BEFORE THE
PHILADELPHIA WATER, SEWER AND STORMWATER RATE BOARD
HEARING OFFICER NANCY BROCKWAY PRESIDING

Re: Application of the Philadelphia Water Department for Increased Rates and Related Charges	:	Fiscal Years 2017-2018

BRIEF OF PECO ENERGY COMPANY AND EXELON GENERATION CO., LLC

Brief in Opposition to the Department's Proposed Changes To Water Charges and Sewer Charges for Fiscal Years 2017 and 2018

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INTRODUCTION

This Brief is filed on behalf of PECO Energy Company ("PECO") and Exelon Generation Co., LLC ("Exelon") (collectively, "the Companies"). PECO is a corporation organized and existing under the laws of the Commonwealth of Pennsylvania with its principal office located in Philadelphia, Pennsylvania. PECO provides electricity to approximately 1.6 million customers. Exelon is a competitive energy provider and has facilities within the service territory of the Philadelphia Water Department ("PWD"). Both PECO and Exelon are water, wastewater and stormwater customers of the PWD. The Companies have participated in prior PWD rate cases and have an interest in the Philadelphia Water, Sewer and Stormwater Rate Board's ("Board") decision in this proceeding. The Companies have intervened in this proceeding to ensure that the Board's decision is consistent with the requirements and standards of the Philadelphia Home Rule Charter and the Philadelphia Code related to revisions to PWD's rates and charges.

PROCEDURAL HISTORY AND RATE CASE SUMMARY

A. Procedural History

This proceeding is the first rate case to be decided by the Board pursuant to the 2012 revisions to the Home Rule Charter ("Charter") and the Board's regulations adopted in December 2015 establishing a process for setting water, sewer and stormwater rates and charges. On January 8, 2016, PWD published its advance rate filing. Formal notice of the filing was issued by the PWD on February 8, 2016. Both notices proposed increases in water, sewer, stormwater and miscellaneous rates and charges as set forth in PWD Exhibit 3, Rates and Charges. The proposed changes in rates and charges are to be implemented in a two-phase rate increase effective in FY 2017 and FY 2018. The first phase is proposed to become effective July 1, 2016. Nancy Brockway was appointed to serve as Hearing Officer in the rate proceeding. Prehearing conferences were conducted in February and March, 2016, which established a schedule and procedures for the case. The Companies filed a notice of appearance on February 2, 2016 which was served on the Hearing Officer and the parties to the proceeding. The Companies conducted formal and informal discovery on the PWD filing in February and March, 2016, including participating in the discovery session held on February 22, 2016. On March 24, 2016, the Companies filed their direct testimony in the case. Six days of technical hearings were conducted in April 2016. The Companies participated in the technical hearings, presented the direct testimony of their expert witness, Robert A. Rosenthal, and cross examined several of the witnesses presented by PWD. The Companies file this brief in support of the recommendations of Mr. Rosenthal.

B. Rate Case Summary

PWD proposes to increase its annual revenues for water, sewer and wastewater services through revisions in rates over a two year period. In its cost of service study PWD projected a need for an increase in water and wastewater revenue requirements of $34,735,000 for FY 2017 and $36,171,000 for FY 2018. This increase in revenue requires an increase in 2016 rates of approximately 5.42% in FY 2017 and 5.42% in FY 2018. The overall increase in revenues from the combined water and wastewater systems over the 2 year period is approximately 11.1% (PWD Stmt. 9-A at p. 20). With the increase in revenues, the retail rate of return for water service in 2017 will be 3.31%

(Exhibit BV-E1, Table W-15). The rate of return for wastewater service in FY 2017 will be 5.16% (Exhibit BV-E1, Table WW-II).

Table W-6 of Exhibit BV-E1 identifies the projected revenue and revenue requirements for water service for FY 2016-2021. Lines 3 and 4 of the table indicate that the water rates will be increased 5% each for FY 2017 and FY 2018. Line 29 identifies the total water debt service coverage for FY 2015-2021. The indicated debt coverage for 2017 is 1.10x, and the coverage for FY 2018 is 1.12x. Table WW-6 of Exhibit BV-E1 identifies the projected revenue and revenue requirements for wastewater service for FY 2016-2021. Lines 2 through 8 of the table identify the percent increases in wastewater service rates for FY 2016-2021. The percentage increase for FY 2017 is 5.7%, and the increase for FY 2018 is also 5.7%. Line 29 of the table identifies the total wastewater debt coverage for FY 2015-2021. The indicated debt coverage for FY 2017 is 1.14x, and the coverage for FY 2018 is 1.15x.

