: I was going to say, I think that would be easier.

MS. BROCKWAY: Any questions?

MR. BALLENGER: No.

MS. BROCKWAY: Anymore questions? Anymore redirect? Thank you very much, Panel. It's been an education.

MR. DASENT: We have Mr. Palladino, if you just give us a moment to make the transition.

MS. BROCKWAY: Yes.

(Pause.)

MS. BROCKWAY: We have the testimony of James Palladino for the Department and mercifully, your testimony is fairly short, and we will try to keep your time in that chair fairly short today.

Mr. Dasent, do you want to --

MR. DASENT: Yes. We marked for identification Mr. Palladino's statement five yesterday and we're proffering him as our witness today. Obviously we have a panel here, so if he needs assistance, we are here.

MS. BROCKWAY: All right then.

MR. DASENT: Thank you.

MR. BALLENGER: Good afternoon, Mr. Palladino.

MR. PALLADINO: Good afternoon.

MR. BALLENGER: I really wanted to focus on Exhibit JP-2 of your testimony for a couple minutes. And I have reproduced that in PA hearing Exhibit-1. But I believe he may need the exhibit because there's another page that follows it. I asked Mr. Dasent to loan you his copy of the exhibit.

So you state on page one of your testimony that one of your purposes was to provide a comparison of rates, is that correct?

MR. PALLADINO: Yes, it is.

MR. BALLENGER: Looking at Exhibit JP-2, I think you have done just that, you have given us a comparison of rates and charges between the Department and the number of other cities?

MR. PALLADINO: Yes.

MR. BALLENGER: And I just want to make sure I understand, on your chart Philadelphia, you showed the current average usage at 7159 per month, but that reflects the first stepped increase that's being requested in this case, am I right?

MR. PALLADINO: That's correct.

MR. BALLENGER: And I'm on page 20 of Public Advocate Exhibit-1, which is reproduced from Mr. Palladino's testimony, but we'll also look at page 21 in just a moment.

I notice, Mr. Palladino -- and the reason I notice this is that I grew up in Louisville, so my eyes were immediately drawn to the footnotes where you reference a couple of other utilities, and none -- I just want to make sure none of those -- you're not using any of those utilities as comparison utilities for purposes of your chart?

MS. LABUDA: It's Melissa LaBuda. May I speak, please? So in this chart, we inadvertently left the City of Louisville as a footnote and did not -- I'm sorry, City of St. Louis and we did not include it.

MS. BROCKWAY: St. Louis or Louisville?

MR. BALLENGER: Both.

MR. PALLADINO: Both. Both.

MR. BALLENGER: As well as, I believe, New Orleans and San Antonio, is that correct?

MS. LABUDA: It's an error on our part. We didn't update the footnotes. I apologize.

MR. BALLENGER: Okay. So just --

MS. BROCKWAY: Excuse me. Update the footnotes. Do you mean update the chart?

MS. LABUDA: No, I think we would update the footnotes. We would remove the footnotes if we were to provide an updated Exhibit JP-2 with references to cities that are not important portrayed graphically at the top.

MS. BROCKWAY: With reference or without reference? I'm not following.

MS. LABUDA: Sure. So JP-2 has footnotes for a few cities that aren't portrayed in the graph under comparable monthly water, wastewater and stormwater rates. To update JP-2 properly, I would remove the footnotes and not change the list of cities that are portrayed in the graphic at the top.

MS. BROCKWAY: I don't think you need to refile it. I think we understand that the footnotes --

MR. BALLENGER: No, it's okay.

MS. BROCKWAY: Excuse me, the footnotes are not to be considered part of the analysis?

MS. LABUDA: Correct.

MR. BALLENGER: Fair enough. Thank you.

MS. BROCKWAY: So this would be footnotes two and three which refer to Louisville and St. Louis?

MR. DASENT: Yes.

MR. BALLENGER: I believe, Madam Hearing Officer, it would also refer to the reference in footnote one to New Orleans and San Antonio.

