

PHILADELPHIA WATER DEPARTMENT REBUTTAL TESTIMONY OUTLINE – LAFAYETTE MORGAN

Summary of Rebuttal Testimony – The Philadelphia Water Department (Department or PWD) will proffer rebuttal testimony addressing the following subject areas to rebut the contentions of the Public Advocate’s witness Lafayette Morgan indicating (1) the necessity of rate relief for the Department to continue to pay operating expenses, appropriately fund its capital program, meet escalating regulatory requirements and otherwise perform its mission; (2) the legal implications of Mr. Morgan’s recommendations as set forth in Schedules LKM-1 through 3, (i.e., covenant default); (3) the future budgetary, financial and rate implications created by Mr. Morgan’s recommendations; (4) the errors in Mr. Morgan’s argument that the rate model is flawed; (5) the inconsistencies and failed application of the rate model by Mr. Morgan as presented in his schedules and testimony; and (6) the errors in Mr. Morgan’s over-stated recommendations artificially inflating projected revenues, eliminating all revenue adjustments and manipulating escalation factors and budget factors.

The Outline of Rebuttal Issues for Mr. Morgan is set forth below. PWD rebuttal witnesses include: Debra McCarty, Melissa LaBuda, Valarie Allen, Katherine Clupper, Jon Davis and Black & Veatch (B&V) witnesses, David Jagt, Prabha Kumar and Ann Bui. The subject area to be addressed by PWD witnesses is noted in the outline.

Outline of Rebuttal Issues

- I. Mr. Morgan’s Contentions that the Rate Model Is Flawed Are Mistaken (B&V; LaBuda)
 - A. Integrity of Cost of Service Rate Model
 - B. Model is Mathematically Accurate
 - C. Model Used for Financial Plan and Cost of Service
 - D. Model Utilizes Reasonable Projections for the Study Period
 - E. Model Utilizes Industry Accepted Principles
 - F. Model Designed to Meet Water Fund Financial Requirements and Bond Covenants
 - G. Cost of Service Study Assumptions Are More Closely Aligned with the City’s Five Year Plan at Present than in the Past
 - H. PWD Has Outperformed Cost of Service Study Assumptions in Past
 - I. Performance of Historical Revenue and Revenue Requirement Projections Impacted Fund Balances
 - J. PWD Has Revised Historical Forecasting Methods and Made Appropriate Changes

- II. Mr. Morgan’s Testimony and Analysis Demonstrate Significant Inconsistencies and a Fundamental Misunderstanding of the Rate Model and PWD Account Structure. (B&V)
 - A. Projections Indicate a Covenant Default in FY 2018
 - B. Revenue Increase and Fund Balance Projections Are Based on Flawed Analysis and Misapplication of the Model
 - C. Narrative Testimony and Schedules LKM 1-3 Are Inconsistent
 - D. Analysis and Recommendations Based Upon Misapplication of Rate Model and Erroneous Presentation of Financial Consequences

- III. Mr. Morgan’s Adjustments and Recommendations Flow From a Misunderstanding of the Rate Model and the Financial Plan (B&V; LaBuda)
 - A. Additional Costs
 1. Adverse Impact of Eliminating All Additional O&M Costs
 2. Operations, Infrastructure Integrity, Regulatory, Affordable Rates
 - B. Other Revenue Requirement Adjustments
 1. Risk of Adjusting Spend Factors, Escalation Factors and Liquidated Encumbrances
 - C. Revenue Projections
 1. Risk of Usage Factor and Billing Factor Adjustments

D. Other Adjustments

1. CIP Inflation Factor
2. Indemnities
3. Debt Interest Rates
4. Debt Issuance Costs

E. Future Rate Implications

IV. Mr. Morgan's Recommendations Have Significant Budgetary and Financial Implications

(LaBuda; Clupper)

A. Elimination of All O&M Claims Has Serious Budgetary and Financial Impacts

1. \$105 Million Shortfall
2. Debt Service Coverage Requirements
3. FY 2018 Projections Not Speculative

B. Erroneous Assumptions Underlie the Advocate's Proposal

1. Class 100 and 500 Spend Factors
2. Assumed Vacancy Rate (Budgeted Positions)
3. Pension Expense and Obligations
4. Liquidated Encumbrances
5. Rate Case Amortization
6. Bond Interest Rates
7. Debt Issuance Costs
8. Debt Service Coverage and Peer Data
9. Pro Forma Adjustments

10. Rate Stabilization Fund Utilization and Requirements

C. Financial Plan Wholly Ignored by the Advocate's Recommendations

D. Peer Data and Utility Best Practices Ignored

E. Future Rate Impact Ignored

V. Mr. Morgan Erroneously Concludes that the Department Is Not Facing Financial Distress

in View of His Recommendations (Allen)

A. Covenant Default Indicated in FY 2018 (Schedule LKM-1)

B. Rate and Insurance Covenants

1. Prospective Analysis When Rates Are Being Set, Tested Prospectively
2. Reasonable Belief Required that Rates Will Be Sufficient to Meet Covenants
3. Ordinance Requires Review of At Least Rates Annually to Ensure Compliance
4. Additional Testing of the Sufficiency of Rates Required to Issue New Bonds

C. Covenant Default is a Default under the 1989 General Ordinance

1. Default - If City Adopts Rates and Charges It Does Not Demonstrate Are Sufficient
2. Default - If City Tests Actual Results and Fails to Meet Coverage
3. In the Event of a Covenant Default the Fiscal Agent Must Notify the Bondholders within 30 days

D. Remedies of Bondholders

1. 25% of Bondholders May Appoint a Trustee to Pursue Remedies
2. Trustee May (or if so requested by at least 25% of Bondholders must):
 - (a) by mandamus or other action, at law or in equity, enforce all rights of Bondholders;
 - (b) bring suit in equity to require the City to account, as if it were trustee of an express trust for Bondholders, for any Pledged Revenues;
 - (c) bring suit in equity to enjoin City from acts that may be unlawful or violate rights of Bondholders.

VI. Mr. Morgan Is Wrong in His Contentions that the Department Can Reasonably Sustain its Operations Without Rate Relief (McCarty; LaBuda; Davis)

A. The Department Must Have Sufficient Resources to Operate

1. Rate Filing Based Upon Reasonable Projections
2. Advocate Has Overly Restrictive View of Municipal Ratemaking

- B. The Department Must Be Able to Make Infrastructure Improvements
- C. The Department Must Meet Its Regulatory Mandates
- D. The Department Must Provide Ratepayer Value
- E. The Department Must Meet Requirements of City Ordinances and Court Decisions