LEGAL STANDARD

Section 5-800 of the Charter authorizes PWD to operate the water and wastewater utilities within the City. The Charter authorizes PWD to fix and regulate rates and charges for utility service. In November 2012, an amendment to the Charter was approved to allow the City Council to establish by ordinance the Board as an independent ratemaking body responsible for fixing and regulating rates and charges for water and wastewater services. In January 2014, the City Council adopted an ordinance establishing procedures for the Board's operations. The procedures included ratemaking standards to be followed by the Board which are now contained in Section 13-101(4) of the Philadelphia Code. These standards include a direction that rates and charges adopted by the Board must be developed in accordance with sound utility ratemaking practices and consistent with current industry standards for water, wastewater and stormwater rates. Industry standards include ones published by the American Water Works Association and the Water Environmental Federation.

SUMMARY OF ARGUMENT

The direct testimony of Company witness Rosenthal proposed four adjustments to PWD's proposed revenue and expenses. As explained in this brief, PWD has withdrawn two of the proposals addressed by Mr. Rosenthal. The Companies are revising their proposed adjustment concerning PWD's projected chemical expense for the FY 2017-2018 rate period as a result of the additional information provided by PWD's witness at the technical hearing conducted on April 13, 2016. The Companies have finalized the FY 2015 chemical expenses at $19.3 million, which should be the starting point for their escalation of the actual chemical expense, rather than the $22.3 million proposed by PWD.

The remaining adjustment discussed in this brief addresses the Companies' proposal to revise the rate increases proposed by PWD for water and wastewater services. As explained in Mr. Rosenthal's direct testimony and this brief, the Companies believe that these revisions will correct the imbalances in the debt coverage for these services and improve PWD's credit rating. The results of the switch in rate increases would be that the debt coverages of the services would move closer to parity. Such a change would strengthen PWD overall by reducing its risk exposure to changing conditions in either service, and aligning the revenue to cost requirements of each service on a current basis. The debt coverages are also improved as a result of this switch.

PWD's criticisms of Mr. Rosenthal's testimony are incorrect and should be rejected by the Board. PWD's rebuttal testimony ignores PWD's goal to increase its current cash coverage for its capital needs. The Total Coverage measure proposed by Mr. Rosenthal better represents the financial planning goals of PWD and should be utilized as the measure of whether the services are equally contributing to the long term health of PWD. Contrary to PWD's arguments, Mr. Rosenthal's proposal did not adjust PWD's cost of service. PWD's tables demonstrate both an imbalance in coverage as a result of PWD's proposed allocation of revenue and a cross-subsidy of the debt coverage from PWD's allocation of the increased revenues.

ARGUMENT

I. PROPOSED COMPANY ADJUSTMENTS RESOLVED AT HEARING

Two of the revenue and expense adjustments proposed in the direct testimony of witness Rosenthal were resolved in the technical hearings and need not be decided by the Presiding Officer. The Companies' adjustment to PWD's chemical costs have been revised in response to testimony provided by PWD at hearing, although the parties remain approximately $4 million apart on the starting point for the escalation of the actual chemical expense. The resolved adjustments are described in the footnote below.[1]

[1] Escalation of Power Costs. PWD had proposed in its rate filing that its electric costs be escalated by 5% for FY 2018. Mr. Rosenthal argued on pp. 5-6 of his direct testimony that the proposed escalation was too high and that a lower percentage should be used for escalation. At the technical hearing conducted on April 13, 2016, PWD's counsel stated the proposed increase in power costs for FY 2018 had been withdrawn by the PWD (Transcript ("Tr.") p. 61, lines 4-8).