MS. LABUDA: That is correct.

MS. BROCKWAY: All right. Maybe it would be easier, Andre, if you would be so kind as to file a revised JP-2 which takes out Ms. LaBuda's changes.

MR. DASENT: Will do.

MS. LABUDA: Happy to.

MR. BALLENGER: And I guess based on the discussion here, you and the Department collaborated to put together this exhibit, is that fair?

MR. PALLADINO: That's correct.

MR. BALLENGER: Okay. Just would like to turn to the next page in the exhibit and just -- I just wanted to ask a couple of questions here on this exhibit. This is page 21 of --

MS. BROCKWAY: Mr. Palladino?

MR. BALLENGER: Public Advocate hearing -- I did front and back here, so it's this one. Philadelphia compares favorably --

MR. PALLADINO: Yes.

MR. BALLENGER: -- nationally. That's the title of -- I think that's probably true in a number of ways. I just -- I notice that in this presentation, would you agree that Philadelphia has been placed sort of between Indianapolis and Baltimore in terms of its comparators there?

MR. PALLADINO: Yes, sir.

MR. BALLENGER: And that placement would not then reflect the first year of rate increase, because if that were factored in, the rate would be 7159, as opposed to 6743?

MR. DASENT: Subject to check.

MR. BALLENGER: Okay. And looking at this -- and just sort of comparing back and forth between your exhibit and the exhibit the Department has included here, and I believe this was the presentation to the Board on February 22nd. Do you also notice that Portland, Oregon was added to page 21 and was not included in your comparison?

MS. LABUDA: That is -- may I

answer, Jim? Melissa LaBuda. Yes, that is correct. Because in the page that's not here in this packet, we added Portland, Oregon on a separate breakout which demonstrated stormwater. So to normalize peers between what was on the stormwater table and what was on the broader national comparison, we did, in fact, add Portland to the table that's on page 21 of 43 of Public Advocate Exhibit-1.

MR. BALLENGER: And then, Ms. LaBuda or Mr. Palladino, wouldn't it also be true that you added Norfolk, Virginia and Detroit to the page -- what I'm showing is page 21? Those are not included in JP-2? They are included in the presentation that was given to the Board?

MS. LABUDA: That is correct, for the same reasons.

MR. BALLENGER: Okay.

MS. LABUDA: For stormwater.

MR. BALLENGER: And just to be clear, the City of Cleveland appears in neither of these two presentations, isn't that correct?

MR. PALLADINO: Yes.

MR. BALLENGER: Okay. Thank you. That's all I have. Short and sweet. That's actually all I have. If Mr. Delaney or Mr. Helbing has anything, I appeal to them, and of course to our Hearing Officer and the Board.

MS. BROCKWAY: Thank you. Do any other parties have any questions?

MR. DELANEY: I have no questions.

MR. HELBING: No.

MS. BROCKWAY: Any redirect?

MR. DASENT: Nothing more.

MS. BROCKWAY: Nothing more. Thank you. Thank you very much, Mr. Palladino. You are excused.

MR. PALLADINO: Thank you.

MS. BROCKWAY: So we're done for the day. Go off the record.

(Discussion held off the record.)

MS. BROCKWAY: Tomorrow morning we start with our public hearing at the City Council chambers at 8:30. We will be out of there by 10:00 and come back to the Gas Commission room where we were yesterday and start as soon as we can all collect. And we'll start with Mr. Morgan and when we have finished Mr. Morgan, we will turn to the stormwater witnesses. Anything else? Seeing none, thank you very much. We're off the record.

(Hearing adjourned 1:45 p.m.)

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C E R T I F I C A T I O N

I hereby certify that the proceedings, evidence and objections noted, are contained fully and accurately in the notes taken by me on the hearing of this matter, and that this copy is a correct transcript of the same.

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SUSAN A. HURREY, R.P.R.

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