A. Revision to the Chemical Cost Adjustment

PWD has proposed increases in chemical costs for FY 2017 and FY 2018. On p. 27 of PWD Stmt. No. 9A, PWD indicates that its chemical costs are projected to increase by 3.3% annually for FY 2017-2021. The escalation factor was based on the most recent three year average of PWD chemical costs. In his direct testimony, Mr. Rosenthal proposed that this adjustment should be rejected on the basis that the PWD estimate for 2015 chemical costs was not accurate. PWD's historical cost for chemicals in the base year of 2015 is identified in Appendix 2 of document BV-S1, p. 20 as $22,324,969. However, several PWD exhibits and interrogatory responses described the total amount spent on chemicals for FY 2015 to be $17,915,484. *See* p. 6 of Mr. Rosenthal's direct testimony at lines 6-21. At the hearing conducted on April 13, 2016, PWD witness LaBuda explained the FY 2015 cost of chemicals identified in PWD's testimony and interrogatory responses. Ms. LaBuda explained that PWD received chemical deliveries during FY 2015 but, for some, PWD did not receive invoices for the chemicals simultaneously with the deliveries (Tr. p. 98, lines 4-11). An encumbrance was established for chemicals delivered by suppliers during FY 2015 for which PWD did not receive invoices from the suppliers during FY 2015. PWD had a $4 million encumbrance or reserve for chemicals at the end of FY 2015 and had processed to date $1.4 million of invoices against that reserve. The remaining encumbrances would

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Recovery of AMI Costs. In Commissioner McCarty's direct testimony (PWD Stmt. No. 1 at p. 8), the Commissioner explained the launch of a second generation Advanced Metering Infrastructure ("AMI") System would be initiated during the rate period. At the Board discovery session held on February 22, 2016, the Commissioner stated that the AMI project would no longer be part of the present rate case, since the AMI contract had not been negotiated or approved by the City Council. On pp. 6-7 of his direct testimony, Mr. Rosenthal recommended that the AMI expenses should be removed from the present case since PWD's customers were unlikely to receive any benefit from AMI in the FY 2017-2018 rate period. At the hearing conducted on April 5, 2016, PWD's counsel indicated that PWD had entered into a stipulation withdrawing all AMI costs from the rate filing, which was approximately $500,000 (Tr. p. 132, lines 1-4).

be liquidated in the following fiscal year (Tr. pp. 96-97, lines 22, et seq.). With this clarification of the basis for the differences in PWD's FY 2015 chemical expenses and the establishment of an encumbrance or reserve for the unpaid balance, the Companies have finalized the FY 2015 chemical expenses at $19.3 million, which should be the starting point for their escalation of the actual chemical expense, rather than $22.3 million. The liquidation of the FY 2015 encumbrance offsets the cost requirement for FY 2016. The Companies propose that the FY 2017 and FY 2018 chemical expense reflect the actual paid FY 2015 chemical expense of $19.3 million with the PWD escalation factor of 3.3%. The result would be a FY 2017 chemical cost of $19,936,900 and a FY 2018 chemical cost of $20,594,818.

II. THE BOARD SHOULD IMPROVE PWD'S DEBT COVERAGES BY SWITCHING THE PROPOSED RATE INCREASES IN FY 2017 AND FY 2018

Mr. Rosenthal explained his proposal to switch the proposed rate increases on pp. 4 and 5 of his direct testimony. The results of switching the water and wastewater increases in FY 2017 and FY 2018 are summarized on Exhibit 1 to his testimony. A copy of Exhibit 1 is attached to this brief. The results of the switch would be that the debt coverages of the services will move closer to equality, which would strengthen PWD overall by reducing the risk exposure to changing conditions in either service and align the revenue to cost requirements of each service on a current basis. The debt coverages are also improved as a result of the switch. According to PWD's testimony, the improvement of the debt coverage is an important objective of the current rate case. The importance of increasing debt coverage was emphasized by Deputy Commissioner LaBuda at the February 22 discovery session with the Board. In responding to a question concerning PWD's coverage, Ms. LaBuda stated:

> We are nearly a hundred percent leveraged. The only way we can begin to de-leverage the utility and reduce the debt burden on the account per customer is by growing coverage and beginning to do more pay-as-you-go capital, which would be in line with the best industry practices with our peers but it also benefits our base.

February 22, 2016 Tr. at p. 73 (emphasis added).

At the April 5, 2016 hearing, PWD witness Clupper was asked what advice she had for PWD to increase its debt coverage. Ms. Clupper replied:

> Our recommendation was to continue to increase the coverage beyond the legally required 1.2 coverage because you need to generate additional resources to increase the amount of pay or internally generated funds that you use to pay for capital so that you are not approaching 100% or a higher level. And it's something all the rating agencies mention in their report, and it's something that they all mention in their criteria.

April 5, 2016 Tr. at pp. 127-128 (emphasis added).

As indicated in Mr. Rosenthal's direct testimony and his summary exhibit, adoption of his proposal will be beneficial to PWD's debt coverage in FY 2017 and FY 2018 and should be approved by the Board.

A. Switching the Rate Increases

The results of switching the water and wastewater increases in FY 2017 and FY 2018 are summarized on Exhibit 1 to Mr. Rosenthal's testimony. The results of the switch would be that the debt coverages of the services will move closer to equality, which would strengthen PWD overall by reducing the risk exposure to changing conditions in either service and align the revenue to cost requirements of each service on a current basis. The debt coverages are also improved as a result of the switch.

PWD has proposed increases in both water service and wastewater service for FY 2017 and FY 2018. Table W-6 of Exhibit BV-E1 identifies the projected revenue and revenue requirements for water service for FY 2016-2021. Lines 3 and 4 of the table indicate that the water rates will be increased 5% each for FY 2017 and FY 2018. Line 29 identifies the total water debt service coverage for FY 2015-2021. The indicated debt coverage for FY 2017 is 1.10x, and the coverage for FY 2018 is 1.12x.

Table WW-6 of Exhibit BV-E1 identifies the projected revenue and revenue requirements for wastewater service for FY 2017-2018. Lines 2 through 8 of the table identify the percent increases in wastewater service rates for FY 2016-2021. The percentage increase for FY 2017 is 5.7%, and the increase for FY 2018 is also 5.7%. Line 29 of the table identifies the total wastewater debt coverage for FY 2015-2021. The indicated debt coverage for FY 2017 is 1.14x, and the coverage for FY 2018 is 1.15x. The debt coverages identified on Line 29 of table WW-6 for wastewater are generally higher than the debt coverage for water service which appears on Line 29 of table W-6.

Mr. Rosenthal recommended that the debt coverage of the two services would be better balanced by switching the proposed percentage increases between them, increasing the water service rate increase to 5.7% and reducing the wastewater rate increase to 5%. Through this approach, the debt coverages of the services will move closer to equality and the cross-subsidy between them would be lessened. This would strengthen PWD's financial condition overall by reducing the risk exposure to changing conditions in either service and align the revenue to the cost requirements of each service on a current basis. The impact of switching the increases would be a $1,374,000 reduction in the proposed revenue for the wastewater service and an increase in the revenue for the water service of $1,374,000 for FY 2017 and FY 2018. The debt coverages of the services will move closer to equality and the cross-subsidy between them would be lessened. The water coverage rates resulting from the rate switch are identified in Mr. Rosenthal's Exhibit 1 on the Total Coverage line. The water coverage rates in FY 2017 would be 1.13x and the wastewater coverage rates in FY 2017 would be 1.13x and the combined coverage would also be 1.13. The water coverage rates in FY 2018 would be 1.16, the wastewater coverage in FY 2018 would be 1.14, and the combined coverage would be 1.15. These revisions will correct the imbalances in the debt coverage for these services and improve the PWD's credit rating.

Exhibit 1 is attached to this brief and summarizes the results of switching the proposed increases in FY 2017 and FY 2018. The Exhibit demonstrates the effect of increasing water service revenue. The exhibit has no changes in the O&M expense or debt service cost identified in PWD's exhibits. The exhibit changes the water revenue number to better balance the actual coverage of debt and covenant obligations. The revised debt coverages identified in the exhibit are based on the revisions to revenue.

III. PWD's CRITICISMS OF MR. ROSENTHAL'S TESTIMONY ARE INCORRECT AND SHOULD BE REJECTED BY THE BOARD

At the April 13, 2016 hearing, David Jagt of the Black & Veatch Corporation presented rebuttal testimony responding to Mr. Rosenthal's direct testimony. Mr. Jagt challenged Mr. Rosenthal's proposal that switching the water and wastewater increases would benefit PWD. However, Mr. Jagt's proposal is inconsistent with PWD's goal to increase its current cash coverage and reduce its dependence on long term debt and should be rejected by the Board.

A. PWD's Rebuttal Testimony Ignores Its Goal to Increase its Current Cash Coverage of its Capital Needs

Mr. Jagt criticized Mr. Rosenthal's conclusion that the PWD's proposed distribution of the requested increase results in a cross-subsidy between the sewer services and water services that should be modified. Mr. Jagt contends that the driving factor for the apportionment of the increase is the Senior Debt coverage identified in the Restated General Water and Wastewater Revenue Board Ordinance of 1989 ("the 1989 General Ordinance"), in order for equity to be maintained between the services. The PWD proposal focuses on this measure in the level of its request and its apportionment. However, the long term goal of PWD is to increase its current cash coverage of its capital needs and therefore reduce its dependence on long term debt. It is why it is seeking to raise its target coverage to 1.34 in FY 2019-2021 over senior debt through its financial plan. The importance of increasing PWD's debt coverage is emphasized in the testimony of PWD witnesses LaBuda and Clupper which is quoted in Argument II of this brief.

This goal is what is ignored in Mr. Jagt's criticism of Mr. Rosenthal's proposal. Mr. Rosenthal's measure of coverage is the Total Coverage calculation identified in the bottom line of Mr. Rosenthal's Exhibit 1. The Total Coverage measure includes the Capital Account Deposit that is also a requirement of the 1989 General Ordinance, but is ignored by Mr. Jagt. The Capital Account deposit is a means to achieve greater cash coverage of the capital needs of PWD. It represents an annual required payment of 1% of the current net plant of PWD paid back to the construction fund to be available for future capital needs. *See* PWD Exhibit 5, p. 10, ¶ 4, and April 13, 2016 Tr. p. 81-2. It is allocated between the services by the current net plant devoted to the service. Hence as property is added to meet a service's needs, the Capital Account deposit reflects the new investment even when new debt is not issued or fully funding the additions. By its payment PWD can begin to mitigate its dependence on the debt market for capital requirements, reducing the exposure risk of PWD to future changes in the cost of debt.

The Total Coverage measure therefore better represents the financial planning goals of PWD and should be utilized as the measure as to whether the services are equally contributing to the long term health of PWD. Through Mr. Rosenthal's adjustment to the revenue apportionment, the Total Coverage measure is in better balance than originally proposed by PWD.

B. Mr. Rosenthal's Proposal Does Not Adjust PWD's Cost of Service

As admitted by Mr. Jagt, Mr. Rosenthal's Exhibit 1 relied primarily on PWD's data (April 13, 2016 Tr., p. 74, lines 5-13). Hence, Mr. Rosenthal did not adjust PWD's cost of service, but focused on the manner of the revenue request's opportunity to meet the coverage calculations. It is from this perspective that Mr. Rosenthal reached his conclusion that adjustment of the revenue apportionment between the services would best serve the long term goals of PWD.

C. PWD's Tables Demonstrate the Imbalance in Coverage as a Result of PWD's Proposed Allocation of Revenue

The differences in the total coverage in Table W-6 and Table WW-6 and line 30 in Table C-1 demonstrate the imbalance in the coverage resulting from PWD's proposed apportionment of the rate increases. As admitted by Mr. Jagt in cross examination, the wastewater total coverages in those tables are different and higher than the water coverage in both years (April 13, 2016 Tr., pp. 74-75). The Companies submit that the difference in these coverage lines demonstrates the imbalance in the initial coverage as proposed by PWD.

D. PWD's Tables Demonstrate a Cross-Subsidy of the Debt Coverage as a Result of PWD's Allocation of the Increased Revenues

The differences in the total coverage in Table W-6 and Table WW-6 and the total coverage numbers on line 30 of Table C-1 demonstrate the cross-subsidy of the debt coverage as a result of the allocation of the increased revenues. As admitted by Mr. Jagt in cross examination, the total coverages on line 29 of Table W-6 and Table WW-6 and the total coverage numbers on line 30 of Table C-1 are not identical (April 13, 2016 Tr. p. 75). The Companies submit that if these coverages on the indicated tables and lines are not identical, then there is a cross-subsidy. The Companies submit that the total coverage on line 29 of Table WW-6 is subsidizing the coverage for water service which results in the level of coverage on line 30 of the combined utility.

CONCLUSION

The Companies request that the Board adopt the rate revisions proposed in Mr. Rosenthal's direct testimony and provide whatever additional relief is just and reasonable under the circumstances.

Respectfully submitted,

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Dated: May 2, 2016

Exhibit 1

RESULTS OF SWITCHING WATER AND WASTEWATER INCREASES IN FY 2017 AND 2018

$1,374 2017/2018 change

Coverage calc	FY2017	Combined	Water	Sewer/Storm	FY2018	Combined	Water	Sewer/Storm
Source BV-E1		C-1	W-6	WW-6		C-1	W-6	WW-6
Revenue		$ 640,641	$ 254,550	$ 386,091		$ 636,557	$ 252,888	$ 383,669
Required Revenues	flip	$ 34,734	$ 14,054	$ 20,680	flip blend	$ 70,906	$ 28,576	$ 42,330
Total Service		$ 675,375	$ 268,604	$ 406,771		$ 707,463	$ 281,464	$ 425,999
Total other income		$ 23,177	$ 12,162	$ 11,015		$ 6,889	$ 5,030	$ 1,859
Total Revenue		$ 698,552	$ 280,766	$ 417,786		$ 714,352	$ 286,494	$ 427,858
Total OPS expense		$ (458,171)	$ (190,039)	$ (268,132)		$ (471,456)	$ (195,259)	$ (276,197)
Rate Stab Fund use		$ 19,300	$ (1,900)	$ 21,200		$ 39,000	$ 8,100	$ 30,900
Net Rev after ops		$ 259,681	$ 88,827	$ 170,854		$ 281,896	$ 99,335	$ 182,561
Senior Debt		$ (207,714)	$ (69,981)	$ (137,733)		$ (223,662)	$ (76,679)	$ (146,983)
Senior Debt Cover	L10/L11	(1.25)	(1.27)	(1.24)		(1.26)	(1.30)	(1.24)
Capital Account Dep		(21,746)	$ (8,929)	(12,817)		(22,289)	$ (9,152)	(13,137)
Total Coverage	L10/L11+L13	(1.13)	(1.13)	(1.13)		(1.15)	(1.16)	(1.14)

PROPOSED FINDINGS OF FACT

The Companies respectfully request the Board to adopt the following findings of fact in its adjudication of this rate case.

1. PWD proposes to increase its annual revenues for water, sewer and wastewater services through revisions in rates over a two year period. As identified in the cost of service study presented by the PWD, the revenue requirement projections for FY 2017 and FY 2018 indicate the need for an increase in water and wastewater revenue requirements of $34,735,000 in FY 2017 and $36,171,000 in FY 2018. This increase in revenue requires an increase in 2016 rates of approximately 5.42% in FY 2017 and 5.42% in FY 2018.

2. The overall increase in revenues from the combined water and wastewater systems over the 2 year period is approximately 11.1% (PWD Stmt. 9-A at p. 20). With the increase in revenues, the retail rate of return for water service in FY 2017 will be 3.31% (Exhibit BV-E1, Table W-15). The rate of return for wastewater service in FY 2017 will be 5.16% (Exhibit BV-E1, Table WW-II).

3. Table W-6 of Exhibit BV-E1 identifies the projected revenue and revenue requirements for water service for FY 2016-2021. Lines 3 and 4 of the table indicate that the water rates will be increased 5% each for FY 2017 and FY 2018. Line 29 identifies the total water debt service coverage for FY 2015-2021. The indicated debt coverage for 2017 is 1.10x, and the coverage for FY 2018 is 1.12x.

4. Table WW-6 of Exhibit BV-E1 identifies the projected revenue and revenue requirements for wastewater service for FY 2016-2021. Lines 2 through 8 of the table identify the percent increases in wastewater service rates for FY 2016-2021.

The percentage increase for FY 2017 is 5.7%, and the increase for FY 2018 is also 5.7%. Line 29 of the table identifies the total wastewater debt coverage for FY 2015-2021. The indicated debt coverage for FY 2017 is 1.14x, and the coverage for FY 2018 is 1.15x.

5. Mr. Rosenthal explains his proposal to switch the proposed rate increases on pp. 4 and 5 of his direct testimony. The results of the switch would be that the debt coverages of the services will move closer to equality, which would strengthen PWD overall by reducing the risk exposure to changing conditions in either service and align the revenue to cost requirements of each service on a current basis.

6. The water debt coverages are also improved as a result of the switch. The coverages identified in the total coverage line of Exhibit 1 for water service are greater than the water coverage identified in Table W-6.

7. According to PWD's testimony, the improvement of the debt coverage is an important objective of the current rate case. The importance of increasing debt coverage was emphasized by Deputy Commissioner LaBuda at the February 22 discovery session with the Board. In responding to a question concerning PWD's coverage, Ms. LaBuda stated:

> We are nearly a hundred percent leveraged. The only way we can begin to de-leverage the utility and reduce the debt burden on the account per customer is by growing coverage and beginning to do more pay-as-you-go capital, which would be in line with the best industry practices with our peers but it also benefits our base.

February 22, 2016 Tr. at p. 73.

8. At the April 5, 2016 hearing, PWD witness Clupper was asked what advice she had for PWD to increase its debt coverage. Ms. Clupper replied:

> Our recommendation was to continue to increase the coverage beyond the legally required 1.2 coverage because you need to generate additional resources to increase the amount of pay or internally generated funds that you use to pay for capital so that you are not approaching 100% or a higher level. And it's something all the rating agencies mention in their report, and it's something that they all mention in their criteria.

April 5, 2016 Tr. at pp. 127-128.

9. The results of the switch would be that the debt coverages of the services will move closer to equality, which would strengthen PWD overall by reducing the risk exposure to changing conditions in either service and align the revenue to cost requirements of each service on a current basis. The debt coverages are also improved as a result of the switch.

10. Mr. Rosenthal recommended that the debt coverage of the two services would be better balanced by switching the proposed percentage increases between them, increasing the water service rate increase to 5.7% and reducing the wastewater rate increase to 5%. Through this approach, the debt coverages of the services will move closer to equality and the cross-subsidy between them would be lessened. This would strengthen PWD's financial condition overall by reducing the risk exposure to changing conditions in either service and align the revenue to the cost requirements of each service on a current basis.

11. The impact of switching the increases would be a $1,374,000 reduction in the proposed revenue for the wastewater service and an increase in the revenue for the water service of $1,374,000 for FY 2017 and FY 2018. The debt coverages of the services will move closer to equality and the cross-subsidy between them would be lessened.

12. The water coverage rates resulting from the rate switch are identified in Mr. Rosenthal's Exhibit 1 on the Total Coverage line. The water coverage rates in FY 2017 would be 1.13x and the wastewater coverage rates in FY 2017 would be 1.13x and the combined coverage would also be 1.13. The water coverage rates in FY 2018 would be 1.16, the wastewater coverage in FY 2018 would be 1.14, and the combined coverage would be 1.15. These revisions will correct the imbalances in the debt coverage for these services and improve the PWD's credit rating.

13. Mr. Rosenthal's measure of coverage is the Total Coverage calculation identified in the bottom line of Mr. Rosenthal's Exhibit 1.

14. The Total Coverage measure includes the Capital Account Deposit that is also a requirement of the 1989 General Ordinance, but is ignored by PWD. The Capital Account deposit is a means to achieve greater cash coverage of the capital needs of PWD. It represents an annual required payment of 1% of the current net plant of PWD paid back to the construction fund to be available for future capital needs. *See* PWD Exhibit 5, p. 10, ¶ 4, and April 13, 2016 Tr. p. 81-2. It is allocated between the services by the current net plant devoted to the service.

15. Exhibit 1 is attached to this brief and summarizes the results of switching the proposed increases in FY 2017 and FY 2018. The Exhibit demonstrates the effect of increasing water service revenue. The exhibit has no changes in the O&M expense or debt service cost identified in PWD's exhibits. The exhibit changes the water revenue number to better balance the actual coverage of debt and covenant obligations. The revised debt coverages identified in the exhibit are based on the revisions to revenue.

16. With the additional information provided by PWD witness LaBuda at the hearing conducted on April 13, 2016, the Companies have finalized the FY 2015 chemical expenses at $19.3 million, which should be the starting point for the chemical cost escalation of the actual chemical expense rather than $22.3 million. The liquidation of the FY 2015 encumbrance offsets the cash requirement for FY 2016. The Companies propose that the FY 2017 and FY 2018 chemical expenses reflect the actual paid FY 2015 chemical expense of $19.3 million with the PWD escalation factor of 3.3%. The result is a FY 2017 chemical expense of $19,936,900 and a FY 2018 chemical cost of $20,594,818.

PROPOSED CONCLUSION OF LAW

PWD's proposed allocation of the revenue increase results in an imbalance in debt coverage and also a cross-subsidy of the debt coverage. PWD's proposal for rates and charges has not been developed in accordance with sound utility ratemaking practices and is not consistent with current industry standards for water, wastewater and stormwater rates. As a result, PWD's proposal is not consistent with the ratemaking standards to be followed by the Board in Section 13-101(4) of the Philadelphia Code.